

Eight Basic Principles for Nonprofit Entrepreneurs

These lessons from the pioneers in the field could save you many heartaches.

BY JERR BOSCHEE

After hovering around the edges of the nonprofit sector for years, social entrepreneurship has moved into the mainstream. Venture philanthropists, traditional grantmakers, boards of directors, nonprofit entrepreneurs, consultants, and academics are all rushing to the table—many without the tools they need.

They can find those tools by turning to the experiences of the pioneers in the field—nonprofit veterans who’ve been quietly making mistakes and learning from them for decades. Here are eight basic principles that have emerged from those travails as articles of faith:

1 Earned income is paramount.

The nonprofit sector has traditionally been driven by a reliance on philanthropy, voluntarism, and government subsidy. Earned income has been viewed as something extra.

Social entrepreneurs have turned that formula on its head: On the revenue side, earned income has become the *primary* goal. Philanthropy, voluntarism, and government subsidy are welcome, but not central.

This is a tectonic shift, and not well understood or accepted by many in the sector, for two reasons.

Innovation can take a nonprofit only so far.

First, they fail to perceive the difference between “innovation” (doing something new) and “entrepreneurship” (doing something that makes money). “Social entrepreneurship” becomes a convenient label for almost any new approach that has a social outcome. But it’s one thing to design, develop, and implement a new program—and quite another to sustain it *without depending on philanthropy and government subsidy*.

And that leads to the second problem. Those who confuse innovation and entrepreneurship are also prone to forget the most important difference between *earned* revenue and *donated* revenue. One can lead to sustainability and self-determination. The other cannot.

Innovation is a precious resource, and it served as the primary engine of nonprofit growth through the 1970s and 1980s. But innovation can take a nonprofit only so far. Without self-generated revenue, nonprofits will remain forever dependent


on the kindness of strangers—and that’s a risk social entrepreneurs are unwilling to take. They’re passionately committed to their mission, but they’re just as passionately committed to becoming financially self-sufficient—in order to do more mission! And as traditional sources of funding became less available during the 1980s and 1990s, more and more nonprofits discovered the importance of paying their own way—and became genuine social entrepreneurs.

2 Be a player or don’t play at all.

Peter Drucker began preaching a new gospel to nonprofits in the early 1990s that has helped social entrepreneurs sharpen their organizational focus and expand their impact.

When Jack Welch took over as CEO at General Electric in 1981, he asked Drucker to tell him the *single* most important thing he could do to improve the company. Drucker’s answer was simple: If your products or services are not number one or number two in the market, kill them. In other words, *stop trying to be all things to all people*. Since then,

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*Stop trying
to be all things to
all people.*

Drucker has repeatedly urged nonprofits to do the same. He calls it “organized abandonment.”

Drucker’s advice runs against the grain of the traditional nonprofit mentality, but most nonprofit executives *will* admit that they’re spread too thin, that they’re trying to do too many things for too many people, and that they’re therefore unable to give *any* of their clients the attention they deserve. Organized abandonment gives them a way out of the morass.

The process can be agonizing. It isn’t easy to kill programs, especially if they’re beloved by board members or funders. And there *is* an important caveat: Being a social entrepreneur does *not* mean eliminating a program just because it loses money. If a nonprofit is the best or the only provider of a program that’s critically needed, it has an obligation to continue the program—and a managerial challenge to find other sources of revenue to cover the cost.

Fundamentally, organized abandonment relies on a nonprofit’s ability to be honest with itself—exceedingly difficult for *any* organization, nonprofit or otherwise. But the results have been worth it, and the ultimate winners have been the clients. Social entrepreneurs have discovered that reducing the number of programs they offer actually enables them to serve more people—because they have the time and resources to expand their efforts.

3 Starting a business venture is *not* the only path to success.

Many nonprofit board members and executives are daunted by the prospect of social entrepreneurship

because they think it means starting a business venture, something few know how to do.

But creating a business isn’t the only way to be successful as a social entrepreneur. In fact, the most fertile ground for most nonprofits is something called “earned income strategies,” which have nothing to do with starting a business venture.

The two approaches differ substantially in terms of purpose, expectations, and structure:

Earned income strategies: Experience has shown that almost every nonprofit has opportunities for earned income lying fallow within its existing programs. The opportunities may be tiny or they may be huge, but exploiting them can have a significant cumulative impact. By turning inward and searching for pockets of opportunities, nonprofits can register impressive gains, often raising their percentage of revenue from earned income by as much as 15% within one to three years.

