



Nonprofit Social Enterprise: Models and Funding

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Introduction

A social enterprise is an organization or venture (within an organization) that advances a social mission through market-based strategies. These strategies include receiving earned income in direct exchange for a product, service, or privilege. Social enterprises can come in both nonprofit and for-profit varieties.

While this idea has had a long history (particularly in international development work), it is becoming an increasingly popular idea in the United States. The idea of earned income is attractive to nonprofits whose funding sources have shrunk due to broad economic trends like cuts to local and national social welfare programs, shrinking foundation portfolios, and the increasing need and decreasing resources that come with an economic downturn. In addition to providing an alternative revenue source, social enterprises provide other benefits, including direct on-the-job (OTJ) training opportunities for targeted employees, marketing advantages, and the integration of innovative business frameworks into thinking and planning.

At the same time, socially responsible business has become an increasingly profitable and sustainable model in the United States. Fair trade companies, green businesses, and worker-owned cooperatives have shown that for-profit businesses can produce triple bottom line results (producing benefits in terms of people, planet and profit). Several states have passed legislation enabling a B-Corporation status which protects social enterprises investment in their social mission.¹ Foundations, corporations and even the White House² are increasingly looking to support social enterprises as a way to spark and support innovation.

At the same time, the enthusiasm about social enterprises often creates unrealistic expectations for nonprofits. Earned income is unlikely to fully replace other sources of funding, and probably shouldn't. Although using a social enterprise model creates opportunities, there are also trade-offs that need to be considered.

This brief aims to provide an introduction to nonprofit social enterprise models and funding sources. It provides an overview of sources of funds, profiles existing lending programs and successful triple bottom line social enterprises, summarizes lender expectations, and introduces questions and meth-

1 For a good discussion of the range of business models from nonprofit to for-profit see the "Hybrid Spectrum" developed by Kim Alter of Virtue Ventures: <http://www.4lenses.org/setypology/print>

2 See the website of the Office of Social Innovation and Civic Participation: <http://www.whitehouse.gov/administration/eop/sicp/initiatives/social-innovation-fund>.

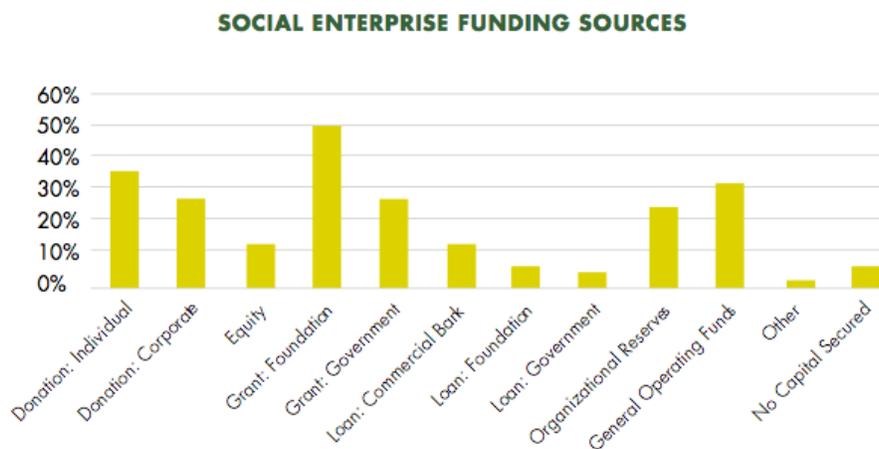
ods for incorporating a social enterprise model into your existing nonprofit. We have included a list of further resources that will be useful if you decide that the social enterprise model is right for your organization.

Sources of revenue for social enterprises

Nonprofit organizations are primarily financed by two mechanisms: grants and loans. Grants are traditionally provided by philanthropic foundations or government entities. They can be used for a wide range of nonprofit activity and are not expected to be repaid; they generally support all ongoing operational costs of nonprofit organizations. Loans, on the other hand, are expected to be repaid and are typically used to cover working capital or the purchase of assets.

Grants and loans are for different purposes. Grants usually cover startup costs, social subsidies, and administration, while loans cover working capital or infrastructure investments and are relatively rare for traditional nonprofits. Loans to nonprofits are typically secured and are increasingly financed through impact investment organizations rather than traditional banks. Impact investors seek to make a profit, but also aim to solve social or environmental challenges.

