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2. For-Profit Social Ventures

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Abstract. Traditional sector boundaries are breaking down as societies search for more innovative, cost-effective, and sustainable ways to solve social problems and provide socially important goods, such as education and health care. One result has been a rise in the number of social entrepreneurs who want to combine a social purpose with a for-profit organizational structure. Is the wealth-creation imperative inherent in for-profit organizations really compatible with optimal social impact? This paper is designed to help would-be for-profit social entrepreneurs understand and address the challenges of using a for-profit organization to serve a social objective. Drawing on a wide range of literature as well as case studies, we identify the challenges facing for-profit social ventures and outline strategies for responding. Of course, there are limits to what can be done within a for-profit structure. Our analysis should help social entrepreneurs recognize those limits and respond to them intelligently as they design their organizations.

Keywords: social entrepreneurship, social enterprise, social purpose business, social impact, social ventures, social sector, entrepreneurship.

1. Introduction

We live in an age in which the boundaries between the government, nonprofit, and business sectors are blurring.[1] This blurring results from a search for more innovative, cost-effective, and sustainable ways to address social problems and deliver socially important goods, such as basic education and health care. Much of the action revolves around experiments using business practices and structures to serve social objectives. Increasingly, government agencies and nonprofit organizations are adopting frameworks, methods, and strategies from the business world in hopes of improving their performance. More dramatically, for-profit organizations are emerging or expanding their presence in arenas formerly dominated by nonprofit or government providers, often with the blessing and encouragement of public officials. This boundary blurring has led to a new breed of social entrepreneurs creating for-profit organizations explicitly to serve social purposes.

1. For treatment of the blurring sector, see Ryan (1999) and Dees and Anderson (2003).

But does it make sense to blend the profit motive with a social objective? Adam Smith was skeptical. In concluding one of his most famous passages about the "invisible hand," Smith (1776) makes the following observation about business people, "I have never known much good done by those who affected to trade for the public good. It is an affection, indeed, not very common among merchants, and very few words need be employed in dissuading them from it (p. 478)." Even those who do not share Smith's skepticism must admit that successful examples are rare and the risks of conflict between pursuing profit and serving a social objective are significant. How can wealth creation be aligned with serving a social purpose and doing it well? This paper aims to help social entrepreneurs who are interested in pursuing a social purpose within a for-profit structure answer that question.

2. Defining For-Profit Social Ventures

In this paper, we are concerned with *for-profit social ventures*, defined as entrepreneurial organizations that are:

1. *Legally incorporated as for-profit entities*, with one or more owners who have a formal right to control the firm and who are entitled to its residual earnings and net assets. For-profit forms include proprietorships, partnerships, corporations, limited liability companies, and cooperatives.

2. *Explicitly designed to serve a social purpose* while making a profit. Having a social purpose involves a commitment to creating value for a community or society rather than just wealth for the owners or personal satisfaction for customers.

For-profit social ventures measure their success in terms of social impact. However, given their choice of the for-profit structure, they must pay close attention to the creation of economic value as well. Thus, whether they view economic value as a means for creating social value or as inherently valuable on its own, for-profit social entrepreneurs have dual social and financial objectives that guide their managerial decision-making and determine their success. This goal is commonly referred to as the "double bottom line."

It is important to distinguish for-profit social ventures from three related types of enterprises that we are not addressing in this paper:

Nonprofit business ventures. Increasingly, nonprofit organizations are operating commercial enterprises within their nonprofit structure. While similar to for-profit social ventures in their objectives and operations, nonprofits are legally prevented from distributing economic surplus. They are also free to use philanthropic support to subsidize their start-up costs and their on-going operations. Thus, they do not face the same capital markets and profit pressures as for-profit social ventures.

Socially responsible businesses. A socially responsible business achieves commercial success in ways that respect ethical values, people, communities, and the environment.[2] These businesses may even provide resources to and actively engage with public or nonprofit organizations to serve a specific social cause. However, unlike for-profit social ventures, their primary goal is the creation of economic value.

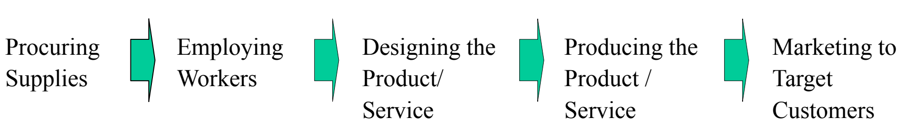
Purely profit-motivated firms operating in the social sector. The boundary blurring of recent years has seen some firms enter the social sector simply in search of profits. These organizations typically do not place inherent value on the social impact they create. Thus, Lockheed Martin's entry into the welfare-to-work arena in order to increase profitability through diversification does not qualify the firm as a social purpose venture.

