



CHAPTER ONE

PUTTING NONPROFIT BUSINESS VENTURES IN PERSPECTIVE

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It has become quite popular for nonprofit organizations to start business ventures. As more and more nonprofits compete for limited pools of philanthropic and government support, the prospect of an additional source of earned income becomes increasingly appealing. Income from a business venture is particularly attractive because it comes without the restrictions commonly attached to grants and major donations. The interest in these ventures is not limited to funding. Many nonprofits are finding that business ventures can serve as effective methods for addressing their social objectives. For instance, a homeless shelter may start a retail bakery to generate funds and provide a live business setting within which the shelter's residents can develop their job skills.

This current experimentation with nonprofit business ventures is, on the whole, a promising development. Creative and judicious use of these ventures can position social sector organizations to accomplish much more than they could by relying only on the limited philanthropic and government resources they are able to attract. In the past, many nonprofits missed worthwhile opportunities to serve their missions effectively and generate funds for their organizations because they did not seriously consider the range of earned-income ventures that might be appropriate

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for them. Their increased willingness to cross sector boundaries gives social entrepreneurs new tools for accomplishing their objectives.

Nonetheless, it would be a mistake to think that nonprofit business ventures are always beneficial. Nonprofit leaders should not jump on this bandwagon without understanding and addressing the challenges, costs, and risks of taking the ride. Making money with business ventures is more difficult and can take much more time and capital than many people realize. If it were easy to create wealth through new businesses, we would not see such high business failure rates. Even when a nonprofit venture succeeds financially, it could pull the parent organization and some of its most valuable resources, such as senior management time, away from the core mission. In some cases, the financial benefits will not be worth the hidden costs to the organization. When the venture also has a social purpose, as many nonprofit ventures do, managing to serve both purposes well increases the degree of difficulty and quite often increases the costs of the venture. Making sure that a business venture is a worthy undertaking for a nonprofit is not an easy process. It requires a firm understanding of the economics of the venture, the market it aims to serve, the competition trying to serve that same market, the direct social impacts of the venture, and any indirect costs or tensions it might create for the parent.

The best way to understand and address all the relevant factors is by developing a business plan for the venture that combines rigorous analysis, creativity, and action-based learning. Conducting a thorough venture planning process significantly increases the probability that the venture will serve the parent organization well, allowing venture managers to anticipate important challenges and avoid common mistakes. It is crucial to stay focused on the ultimate bottom-line, cost-effective mission impact throughout this process.

Combining Rigorous Analysis, Creativity, and Action Learning

Developing a venture that is likely to have a positive net impact on the performance of the parent organization is no easy task. The best place to start is with a business planning process that blends a rigorous analysis of the potential opportunity with creative thinking and action-based learning. Crafting a compelling business plan is a powerful learning experience that should lead to clearer expectations and a more viable venture than would otherwise occur. It forces the venture leaders to do their homework before the parent makes a major irreversible commitment. A comprehensive planning process forces the proponents of a venture to articulate its objectives clearly in the context of the parent's mission, to de-

fine the venture's products and target market, to conduct a realistic assessment of demand and buyer behavior, to create cost and revenue projections that are plausible, to determine the amount of investment likely to be needed until the venture becomes self-sufficient, to craft a creative and compelling strategy, to articulate and test the key assumptions behind the strategy, and to set realistic financial and social expectations as the venture develops. The insights gained in the planning process increase the chances for success. They may also convince the leaders to walk away from a venture that is not likely to yield sufficient benefits to justify the costs. If the business plan sets realistic goals for venture performance, it also provides a tool that the venture leaders can use to manage expectations as the venture develops. Producing a strong plan has the added benefit of helping the venture leaders attract resources to get the venture off the ground. It makes it possible to define the kinds of social and financial returns that can be offered to investors.