A social enterprise model supplements, not replaces, traditional funding sources for nonprofits. The following graph³ shows sources of funding (other than earned revenue) for social enterprises in the US and Canada:



Sources of capital for social enterprises varies among respondents

3 Source: Community Wealth Ventures, Inc., Social Enterprise Alliance, and The Center for the Advancement of Social Entrepreneurs. *Social Enterprise, A Portrait of the Field*. 2011.

There are few nonprofits that can operate without philanthropic support, as revealed by a survey of nonprofit business models⁴:

There were several funding models we thought we might find, but didn't, [including] nonprofits that operated on a strictly fee-for-service model in either a business-to-business or direct-to-consumer fashion, without important supplementary fundraising (from members or prior beneficiaries) or underlying government support... It is our belief that these types of approaches do not lend themselves to large-scale, sustained nonprofit advantage over for-profit entities.

There are several kinds of loans available to nonprofits. These include personal loans (from friends and family, typically up to \$20,000), microloans (from \$500 to \$100,000), bank loans (typically up to \$3 million), and government-backed loans. Loans can be secured (tied to collateral that can be seized in the event of a default) or unsecured. Secured loans are generally available at lower interest rates.

Traditionally, lending decisions are made on "three Cs": capacity (cash flow), character (management), and capital (collateral). These are meant to minimize the risk of default, defined as failure to repay a lender in full. These lending criteria, especially when money supply is tight, prevent those with little financial history from receiving needed money.

A variety of lending organizations make it their mission to provide capital to worthy social enterprises. These include social investors, impact investment lenders, microfinance organizations, and Community Development Financial Institutions (CDFIs). Several of these lending organizations will be profiled in the following section.

⁴ Foster, William Landes. *Ten Nonprofit Funding Models*. Stanford Social Innovation Review. Spring 2009. Available at http://www.ssireview.org/articles/entry/ten_nonprofit_funding_models/.

Profiles of organizations that support nonprofit social enterprises

This section includes snapshot profiles of a few major lenders. It is not intended to be a comprehensive survey of lending programs for nonprofit social enterprises (NSEs)⁵. It is important that you understand your needs and your lender's requirements before seeking any loans.

RSF Social Finance: Since 1984, RSF has loaned over \$230 million to both nonprofit and for-profit organizations. Borrowers get financing to meet their capital needs and the opportunity to join a community of nonprofit and for-profit social enterprises. Nonprofits must have a mission in one of three impact areas (food/agriculture, education/ arts, or ecological stewardship), strong governance, sustainable approaches, fair-trade workforce principles, and a commitment to social good and environmental responsibility. The RSF Prime interest rate for "core lending" is currently at 5% (in 2011), and is adjusted quarterly based on joint recommendations from investors and borrowers. Loans typically are secured. Applicants should have three years of operating history, a strong management team, and a profitable (or soon-to-be profitable) enterprise. Loans typically range from \$200,000 to \$3 million.⁶

Roberts Enterprise Development Fund (REDF): Since 1997, REDF has provided funding and business assistance to a carefully selected portfolio of social enterprises that employ disconnected youth and adults who are overcoming barriers to employment. REDF's support for portfolio companies includes unrestricted and restricted grants, staff consulting, and human capital. REDF does not provide loans.

Nonprofit Finance Fund (a CDFI): Since 1980, Nonprofit Finance Fund (NFF) has made over \$235 million in loans to nonprofits in support of over \$1.3 billion in projects. Their financing helps nonprofits manage growth, build and renovate facilities, balance government contract payments, manage cash flow and bridge capital campaigns. They aim to help organizations better serve their clients and communities. NFF loans typically range between \$100,000 and \$2 million.

Echoing Green: Since 1987, Echoing Green has been supporting social entrepreneurs through seed money grants. Since their inception, they have invested over \$30 million in seed grants to over 500 social entrepreneurs. Through their Echoing Green Fellowship, they provide a stipend of \$60,000 for a one-person social enterprise or \$90,000 for a two-person staffed social enterprise. These funds are paid

5 Some other organizations include Draper Richards Kaplan Foundation, Skoll Foundation, Omidyar Network, Acumen Fund, and Schwab Foundation

6 For more information, see <http://rsfsocialfinance.org/services/lending/core/>.

over a two-year period. In addition to seed capital, they also offer social entrepreneurs a stipend for medical insurance and access to a number of free business support services.