Business ventures: Once a nonprofit has gained experience with earned income strategies, it may want to consider launching a formal business venture—but the goals would be much more ambitious and the strategy completely different. The *only* reason for a nonprofit to start a business venture is to exploit a specific opportunity for significant growth and profitability—a substantial difference from earned income strategies, which are designed primarily to cover more of a program’s costs, without any real expectation of making a profit or even reaching a break-even point.

The pioneers in the field have also discovered that the chances for success will be dramatically increased if the organization creates a “skunkworks”—a completely separate entity insulated as much as possible from the day-to-day operations of the parent organization. That means having a separate board, sepa-

rate staff, separate compensation policies, and as much independence as possible.

4 Unrelated business activities are dangerous.

Most nonprofit entrepreneurs have discontinued the attempt to mount businesses unrelated to their mission. Twice (in the late 1970s and mid-1980s), nonprofits chased the chimera of a cash cow—the apocryphal unrelated business venture that would operate almost as a perpetual motion machine, without much need for supervision, churning out floods of cash to fund the nonprofit’s mission.

Those nonprofits learned a painful lesson: Attempting to start an unrelated business venture means they were hit with a double whammy. They were trying to start a business (which they probably didn’t know how to do), and they were trying to start it in an arena they knew nothing about! At least by eliminating the second aspect, they could improve their odds.

The business ventures being started by nonprofits today are therefore emerging directly from their core competencies and basic strengths—from their missions, the programs they have already perfected, and the assets they have developed in the process. This also avoids trouble with the IRS, since their ventures are mission-related and no threat to their tax-exempt status.

Instead of unrelated businesses, nonprofits have been concentrating on two types of ventures:

Affirmative businesses. John DuRand of Minnesota Diversified Industries (MDI) invented the concept of an “affirmative business” in the early 1970s, and it has since become the most common form of social enterprise. Unlike a sheltered workshop, an affirmative business is created specifically to provide *permanent* jobs, *competitive* wages,



The greatest danger is under-capitalization.

career opportunities, and even ownership for people who are disadvantaged, whether it be mentally, physically, economically, or educationally. Employees have included people who are developmentally disabled, chronically mentally ill, recovering substance abusers, former convicts, visually impaired, physically challenged, members of inner-city minority groups, and others. Over the years, DuRand took MDI from an initial investment of \$100 and seven employees to a \$68 million business employing more than 600 people who were developmentally disabled. Recently, dozens of other nonprofits have followed his example.

Mission-driven product or service businesses. Many nonprofits have started businesses that deliver mission-driven products or services directly to clients, although payment may come from a third party such as a government agency or entitlement program or from a private insurance company. Unlike affirmative businesses, few of these businesses actually employ the people they serve. Examples include assistive devices for people who are physically challenged, personal care services to help elderly people at home, interactive instructional programs for potential high school dropouts, seminars for couples contemplating divorce, hospice care for terminally ill patients, and many, many others.

5 Be patient—and don't run out of money.

Social entrepreneurs are notorious for underestimating the amount of time and money they'll need to

reach their goals. According to an MIT study, significant revenue for most companies doesn't begin to flow until the *seventh* year of existence. And by the sixth year, the nature of the business has typically changed completely.

In addition, social entrepreneurs are as exposed to the vagaries of the market as any other business, and that means the greatest danger is under-capitalization. Profitability is no protection: The crucial element is cash flow. More than one profitable company has failed because it didn't have the money it needed at the time it was needed.

The rubric here is simple: Nonprofits must *invest* in their business ventures. If they cling to a *cost* mentality, their chances for success are minimal.

6 Recognize the differences between innovators, entrepreneurs, and professional managers.

Perhaps the most important lesson learned by the pioneers in the field has been one that strikes to the very heart of their self-perceptions. So often, nonprofits discover (too late) that their entrepreneurial efforts are doomed because they're being led by people with the wrong skills.

Regardless of whether a nonprofit is attempting to engage in a variety of earned income strategies or is trying to launch a business venture, it's important to understand the differences between three types of leaders.

Innovators, entrepreneurs, and professional managers are all needed in the evolution of a program or an organization, but at different times. Rarely does an individual possess more than one of the three skills.

Innovators are the dreamers. They create the prototypes, work out the kinks—and then get bored, anxious to return to what they do best, which is inventing more prototypes. Entrepreneurs are the builders. They

turn prototypes into going concerns, then *they* get bored. And that's when the professional manager arrives to secure the future. They are the trustees, the ones who install the systems and other parts of the infrastructure that make sure the going concern keeps going.