Rigor is essential to this process. If entrepreneurial nonprofit leaders do not subject their new venture ideas to a fact-based, analytic planning process, they run the risk of moving prematurely or making costly strategic mistakes. Rigorous analysis is not enough, however. It must be accompanied by creativity. The analysis is bound to uncover unexpected complications, challenges, and problems. Creativity is needed for designing and redesigning your venture to address these issues. Even with a rigorous analysis and creative venture design, it is not possible to know for sure how a venture will work until you try it. Uncertainties will remain. As a result, business ventures are continual works in progress. They evolve and sometimes change radically based on experience in the marketplace. This means that the rollout plan should be designed to promote action-based learning in a timely way so that changes can be made before too much time and money have been wasted.

You will no doubt hear that many new ventures succeed without a business plan. This is true. Planning does not come naturally to many action-oriented entrepreneurs. What you do not hear about are the large number of ventures that fail for reasons that could have been addressed in a good planning process. A team can climb a mountain without a map or any particular plan for the ascent, but their chances of reaching the summit in a timely fashion are greatly increased if they have a map and a plan that are grounded in knowledge of the terrain they will have to cross. Of course the team cannot control or even predict with certainty important weather conditions, and landslides may have destroyed trails that were previously available, but with a map and a plan it is better positioned to make adjustments when difficulties are encountered. In the same way, a well-crafted business plan increases the probability of a venture's timely success, especially when it takes the parent organization into unfamiliar territory. It is worthwhile even if the details of the plan have to be changed along the way.

Developing a business plan for a nonprofit venture is not exactly the same as developing a business plan for a traditional business venture. If it were, we would not need this book. Nonprofit leaders starting new ventures could simply read any of the dozens of very good books already available on business plans and enter traditional business plan competitions. The main difference is that nonprofit ventures are first and foremost a means to help the parent organization serve its social mission. The business plan must be structured with that in mind. If the plan makes clear how the venture will help the parent organization directly or indirectly improve its mission performance, it should provide proponents of the venture with ammunition to persuade key stakeholders (both internal and external) that this is a good thing to do, not for the money alone but for the mission. After all, the mission is presumably the glue that holds the stakeholders together.

Conducting a Thorough Venture Planning Process

Venture planning, if done right, is a demanding process. For more than twenty years I have been involved in business strategy and venture planning as a consultant, teacher, and researcher. For the past decade I have been able to focus my work on social entrepreneurship. I have a broad perspective on social entrepreneurship that is not limited to launching business ventures, but many of the organizations I have studied and written about are nonprofit organizations exploring this avenue. Through this work I have identified a number of challenges and mistakes that are commonly made in the venture creation process. The following recommendations are designed to help nonprofit leaders address the challenges, avoid the common mistakes, and increase the chances that their ventures will succeed in serving or supporting their organization's social mission.

Identify Suitable Venture Opportunities

The first step in developing an attractive venture opportunity is coming up with an idea. Too often nonprofit leaders will see what others are doing and want to copy it. "If their drug rehab program can run a moving business, why can't we run one with residents from our drug rehab program?" Or they spot some market trend and want to jump on the bandwagon. "Look at all the Starbucks! Why can't we start a high-priced coffee shop?" Some of these ideas may well work, but chances of success increase when nonprofit leaders focus on opportunities that have a natural fit with their organization's resources, assets, capabilities, clientele, and mission. These factors can serve as the basis for a competitive advantage. A theater group with a large stock of costumes is better positioned to enter the costume rental

business than to open a restaurant. As you look for suitable opportunities, keep in mind intangible assets, such as relationships and reputation. The point is to identify opportunities that the parent organization is well positioned to pursue and that will be seen by key stakeholders as natural extensions of its operations.

Assess Organizational Openness and Readiness

Many nonprofits are not ready to launch and run businesses, especially when the businesses require new skills, behaviors, and values. The time demands can be tremendous and the learning curve dangerously steep. Even when the opportunity fits well with the parent organization's capabilities, program staff in the parent organization may resist the venture, perceiving it as competing with them for scarce internal and external resources. The new venture may require methods of operation that are antithetical to the values of the parent. One social service organization reported a tension between the loan officers in its new microlending operation who were trying to collect loan payments and the social workers assisting the same clients. The new venture may even require higher compensation levels as you compete with businesses for management talent. This can also be a source of tension with core program managers. Be realistic in assessing the fit of the new venture with your culture and in identifying potential points of tension. Chances of success are greater if your organization is ready, willing, and able to take this on. Of course, some level of tension is tolerable and may even be a good thing, but too much conflict between the new venture's values, methods, and skill requirements and those of the parent organization can be costly, undermining the value of the venture.