Is the social enterprise model for you?

Social enterprises provide up to three forms of returns: social, environmental, and financial. Existing organizations should understand each of these returns before implementing a social enterprise model. Think of the challenges of running an organization when there is only one goal – for example, maximizing profit, or hiring people with barriers to employment. Imagine how much more complicated that gets when you are balancing two or three goals, and imagine what the trade-offs could look like. A social enterprise model may not be right for some organizations. There are several questions to consider before adopting such a model in an existing nonprofit:

1. Is our organization prepared to take on the risk, including risk of failure, associated with growing a business?
2. Is our organization willing to accept a possible dilution of social or environmental goals?
3. Is our organization willing and able to be entrepreneurial? Can we reorganize or invest in the organization's infrastructure?
4. Do we clearly understand the costs and benefits associated with this venture?
5. What returns do we desire? What does success look like?
6. Is there a reasonable chance of success? Do we have a true competitive advantage? This is particularly important for NSEs that start off with loans as their primary source of financing.
7. Do we have appropriate industry expertise? Or do we have capacity to hire for it?
8. Does the board understand the risks, timeline, and costs associated with starting a SE and does it full support this endeavor? A split board, over time, will slowly work against the SE.

If the organization determines that creating a social enterprise makes sense, the following questions may help to discern which of the organization's existing services can be monetized and which should remain social benefits:

1. Would others pay for this service?
2. Are the *existing* clients that use this service deserving of social (philanthropic) subsidy? Can

they afford market rates?

3. Can this service, with or without subsidy, compete in the private market?
4. Would offering this service dilute the organization's social mission?
5. Is there an opportunity for on-the-job training opportunities through this service?
6. Can philanthropy, rather than loans, support these existing services?
7. Would charging for this product help or hurt interactions with the clients?
8. Can the organization effectively manage this business transaction?

The costs and returns of normal businesses and social enterprises differ. Figure 1 offers an illustration of these differences⁷.

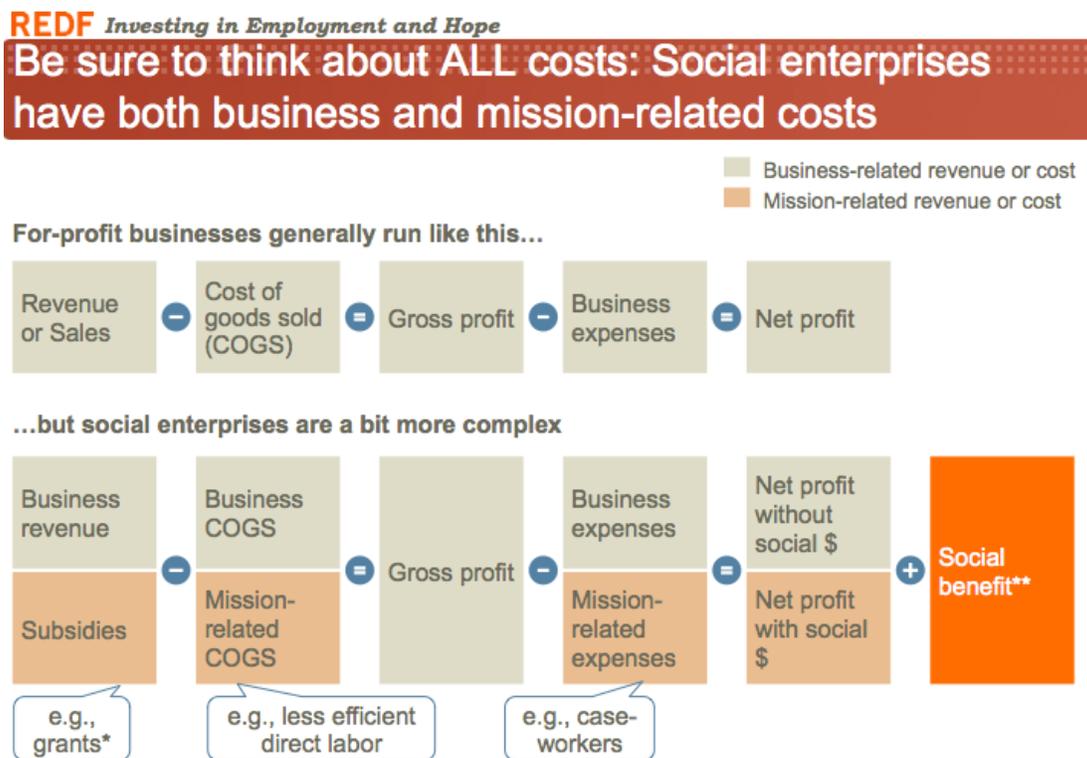


Figure 1. Differences in costs for social enterprises versus for-profit businesses.