Unfortunately, in the nonprofit sector, often because resources are scarce, organizations try to shoehorn people into positions where they don't fit, and many of the problems nonprofits have when they begin adopting entrepreneurial strategies arise from having an innovator trying to do an entrepreneur's job or a professional manager trying to be an innovator, and so on.

7 The "nonprofit" culture gets in the way.

What is a "culture"? In the nonprofit world, it is usually a collection of unspoken compacts that tell us who we are, who we serve, why we serve them, and how. We rarely pause long enough to examine the tenets of our cultures, but new employees absorb them almost by osmosis. Within weeks of their arrival, they understand what it is about *this* organization that makes it different from *that* organization.

But culture eats change for breakfast, and any nonprofit that hopes to become entrepreneurial, regardless of whether it's starting a business venture or pursuing earned income opportunities within its programs, must undergo a radical set of changes. Here are five of the most important ones:

Be willing to take risks. There is a myth that entrepreneurs love to take risks. Not true. But they *will take* risks. That's part of what makes them entrepreneurs. Unfortunately, there's no more risk-averse entity than a nonprofit board of directors. To a degree, this is as it should be: The board is the steward of scarce resources. Too often, however, the

There are a lot of wannabe social entrepreneurs.

result is a mentality that shies away from anything new until success can be guaranteed, and nothing is more antithetical to entrepreneurship. Nonprofit entrepreneurs enter the game knowing that three-quarters of what they try will fail, but they have the personal and institutional courage to make mistakes, learn from the experience, and start all over again. As Ben Cohen, the founder of Ben & Jerry's, is fond of saying, "To stumble is not to fall. It's just a way of moving ahead more quickly!"

Make tough choices about staff members. Some of a nonprofit's longest-serving, most loyal staffers won't understand the principles of entrepreneurship, or won't agree with them, or won't have the skills to live in an entrepreneurial world; compassionate out-placement is the only solution for both them and the organization.

Relinquish control. Too many layers of approval weigh down an organization's ability to move quickly—a hallmark of entrepreneurship, where opportunities appear on the radar screen for an instant and then blink out of existence. Changing a nonprofit's culture means eliminating some of those layers.

Emphasize market pull. Changing its culture also means aggressively adopting the type of "customer focus" mentality that eludes most traditional nonprofits. Regardless of their protestations to the contrary, nonprofit planners still begin too often with the needs of their own organization, not with the people they serve.

Price more aggressively. For-profit service companies build a 50% gross profit margin into their pricing

strategies in order to have a 3-5% net profit margin at the end of the year—their definition of success. Nonprofits, however, are usually gleeful if they can cover their direct costs, a reaction that bars them forever from achieving any significant progress financially. If nonprofits are going to be serious about financial self-sufficiency, they *must* adopt more aggressive pricing policies. Doing so may be difficult in the short run, but, over time, it's the only sure way to be certain all of the organization's direct and indirect costs are covered.

8 Remember the Noah Principle.

The final lesson learned by the pioneers in the field has been the importance of making a commitment. There are a lot of wannabe social entrepreneurs in the world, who talk and plan and talk and plan—but never *do* anything! The courage to act is in distressingly short supply.

True, there aren't any guarantees—except for one. If you always do what you've always done, you'll always get what you've already got. As Wayne Gretzky, the Hall of Fame hockey player, has often pointed out, "I always missed a hundred per cent of the shots I never took."

So the pioneers have learned to live by the Noah Principle: No more prizes for predicting rain.

You only get a prize if you build an ark. ■

Selected Resources

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Cohen, Jan, "You've Got to Know When to Hold 'Em, Know When to Fold 'Em," *Nonprofit World*, Vol. 17, No. 1.

Emerson, Jed, "Famous Last Words of Failed Nonprofit Entrepreneurs," *Nonprofit World*, Vol. 15, No. 4.

Lauer, Larry, "Using Your Organization's Culture to Build Productivity and Reputation," *Nonprofit World*, Vol. 11, No. 6.

Muehrcke, Jill, *Are You Sitting on a Gold Mine? Fundraising Self-Assessment Guide*.

Muehrcke, Jill, ed., *Enterprise, Leadership Series*.

Skloot, Edward, "Seeking Earned Income Ventures," *Nonprofit World*, Vol. 7, No. 4.

Wilson, Leslie, "A Study in Nonprofit Entrepreneurship," *Nonprofit World*, Vol. 6, No. 6.

These resources are available from the Society's Resource Center, 608-274-9777, Ext. 221, www.danenet.org/snp.



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