Be Clear About the Venture's Objectives

Many nonprofit ventures are launched with a certain amount of ambiguity about the objectives. Will the venture serve the mission directly? If so, how? And how can we measure its success on this dimension? What kind of social impacts are expected and by when? Is the venture primarily designed to be a source of funds for the parent organization? If so, how much funding is it reasonably expected to generate? When will it begin generating funds? What investment is required to get it to that point? Rough objectives and measures should be defined from the beginning of the venture planning process and revised along the way based on what the venture team is learning. In the process it is especially important to define the kind of minimum thresholds that the venture must meet to be worthwhile. These thresholds are akin to a "hurdle rate" in business. If the venture does not look like it will get over the hurdle, it should not be pursued. Because social impact

is often hard to measure or convert to dollar equivalents, the process for nonprofit ventures cannot be as mechanical as it is in business, but minimum targets can be set through a judgment process. Rough minimums can be set by comparing the expected impacts created by the proposed venture with what could be accomplished if the same time, energy, and money were used for other purposes.

Define, Research, and Test the Venture's Value Propositions

For any venture to succeed it has to create attractive value propositions for all the key stakeholders. A value proposition describes an exchange in terms of what the stakeholders in question must give or give up and what they get in return. An attractive value proposition is one that, in the eyes of the stakeholders involved, creates value, in the sense that stakeholders get something more valuable to them than what they have to give. So far we have focused on the value proposition for the parent organization. This is the ultimate test from the parent organization's point of view. However, in order to be successful over a significant period, the venture must be able to create attractive value propositions for other key stakeholders as well.

From a business point of view, the value proposition for customers is most important. The key question is whether customers will believe that the venture offers them enough value to make it worth all the costs of doing business with it. The value created for customers must be assessed relative to their next best alternative. This is what links market and competitor analysis in the business plan. Competitor analysis is all about determining the alternative value propositions that competitors offer customers now, and how competitors might change their propositions as a result of your entry into the market. Venture founders often make several mistakes in assessing the attractiveness to customers of their value proposition. Because the nonprofit sector is heavily needs driven, nonprofit entrepreneurs sometimes mistake need—something important that is lacking—for demand—the ability and willingness to pay. In some communities, the need for day care is high but the demand is low because those who need it cannot pay enough to cover the cost of supplying it. Alternatively, demand for large sport utility vehicles is high, but the actual need for the capabilities they offer may be low. The ideal is to find an opportunity with both high need and high demand, but in the end demand is what matters most from a business point of view. Another mistake is to think too narrowly about competition, including thinking only about those competitors who offer exactly the same products or services. A competitor is anyone who can deliver a comparable value to customers. Look at it from the point of view of a customer making a decision. What alternative would you consider? An environmental group that wants to offer river rafting trips should focus not only on rafting competitors, but also on other activities that might appeal to

the same target market in exchange for their vacation time and money. Another common mistake is to consider only price in thinking about what customers give up. Often it is not enough to be competitive on price. Other factors, such as location, convenience, responsiveness, loyalty (to existing suppliers), switching costs of changing to a new supplier, perceptions about quality, and more, may play key roles in driving customer behavior. Again, the key is to look at the decision from a potential customer's point of view.