In addition to social and financial returns, NSEs have both business- and mission-related costs. Mission-related costs can be offset by subsidies such as grants but are burdened by both mission-related cost of goods sold (COGS) and mission-related expenses. Social benefits are also hard to quantify in

⁷ Source: Haider, Samra. "Social Enterprise 101." Presentation to National Transitional Jobs Network and Green for All Communities of Practice. 9/9/2010.

financial terms.

Furthermore, these social and financial costs are different and should be managed separately. Figure 2⁸ shows REDF's recommendations for managing costs⁹.

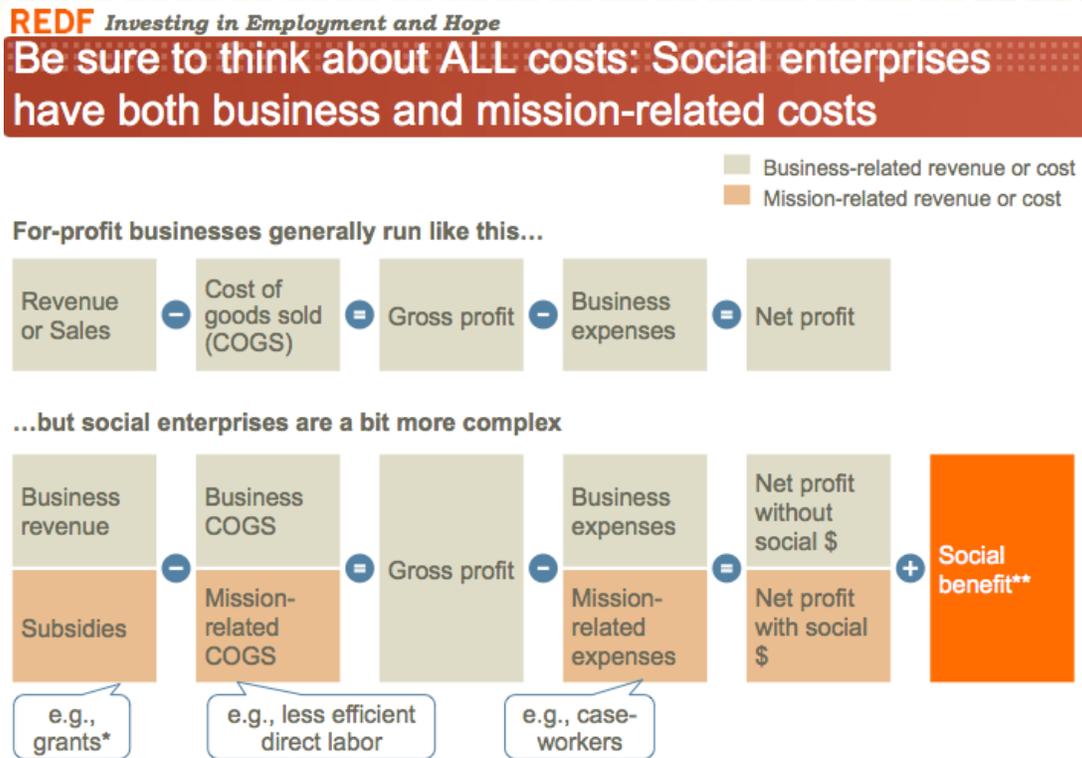


Figure 2. Suggestions for identifying and managing social costs in a social enterprise.

There are a number of factors to consider before pursuing a social enterprise model. This brief has provided a quick glimpse into some of those key issues. We suggest careful consideration of these issues before deciding if this model will work for your venture, whether existing or planned. There are a number of resources, some of which are referenced here, that can help in determining whether or not this model will work for you. The following section highlights some successful social enterprise models.

8 Ibid.

9 For information on setting up a social enterprise, please see REDF's "Social Enterprise Start Up Kit" available at <http://www.redf.org/learn-from-redf/topic/redf-social-enterprise-start-up-kit>.

