Thinking About Starting A Business?

Read This First.

Nonprofit leaders have long fantasized about creating businesses that generate earned income to fund their operations. In this new age of dynamic capitalism, the dream is more popular than ever.

As a student and teacher of entrepreneurship, I have conflicting feelings about this fantasy. By definition, social entrepreneurs are resourceful and should explore all appropriate strategies to further the missions of their organizations. Too many fail to think creatively about commercial opportunities. Yet too little is said about the risks and demands of creating a profitable business. The attempt could be disastrous for those who are ill-prepared.

If raising philanthropic funds seems grueling, try running a profitable start-up business. I have spoken with a number of successful business entrepreneurs who claim that if they knew in advance what they were getting into, they never would have started a business. Entrepreneurs tend to work long hours; many exist on a thin financial edge for years before they reach consistent profitability. Business success can take monumental energy and effort.

More importantly, the "sustainability" of business income is a myth. The road to riches in the private sector is littered with countless failed ventures. These failures are invisible—unless they are spectacular. Only the successes stand out. According to one prominent study, approximately seven out of ten new businesses fail within eight years. Many struggle financially for years, piling up losses. When a business is on the edge of failing, it is hard for the entrepreneur to give up—especially if the business is her own, and has a social mission. And it is nearly impossible for anyone to identify financial winners and losers in advance. Even seasoned venture capitalists have a hard time; as many as half of the start-up enterprises they support fail or lose money.

Entrepreneurs who do succeed must continually adapt to changing customer tastes, new competitors, shifting technologies, and other environmental factors. If they don't, profits disappear. Consider Community Products, Inc. (CPI), a forprofit producer of Rainforest Crunch candy. Ben Cohen of Ben & Jerry's ice-cream started this independent company. CPI was designed to give 60 percent of its net profits to nonprofit causes. After a booming start, CPI operated unprofitably for several years—despite Cohen's demonstrated business acumen, a sizable contract to supply Ben & Jerry's, and valiant efforts to diversify the product line. No profits meant no donations to charitable causes for years.

Nonprofit entrepreneurs looking for financial salvation may not fully appreciate the challenge in advance. When City Year, the Boston-based national youth service corps, decided to explore profit-making enterprises, co-founder Mike Brown said they were looking for ways to "make money while we sleep." Shrewdly, City Year found a strong corporate partner in Timberland, the boot and outdoor clothing company, but even with Timberland's expertise and brand name, the process of launching a line of City Year Gear (t-shirts, backpacks, etc.) in Timberland stores was intense and demanding for both partners.

Although City Year Gear has been successful, after a couple of years its profits still make up a very tiny portion of City Year's multi-million dollar budget. If Timberland's popularity fades or consumer tastes change, City Year Gear could face the same profitability problems as CPI. And even if it continues to be successful, it is likely to take many years to develop this enterprise into a sizeable source of funding for the organization. If it is challenging for City Year—with its exceptionally entrepreneurial management team, stellar advisory board, $15 million budget, and high national profile—to build a profitable business, imagine a thinly-staffed, under-funded, community-based organization attempting to pull this off.

Nonprofits launching commercial ventures face a distinctive set of challenges related to their mission and core values. While the revenues associated with earned income operations are attractive, key stakeholders may perceive commercialization as a threat to the organization's integrity. The American Medical Association (AMA) recently structured a deal to put its seal on certain health-related products of Sunbeam Corp. In exchange, AMA would receive royalty payments to support education and research. The announcement generated such an outcry from opposed AMA members that the deal was restructured to exclude the product endorsements. Even if AMA management thought this negative reaction was misguided, they still had to address it. In the social sector, values and politics can kill or critically injure potentially profitable business deals. Social entrepreneurs have to work within a different—often more restrictive—set of expectations.

For some organizations, on the other hand, starting a business is a terrific idea. Successful examples of nonprofit earned income operations range from Girl Scout cookie sales to the catalogue business of New York's Metropolitan Museum of Art. Bill Shore's remarkable success with various wealth-creating ventures at Share Our Strength is becoming legendary. And in his book, *New Social Entrepreneurs* (Roberts Foundation, 1996), Jed Emerson uses case studies to document the power of using new nonprofit businesses to provide job training for disadvantaged populations.

Are You Ready?

To determine if your organization is ready to start a business, ask yourself these questions, first posed by the Surdna Foundation's Ed Skloot, editor of *The Nonprofit Entrepreneur* (The Foundation Center, 1988):

1) **What are the risks involved, and can we afford to take them?**
2) **What are the resources, skills, and knowledge required, and can we supply them?**
3) **How do our values, goals, and attitudes differ from those required to support the venture, and can we adapt?**
4) **What are the timing requirements for launching the venture, and can we meet them? (For social entrepreneurs with limited business experience, it may be wise to find a partner to provide commercial expertise and a buffer from some of the risks.)**

To Skloot's list, I would only add one question:

5) **How will the pursuit of this venture affect our mission-related performance?**

—JGD

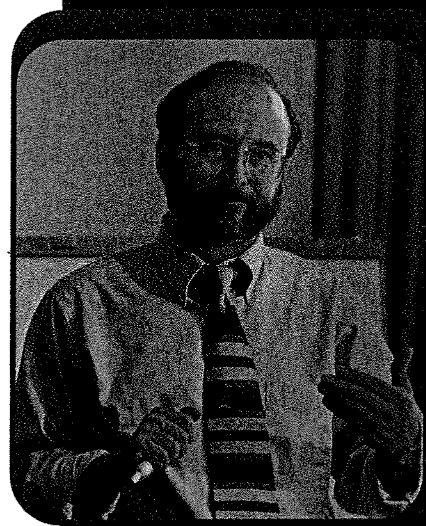
One example featured in the book is Rubicon Programs, Inc., a nonprofit agency serving the disabled, the homeless, and people at risk for homelessness in the East Bay area of Northern California. In 1995, Rubicon's Building and Grounds Services business had revenues of $3 million and contributed a profit of $250,000 to fund other Rubicon programs. But it was no overnight success. Profitability was the result of a long process that started in the late 1970s when Rubicon entered the retail tree nursery business. The nursery proved to be "good therapy, but bad business" according to the Roberts Foundation report. It closed in 1984, only to be followed by an unprofitable lawn service business for homeowners. Only in the 1990s did Rubicon find its profitable niche: Large maintenance contracts with public agencies.

Rubicon also operates a promising bakery and catering business that grew out of less-successful cafe, cafeteria, and catering businesses started in the mid- to late-1980s. By the early 1990s, these ventures were "losing money and draining the energy and spirit of key staff and managers," according to the Roberts Foundation report. After rethinking its strategy (with the Roberts Foundation's help), Rubicon decided to focus on a more sharply-defined, high-end bakery and catering business. In 1997, Rubicon's food business is finally expected to financially break even. It has taken 12 years. Rubicon's ultimate success demonstrates the possibilities; its path to success demonstrates the challenges. Entrepreneurs must be persistent, flexible, and creative.

If you are considering starting a business, I advise nonprofit leaders to exercise cautious realism. If your goal is to create a sustainable means of supporting your organization that will earn income for your organization while you sleep, consider raising an endowment. Start a business only if you are ready for the demands and risks.

Finally, remember: The social entrepreneur's bottom line is her mission. Making more money, only to fritter it away on ineffective or inefficient programs, is a failure, not a success. Because it is unrestricted, earned income provides no inherent check on the quality of the programs it funds. Social entrepreneurs should not let the excitement of creating wealth distract them from their central task of deploying that wealth in truly worthwhile ways.

—*J. Gregory Dees*



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