Entrepreneurs often conduct surveys to help them predict customers' buying decisions. Often these surveys are poorly designed and solicit only opinions rather than gather data about past behavior. Asking "How much do you pay on average for a loaf of freshly baked whole wheat bread?" is better than asking "Would you pay \$3 for a loaf of freshly baked whole wheat bread that is made by homeless people trying to better their lives?" What someone has done is a much better predictor of future behavior than what they say they will do. Opinion surveys are particularly problematic when it comes to testing the willingness of customers to purchase a socially beneficial product or to do business with a socially oriented firm. It is natural for respondents to give answers that make them look good. Again, it is best to focus on behavior. Ask when they last used social criteria in actually making a purchase, then follow up for details. People may still misrepresent their past behavior in order to look good, but this is less likely than misrepresenting future intentions. The best information will come from a test market or pilot in which actual buying behavior is measured and analyzed.

The heart of the business plan, particularly the sections on the market, the competition, and the strategy, are all about demonstrating that the venture will present an attractive value proposition to its intended customers. Other value propositions that should be assessed carefully are those for the venture's work force and for any investors (philanthropic or commercial) that might be needed. People drive the success of any venture, and the ability to attract the right people can be a crucial factor in the venture's success. In the case of ventures that employ clients of the parent organization for training purposes, the workforce value proposition is where the social value is created. The clients, such as homeless shelter residents, may not have very attractive employment and training alternatives, making it easy to convince them to participate. However, some ventures may provide more valuable training and be more inherently appealing than others. Because the staffing model is related directly to serving the mission, the venture development team should pay special attention to how the venture creates value for these clients and work to increase that value where possible. If outside investors are needed, it will be important to understand the kind of value, social or financial, they want to get out of the investment. Deals need to be structured to reflect the different interests and values of these potential investors.

Be Fair and Thorough in Allocating Costs

Many nonprofit ventures look good financially only because of hidden subsidies from the parent organization. Proper allocation of costs is crucial and often not done very carefully, largely because it is no simple matter, especially when costs are shared between the new venture and the parent organization. The most common mistake is not to allocate the cost of senior management time. This is often a scarce and valuable resource, and its value needs to be reflected in the costs of the new venture. In an ideal world, this time would be sold to the new venture based on its opportunity costs, not on executive salaries. The issue is what that time is worth to the parent organization. For instance, if senior management could raise \$100,000 a year in the time they devote to the new venture, this is the true value (cost) of that time to the parent organization. The venture should have to cover this much just to make the parent organization whole. Of course few organizations will go through an honest assessment of opportunity costs. In any case, a fair share of senior executives' salaries should be allocated to the new venture based on the time they devote to it.

A related mistake is to assume that if the new venture is purchasing something from the parent organization, this constitutes additional financial benefit for the parent. This is rarely the case. Consider a nonprofit arts center that owns and occupies a building in a downtown shopping district. It launches a gallery to sell art in the ground-floor space. The gallery venture agrees to pay the parent organization \$2,000 per month for the store and storage space. Does this represent an additional \$24,000 financial benefit for the parent? No, it does not. The space has a fair market value, particularly if it could be leased to some other retail business. If \$2,000 per month is the fair market value, then this is an appropriate cost for the gallery and should not be treated as a financial benefit to the parent organization, because the parent could receive the same revenue from leasing the space to anyone else. At most the parent organization saves the expense of finding another tenant. If the parent could charge a higher price to another tenant, say \$3,000 per month, then the \$24,000 in rent paid by the gallery actually represents a \$12,000 annual loss to the parent organization, not a gain at all. It masks a hidden subsidy. New ventures need to be charged the full fair-market value or opportunity value for any services or resources they are using from the parent organization, and no more (for IRS purposes). Only if the parent could not realize any other benefit from the shared resource should these transfer payments be treated purely as incremental cash flow from the venture to the parent organization. Fair cost allocation can be tricky, but it is worth a serious effort if the parent organization wants to understand the true value of the business venture.