Case studies: triple bottom line social enterprises

RecycleForce (formerly Workforce Inc.), Indianapolis, IN



A RecycleForce participant says: “We’re helping to save the world and it feels good! We’re not just recycling “stuff”, people too!” Photo courtesy of RecycleForce.

RecycleForce (formerly known as Workforce, Inc.) is a 501(c)(3) nonprofit that operates as a social enterprise. Their stated mission is twofold: (1) become the most comprehensive recycling hub in Indianapolis, Indiana; and (2) help those returning from prison gain immediate, legitimate earnings combined with a broad array of social support.

In 2006, RecycleForce (RF) started providing recently released offenders with transitional jobs in the emerging electronic waste recycling industry. Waste is one of the top three exports of the United States. Recycling businesses in developing countries gather raw materials from US “waste” to produce goods, many of which are resold to the US. Given this, it makes sense to process or add value to the waste before it goes overseas to be used for manufacturing. By doing so, RF can create jobs and

reduce the risk of harm due to a lack of regulatory oversight of recycling processes in some developing countries. This program seeks to keep as much electronic waste as possible out of landfills and recover the waste so that it can be reused in industry.

Since its launch in 2006, RF has grown from two workers and 600,000 pounds of processed materials to more than 35 employees and 3.4 million pounds of processed recyclables annually. During this time, the program has employed nearly 400 people and paid over \$2.3 million in wages. Only 28% of participants have been returned to prison, as compared to an average rate of around 50% in Indianapolis. Employees who owe child support pay an average of \$1,300 in child support during the 4 months of transitional employment, and most report improved relationships with their children. Most are proud to show their kids they can work in the mainstream economy, many for the first time in their lives.

Although RF began specializing in recycling electronic waste, it has expanded to offer recycling services for a whole host of materials, including plastic, aluminum, paper and cardboard. Since its inception, RF has helped clean up our environment by processing a total of 11 million pounds of recyclable material.

RF uses its revenues from the recycling business to help formerly incarcerated individuals rebuild their lives by providing gainful employment. As its recycling operation has grown, so has RF's capability to employ and train hundreds of ex-offenders, successfully guiding their re-entry back into the community. RF participants benefit not only from jobs but also from state programs to improve literacy and math skills, as well as "contextualized learning" opportunities with accompanying certifications (e.g., forklift operation or HazMat handling).

Formerly incarcerated individuals have the odds stacked against them upon their release. Most have no job and no home to return to. Without these foundational elements, the rate of reoffending and returning to the criminal justice system is higher than necessary. In fact, more than half of all ex-offenders returning to Indianapolis/Marion County in 2009 ended up back in the prison system.

RF's social enterprise revenues totaled over \$1 million in 2010. Their goal is for the venture to become 60 to 70% self-supporting through the sale of recycled material. In fiscal year July 2010 – June 2011, sales supplied 60 percent of income.

RF also receives funding from philanthropic organizations and public contracts. RF has been awarded a \$5.5 million random assignment grant from the U.S. Department of Labor to test the validity of their

model as compared to “services as usual” for ex-offenders coming home. MRDC¹⁰, one of the nation’s premier evaluation firms, will study the experiences of 1,000 people. The study will help inform government on the efficacy of social enterprise as a means to help people reenter society and succeed after incarceration. RF is also beginning to offer fee for service technical assistance to support more recycling based social enterprises like themselves to get off the ground in other communities nationwide.

RF’s Executive Director, Gregg Keesling, notes that it is a challenge to get stakeholders to understand that they must function as both a social venture and a business. People who see RF solely as a business may not understand that RF has added costs and inefficiencies associated with employing ex-offenders and trying to get them back into productive lives. At the same time, those who see RF as a nonprofit with a social mission may not understand why RF cannot serve all people who need help or why it may make decisions that are as much focused on business needs as social needs.

Generation Water, Los Angeles, CA

Every year, Southern California imports approximately two-thirds of its water from the Western U.S., while its population grows by 150,000 people. The region’s long-term water usage patterns are unsustainable. Over time, the region must develop new sources of water, including (1) conservation – getting people to use less water; (2) increasing efficiency – making better use of the water we have; (3) recycling water; and (4) infiltrating rainwater into local aquifers.