Use Cash Flow, Not Revenue or Profit, as the Measure of Financial Impact

It is fascinating how many people simply look at business ventures as means to diversify their revenue streams. They seem to miss the obvious point that if the incremental revenues do not exceed the incremental costs of running the venture, the venture will be a net drain on the parent organization. They will actually have to raise more money to subsidize the venture, quite possibly at the expense of more mission-oriented programs. Imagine a \$3 million dollar agency that is totally dependent on grants launching a new venture that will generate \$1 million in new revenue per year but actually cost \$1.2 million to operate. The agency's revenue is certainly more diversified, with nearly 24 percent of its budget coming from earned income (\$1 million out of \$4.2 million). But not only does the executive director have to spend valuable time overseeing the launch of a new venture, but she also has to raise not \$3 million a year but now \$3.2 million to keep all her other programs operating at the same levels and the venture alive. The diversification does not ease the organization's fundraising burden or make it less vulnerable to cuts in donor funding. This kind of subsidy makes sense only if the new venture provides sufficient direct mission impact to justify the additional fundraising and the time commitment by agency management.

A more common and potentially devastating mistake is to assume that the parent can take all the profits out of the business venture once it becomes profitable, or that its subsidy is limited to operating losses. One of the most painful but important lessons many entrepreneurs learn is that profits are not the same as free cash flow. Free cash flow is cash that is produced by the venture that is not needed for its continuing operations. Free cash flow is what you can take out of the business without harming its ability to operate. Many businesses, especially growing businesses, require that a large portion of any profits be reinvested in the business. How many companies do you know that pay out 100 percent of profits as dividends to shareholders? Very few, if any, could afford to do this while keeping their companies strong. It is true that once a venture stops growing, its cash needs decline significantly and the tables turn. To use an old business consulting expression, if the venture is a success, it may become a cash cow that can be milked. However, achieving this point can take much longer than most people expect. Even if the venture gets there, it might be wise to reinvest some of the cash it generates in looking for the next business idea, because this once-profitable business may well decline. New competitors may enter the market. New technologies may create better value for customers. Customer tastes may change. Few businesses can be milked forever; only a safely invested endowment lasts forever. This is why it is crucial to understand the cash dynamics of the venture you are starting and to manage cash carefully.

Every business plan needs a detailed projected cash flow statement to supplement the income statements and balance sheets. The cash flow statement will show how much cash the venture needs as it grows and when the venture can realistically expect to generate cash for the parent organization. It is not uncommon for new ventures to require cash infusions for years, especially as they grow. In addition to covering the loss in year one, the parent organization may need to put in another \$50,000 to cover working capital needs. The expected profit of \$100,000 in year two may not be enough to cover the cash needed to grow in year three, requiring a small cash subsidy even though the business is profitable. The projected \$2 million in revenue and \$200,000 in profits in year three may yield only \$30,000 in free cash that the parent can extract from the venture without harming plans for year four. It may be five or more years before a successful business reaches a steady state in which free cash flow equals or exceeds its profits. Struggling businesses may never get there. Of course this is just an illustration. The cash dynamics of every business are different. They depend primarily on working capital needs, such as inventory and accounts receivable, on payment terms with major suppliers, as well as on additional required investments in space, furniture, and equipment as the business grows. Available financing from leasing companies, banks, or others may offset the venture's internal cash needs, but these methods of managing cash flow have a cost and may be hard to secure for a young nonprofit venture. This is an area in which it pays to understand the details of the business. Do not assume that you can take the profits out and use them for mission-related purposes. You could be in for a major disappointment. From the parent's point of view only free cash flow is available and this is what should be counted in deciding whether the venture is worthwhile.

With this in mind, do not expect a quick financial fix from a business venture. New ventures are not promising for organizations in need of emergency financial aid. Even with promising business ventures, it can take years and significant investment to reach the point at which the venture is creating cash that can be used to support the parent organization. It typically takes a very healthy parent organization, perhaps with a sympathetic funder, to launch and build a business venture to the point of self-sufficiency. Even then, business is risky and market conditions are constantly changing. The parent organization should not expect the venture to generate cash in perpetuity without requiring major reinvestment from time to time.

Recognize That Negative or Low Cash Flow Can Be Justified by Direct Social Impact

Another mistake that nonprofit leaders make in evaluating venture possibilities is to focus too much on financial performance, forgetting that the only rationale for the venture to begin with is to improve the mission performance of the parent or-

ganization. Generating cash is only one way to do this. Direct mission impact is another. A mission-related venture might be worthwhile even if it needs an on-going subsidy. Cost-effective performance may justify the subsidy. Consider a bakery that is created as a training ground for homeless people to learn job skills. Even if it needs to be subsidized, it may be the most efficient and effective way to accomplish the training and place people in jobs. The net subsidy per participant could be lower than a comparable classroom-based job-training program, and working in the bakery could be a more effective way of preparing participants for real jobs. The central question is, Could the parent organization achieve greater social impact by allocating the same resources to another approach? If not, then the subsidy is justified. This is an important concept for funders, as well as for entrepreneurial nonprofit leaders, to embrace. Just because the venture is structured as a business does not mean it must be profitable to be worthwhile. It just has to be the best use of scarce philanthropic and management resources. Of course in the best of circumstances a nonprofit venture will create both effective mission impact and significant free cash flow to be used to support other programs, but this wonderful combination is relatively rare. When a venture creates direct social benefits, these must be factored into the assessment and given proper weight.

Plan for a Staged Launch in Order to Test Assumptions and Resolve Uncertainties

Starting and running a successful business of any kind requires passion, commitment, persistence, and flexibility. It is a common mistake to forget about the flexibility. Most business ideas evolve significantly as they are tested in the marketplace. This is because no amount of research will resolve all the key questions about the venture. Key uncertainties will remain. The plan will make assumptions that need to be tested. Entrepreneurship, at its best, is a form of action learning. The rollout plan for a venture can often be structured to enhance the action learning and to make sure that key assumptions are tested before major irreversible commitments are made. Of course some businesses, such as Federal Express, cannot be launched without a major commitment of resources, but most business launches can be staged with significant investment coming in once core assumptions have survived a market test. This is the idea behind pilots and so-called beta tests. Entrepreneurs commonly blend action, analysis, and creativity as they refine their ideas. This process can be designed in a strategic way to test the most crucial and uncertain assumptions first. Entrepreneurship experts commonly recommend that the rollout of a new venture should proceed in stages, with milestones or checkpoints built in to indicate when core assumptions will have been tested and some uncertainties resolved. This is one of the most powerful risk management tools for entrepreneurs because each untested assumption presents a risk for their original

business model. New venture creation is a process of discovery and continuous adaptation to the realities of the marketplace. If nonprofit leaders want to enhance their chances of success, they will stage their ventures and test their assumptions.

Balance a “How Can” Mind-Set with an Objective Assessment

Most of the mistakes discussed thus far cause nonprofit leaders to pursue unwise ventures or to pursue ventures in unwise ways. Another kind of mistake is abandoning a venture idea without sufficient effort to make it work. New ventures are inherently risky, and it is easy for critics and doubters to find reasons not to take the risks. Yet most successful entrepreneurs have been persistent in the face of adversity and skepticism. It is important not to give up on a venture prematurely, but stubborn commitment to a bad idea can also be a disaster. The key lies in adopting a “how can” mind-set, then balancing that with objective judgment. Instead of asking, “Can we make this venture work?” successful entrepreneurs ask, “How can we make this venture work?” Each nonprofit venture should have a champion who adopts this mind-set and has the creativity and knowledge to apply it well. Venture champions are constantly on the lookout for solutions to problems and ways of overcoming barriers that arise in the planning process or in the early stages after launch. Their job is to make the venture work from the point of view of the parent organization. Of course the venture champion should not be given final decision-making authority about whether the parent organization will support the new venture. A review board that can objectively assess the venture as the champion designs and redesigns it would be better positioned to make the decision. This review board should involve parent organization staff or board members, as well as outsiders with relevant expertise or crucial resources. In this way the parent organization can benefit from the persistence and “how can” mind-set of a venture champion and still assess the venture in a rigorous and objective way.