Unemployment among young adults is high. Young people, regardless of education, often struggle to find a career entry point. At the same time, water utilities are facing a retirement crisis as baby boomers retire.

Generation Water (GW) is focused on developing a pipeline of diverse, well-qualified young people for the career opportunities of the green economy (Figure 3). GW achieves this mission in two ways:



Figure 3. Generation Water employees at work. Source: www.generationwater.org

¹⁰ For more information on MRDC, go to www.mrdc.org. Note: “MRDC” originally stood for “Manpower Research Development Corporation” (in 1974), but the company changed its registered corporate identity to “MRDC” (in 2003).

1. By completing demonstration projects that reduce water use, recharge groundwater, and improve watershed health through ecosystem renewal.
2. By providing young people, ages 18-24, with training and on-the-job work experience as they begin careers in water conservation, irrigation, sustainable landscaping, and related areas.

A subsidiary of the nonprofit Los Angeles Infrastructure Academy, Generation Water was created as a social enterprise in 2009. Its initial client was the Los Angeles Department of Water and Power. The first project was to conduct water surveys of 120 high schools and middle schools in the Los Angeles Unified School District (LAUSD).

Today, GW has developed three service areas:

1. *Irrigation Surveys and Repair:* GW conducts GIS-based irrigation surveys for schools and parks. These surveys identify all broken irrigation equipment and compare water usage patterns and equipment to the standards set by California's Water Efficient Landscape Ordinance. GW also installs weather-based irrigation controllers and repairs broken irrigation equipment. Clients are typically water districts interested in reducing aggregate water usage on large landscapes. To date, GW teams have successfully completed more than 160 school and park irrigation surveys, located and inventoried more than 400 irrigation controllers and 5,300 valves, and cataloged more than 100,000 sprinklers, including more than 14,000 malfunctioning or broken sprinklers.
2. *Rainwater Infiltration:* GW is installing 1,000 residential "rain gardens" to infiltrate water into the ground from roofs as a mechanism to recharge aquifers and improve the health of the local watershed.
3. *Habitat Restoration:* GW is removing invasive plant species and restoring native vegetation to a local regional park. Habitat restoration promotes watershed health and fosters the return of local flora and fauna.

GW applied for and won a \$2.5 million Green Innovation Challenge grant from the State of California in 2009 in partnership with the Los Angeles Conservation Corps and several other environmental nonprofit groups. Together, these groups are responsible for training 175 young adults, ages 18-24, and placing 70% of them into industry positions.

Generation Water started as a program for at-risk high school students, but as the technical complexity of the work has increased (and as the Green Innovation Challenge grant has provided new op-

portunities), the GW workforce has become older and more experienced. Today, 80% of the 30 employees are either in college or are recent college graduates. Many of the college students are studying (or have studied) environmental science, biology, urban planning, landscape architecture, or related fields. GW team members learn a range of skills including irrigation, water management, sustainable landscaping, construction, Geographic Information Systems, database entry and management, marketing, and business management. GW is becoming a nonprofit business focused on water management by the next generation of water employees for the next generation.

In addition to gaining paid on-the-job experience, young people participate in training sessions on irrigation, water management, horticulture, sustainable landscaping, and other topics. They also attend industry meetings and trade shows. GW also hosts occasional overnight field trips and leadership retreats. Team members also routinely outline their goals and receive performance feedback.

GW's business model currently depends on a mix of earned income, government workforce development funding, and corporate donations. For 2011-12, the mix is budgeted to be 57% earned income, 37% government funding, and the remainder philanthropic or other funding. Generation Water's goal is to be 100% self-sufficient with earned income by June 2012.

Rising Sun Energy Center, Berkeley, CA

Rising Sun Energy Services is a social enterprise run by Rising Sun Energy Center, a 501(c)3 non-profit organization. The enterprise offers bridge employment that provides graduates of Rising Sun's Green Energy Training Program (GETS) the opportunity to put their training into practice through paid employment with Rising Sun's own social enterprise on building performance, Rising Sun Energy Services. The GETS training is designed to prepare individuals who have barriers to employment for entry-level and semi-skilled positions in the residential energy efficiency industry (Figure 4). Through a combination of lecture and hands-on instruction in the classroom, lab and field settings, participants are introduced to the fundamentals of building science and industry-accepted energy efficiency upgrade practices. The on-the-job experience Rising Sun Energy Services Crew Members gain through auditing and retrofitting homes makes