Staying Focused on the Ultimate Bottom Line

Nonprofit leaders considering new business ventures must be able to answer one fundamental question: Is this venture going to be worth the investment of time, energy, and funds it will require? Despite all the popular rhetoric about a “double bottom line” for social ventures, nonprofit leaders have only one ultimate bottom line by which to measure a venture’s worth. In the end, it all comes down to mission. Money is simply a means to an end. No amount of profit can make up for failure on the social side. It is an input into the process, not a bottom line on the same level as mission impact. *A venture is worthwhile only if it is an efficient way to*

serve or support the parent organization's mission performance. This ultimate bottom line can be served directly by integrating mission-related objectives into the new venture, indirectly by using the venture as a cost-effective way to subsidize worthwhile mission-related programs of the parent organization, or by creating both direct mission impact and indirect benefits. Nonprofit leaders should ask whether, from a mission perspective, a venture is the best way to spend and invest the organization's scarce resources and use its abilities to mobilize resources. Improving social performance is the only legitimate reason for a nonprofit to make any significant investment in a new venture.

Many nonprofit venture plans place too much emphasis on profits as the measure of success and neglect the social impacts. The architects of these plans seem to lose sight of the ultimate bottom line for a nonprofit parent organization. Profits are neither necessary nor sufficient for a venture to be a success with regard to social impact. An exclusive focus on profits is shortsighted for three reasons touched on earlier in this chapter. Let me review them because they are important.

First, *nonprofit business ventures can generate sufficient direct social benefits to justify their existence even when they are not profitable.* Consider the example of a homeless shelter starting a bakery to train and employ shelter residents. This could be a cost-effective way to help them become more employable, even if it loses some money each year. It may be both cheaper and more effective than alternative job readiness or skill training programs. It may be worth subsidizing this kind of venture. A nonprofit venture plan should identify the direct social impacts created by the venture and assess the cost-effectiveness of using the venture to generate these impacts. This can make potential investors comfortable with the financial losses projected for the venture.

Second, *a profitable venture may still be a very inefficient way to generate funds for the parent organization.* As we have seen, even profitable ventures may not generate free cash flow, in which case they make no financial contribution to the parent organization. But more important is that even when the venture does generate free cash flow, it may be a very costly way of raising the amount of cash it creates, considering the investments of time, scarce human resources, and start-up capital required. Philanthropic fundraising might be a cheaper and easier way to generate the same amount of money. It may not be as sexy as a business venture, but it may be a more sensible path to mission impact. When the primary benefit created by a venture is cash for the parent organization, a persuasive business plan will make the case that this particular venture is a cost-effective way to generate these funds.

Third, *generating profits simply to sustain the parent organization may not be sufficiently inspiring to important investors and other key stakeholders.* Most nonprofit ventures, even those undertaken only for financial gain, require below-market-rate capital, as well as other forms of in-kind or financial support from suppliers, distributors,

and other partners, who are often, at least in part, socially motivated. For many of these stakeholders, the financial sustainability of a parent organization is not a sufficiently meaningful goal. It is too abstract when compared to the mission impacts that the parent nonprofit was created to serve, whether it is protecting biodiversity, increasing economic opportunities for disadvantaged populations, reducing hunger, fighting crime, enriching lives through the arts, or any of the other social objectives that move people to create and support nonprofit organizations. From a management point of view, financial benefit is certainly important, but it does not have the same inherent value as mission-related social impact, and it does not motivate people in the same way. Failure to convert a venture's profit into desirable social impact undermines the appeal of the venture and wastes the profit. It can strengthen a venture plan considerably to show how the funds created by the venture will be used to improve the parent organization's social impact, illustrating why, in social terms, the venture is important. Clear and meaningful links to social results create a much more compelling plan, and they should. Society is better off when resources flow to nonprofit organizations that can best use them to produce social impact.