Figure 4. A GETS participant performs a blower door test. www.risingsunenergy.org.

them much more attractive to potential employers. Rising Sun Energy Services Crew Members are employed by Rising Sun Energy Center on a part-time basis for a period of three to nine months and are paid \$15 to \$17 per hour. The Rising Sun Energy Services program goals are:

- To provide GETS graduates the opportunity to conduct home performance testing and remediation work to hone the technical and professional skills gained in their GETS training;
- To assist GETS graduates by giving them “bridge employment” until they can be permanently placed;
- To provide energy upgrades to home-owners across Alameda, Contra Costa and Marin County at a significantly reduced cost;
- To improve the efficiency, durability, health, safety, and comfort of homes within the community;
- To stimulate interest and demand for energy efficiency work to encourage the creation of more jobs;
- To assist local governments in reaching their Climate Action Plan (CAP) goals.

Rising Sun’s GETS Energy Services provides energy efficiency services to moderate-income homes in Berkeley and Richmond, CA with the assistance of subsidies and incentives from local governments and the utilities. In addition they provide similar energy efficiency services throughout Alameda, Contra Costa and Marin County with incentives through the utilities. Rising Sun provides this subsidized service to residents who benefit by paying for the service at a reduced rate. The revenue generated from the retrofit service is used to fund the social enterprise, including wages for participants (employees), operational and administrative costs, inventory, marketing, and all other costs associated with doing business. Additional funds are raised via government and foundation grants to cover the costs of additional training, case management, support services, and job coaching and development.

Conclusion

The recent economic downturn has led to a decline in funding for nonprofits. Nonprofit organizations are finding it increasingly difficult to access public and philanthropic funding for their programs. Some nonprofits are using the social enterprise model to create self-sustaining programs by charging a fee for their services. This model provides the potential to diversify funding sources and

sustain financial support for mission-based work. However, significant risks accompany this potential. Organizations should carefully consider the benefits, risks, and alternative options before deciding to create a social enterprise. Organizations that have decided to create a social enterprise should be thoughtful in balancing their nonprofit mission with their profit-driven goals and realistic about their organizational capacity to initiate a business endeavor. There are various examples of nonprofits using social enterprise models to create green jobs for low-income communities and residents with barriers to employment. If the social enterprise model looks promising for your organization, we encourage you to look into further resources and consider the lessons learned from existing organizations.

Further Social Enterprise Resources

Ashoka. *Print Room*.

<http://www.ashoka.org/printroom>

Aspen Institute. *Program on Philanthropy and Social Innovation (PSI)*.

<http://www.aspeninstitute.org/policy-work/nonprofit-philanthropy>

Center for Advancement of Social Entrepreneurship (CASE) at Duke University. *General Social Entrepreneurship Resources*.

<http://www.caseatduke.org/knowledge/generalresources/index.html>

Community Wealth Ventures. *Resources*.

<http://www.communitywealth.com/resources.html>

Community Wealth Ventures, Inc., Social Enterprise Alliance, and The Center for the Advancement of Social Entrepreneurs. *Social Enterprise, A Portrait of the Field*. 2011.

<http://www.communitywealth.com/pdf-doc/Field%20Study%20FINAL.pdf>

Harvard Business Review. *Social Enterprise Case Studies, Articles, and Books*.

<http://hbr.org/search/social%20enterprise>

Institute for Social Entrepreneurs.

http://www.socialent.org/Free_Downloads.htm

RecycleForce.

<http://www.recycleforce.org/>

More information about technical assistance can be provided by contacting info@recycleforce.com

REDF. *Learn from REDF*.

<http://www.redf.org/learn-from-redf>

RSF Social Finance. *Lending*.
<http://rsfsocialfinance.org/services/lending/>

Social Enterprise Alliance. *What is Social Enterprise?*
<https://www.se-alliance.org/what-is-social-enterprise>

Social Enterprise Toolbelt. *Social Enterprise Resources*.
<http://www.setoolbelt.org/>

Stanford Social Innovation Review.
<http://www.ssireview.org/>

Virtue Ventures. *Introduction to Understanding and Accessing Social Investment: A Brief Guide for Social Entrepreneurs and Development Practitioners*. 2009

http://www.virtueventures.com/resources/social_investment

For a full list of our reports and research, visit: <http://www.greenforall.org/resources>

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