Of course, assessing potential new ventures in terms of likely net impact on mission performance requires a complex judgment that weighs the expected positive and negative effects of the venture. On the positive side is the direct social impact likely to be created by the venture itself, plus the impact created by the mission-related activities that are supported by the surplus funds generated by the venture, along with any other benefits that strengthen the parent organization. These other benefits can be hard to articulate or demonstrate, but they are important to recognize. It may take a deliberate effort to make sure they are captured. Starting a business venture may lead the parent organization to strengthen its capabilities in a number of areas, such as marketing, cash flow management, operations, strategy, and more. The key will be making sure that these skills are transferred from the venture team to the rest of the parent organization. The very process of creating a venture plan could force the parent organization to engage in a healthy overall assessment of its various programs from the point of view of both financial strength and mission importance. If handled correctly, the venture could also serve as a rallying point for staff members who are excited about exploring something new, and it could demonstrate to prior supporters that the parent organization is serious about securing its financial future and creative about serving its mission.

On the negative side is any reduction in mission impact caused by diverting valuable resources to the venture, along with any undesirable side effects. This side of the equation is even harder to assess in concrete terms but should not be neglected. It includes the opportunity costs of using resources for this venture that

could have been used for other productive purposes. For instance, if the venture requires a day per week of the parent organization's executive director's time, it is important to think about how that time might have been spent to create social impact or even to generate funds from other sources. Is this venture a worthwhile use of that valuable time? This side of the equation also includes subtle and unintended effects, such as potential harm to the parent organization's credibility or reputation, tensions between staff of the new venture and staff performing core mission functions, political complications that might arise, and harm to others in the community. If a homeless shelter starts a bakery in a neighborhood that has plenty of bakeries already, it may simply drive the family-owned bakery down the street out of business. This alone may not be a sufficient reason to abandon the venture, but it could well be a good reason to consider other options. When the opportunity costs and other negative effects are honestly assessed, pursuing a particular business venture could be a serious mistake from a mission point of view, even if it is expected to make a positive financial contribution. The net effect is what matters. A rigorous venture assessment will take all these factors into account, focusing on the ultimate bottom line of mission impact.

Conclusion: Practicing Social Entrepreneurship

This chapter has argued that nonprofit ventures should be viewed from the perspective of their contribution to the parent organization's ability to serve its social mission. They can contribute to cost-effective mission performance either by creating direct social impact or by providing resources to support core programs of the parent organization. Through a rigorous and creative business planning process nonprofit leaders can assess venture ideas from a mission point of view and improve the chances that their business ventures will prove worthwhile.

Nonprofit ventures are quite popular right now, and perhaps for good reason. It appears that they have been underused in the past and opportunities have been missed. Many people identify nonprofit business ventures with social entrepreneurship. Before closing, it is important to emphasize that business ventures are only one way that nonprofit leaders can be entrepreneurial in serving their social missions.

Successful social entrepreneurs will use the most effective structures, strategies, and funding mechanisms to achieve their social objectives. Social entrepreneurship should not be seen as a funding strategy, and it should not be tied to the idea of business ventures. The concept of entrepreneurship goes much deeper than that. At its heart, entrepreneurship is about establishing new and better ways to create value. The eighteenth-century French economist who popularized the

term, Jean-Baptiste Say, put it slightly differently when he said that entrepreneurs shift resources into areas of higher productivity and yield. What distinguishes social entrepreneurs is their focus on creating social value. They measure productivity and yield in terms of social impact. They help us find better ways to use resources to improve the world in which we live. When ventures serve this purpose, social entrepreneurs will pursue them. Otherwise they will use different organizational strategies and structures. They will not be shy about using philanthropic and government resources when they are appropriate and available. They do not see donor dependency as a disease, nor do they see earned income as a panacea. They recognize the strengths and weaknesses of both forms of revenue. Despite popular conceptions, neither form is inherently more reliable or sustainable than the other. Businesses fail all the time, and many donor-dependent nonprofits have been around for many decades, even centuries. Social entrepreneurs look for the strategy, structure, and funding mechanisms that are most likely to ensure effective and efficient social performance given specific mission objectives and a particular operating environment. Business ventures should be approached from this more comprehensive entrepreneurial point of view.