While our focus is on enterprises that deliberately set out to create social value within a for-profit organizational structure, we may draw on lessons learned in these other categories to inform entrepreneurs who truly want to combine the profit motive with a social purpose.

3. Variations on the Theme

A for-profit venture may pursue its social goals in many different ways. These various methods can be organized around key stages in the business value chain. Strategist Michael Porter (1985) introduced the "value chain" concept as a tool for analyzing potential sources of competitive advantage for a firm. It includes all the activities through which businesses can create economic value, from purchasing raw materials to providing after-sales service. A simplified form of the value chain helps identify the major activities through which a business can create social value.

Figure 1: The Simplified Social Value Chain



2. Adapted from the mission of Business for Social Responsibility, http://www.bsr.org.

Procurement. Entrepreneurs can use their purchasing practices to serve social purposes. The most common practices involve purchasing from disadvantaged suppliers or engaging in environmentally friendly purchasing. For example, one of many "fair trade" organizations, Café Campesino provides specialty coffees by only purchasing coffee grown in socially and environmentally responsible ways, from democratically managed, small-scale farmer cooperatives in Mexico and Latin America. Another for-profit social venture, Recycline develops and delivers to market quality products from recycled materials, initially producing recyclable toothbrushes made from 100% recycled plastic.

Employment. Employment practices can be similarly used for social purposes. One common strategy is to employ disadvantaged individuals (such as people with disabilities, drug addicts, ex-convicts, homeless teens, etc.) with the goal of providing training and development opportunities. For instance, Cooperative Home Care Associates was established to create high quality paraprofessional jobs for low-income women that simultaneously empower the women and improve the quality of the home health care industry. Currently, CHCA employs over 550 African-American and Latina women, 75% of whom had been dependent on public assistance. Average wages and benefits are among the highest in the industry, worker turnover is significantly lower than industry average, and nearly 80% of CHCA's employees with over one year's seniority share in the cooperative's ownership.[3]

Product or Service. Certain products or services have inherent social value. Consider basic K-12 education, which has private benefits for consumers but also benefits society at large. Operating in this industry, LearnNow strives to provide youth from under-resourced communities with a world-class education, certainly benefiting the students, but also helping to produce responsible citizens and leaders for the future. Other examples in this category include products that are more environmentally sustainable or are aimed at alleviating a major social problem, such as hunger, crime, or drug addiction.

Production. Entrepreneurs can also use their methods of producing and delivering their goods to serve a social purpose. Environmentally friendly production practices provide the most common example. For instance, Green Mountain Energy Company provides 500,000 customers with "cleaner electricity" from sources such as wind, solar, water, and cleaner burning natural gas. Energy producers that use renewable sources not only reduce pollution and its associated problems, but they also decrease our dependency

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3. See Dawson, Steven L., and Sherman, L. Kreiner, "Cooperative Home Care Associates: History and Lessons," Home Health Associates Training Institute, January 1993 and information retrieved 5/22/2002 from National Network of Sector Partners, http://www.nedlc.org/nnsp/practitioners/chca.html.

on foreign oil as well as the need for drilling in environmentally sensitive areas.

Marketing to Target Customers. Entrepreneurs can serve a social purpose by targeting a particularly disadvantaged market in a way that not only benefits individuals in that market, but also benefits society. Providing housing to the homeless, family planning for the rural poor, and food to the needy fall into this category. One prominent example involves providing credit to disadvantaged small business owners who would otherwise not have access to capital. Grameen Bank pioneered this concept in Bangladesh over twenty years ago by profitably extending credit to landless poor, primarily women, who had no credit history or assets to secure these loans but rarely defaulted due to the success of peer-lending groups that evaluated, monitored, and supported the borrowers.

Because for-profit social ventures are so diverse in their social purposes and their methods of operation, we have to be careful in making generalizations. Many challenges will vary depending on where in the value chain social entrepreneurs aim to create social value. However, for this paper, we will keep our focus sufficiently general to be helpful to any social entrepreneurs who want to serve a social purpose through a for-profit structure, regardless of their chosen method.

4. Potential Benefits of For-Profit Social Ventures

Social entrepreneurs may be drawn to for-profit structures in part for personal reasons. They may want to see if they can “do well” while at the same time “doing good.” For-profit enterprises offer a potential financial upside that exceeds the financial rewards commonly found in the social sector. However, oftentimes the motivation goes beyond personal rewards. Many social entrepreneurs believe that for-profit structures have virtues that are not easily mimicked by nonprofit or public sector counterparts. These potential benefits tend to fall into five categories.

Promoting efficiency and innovation. The profit motive, if properly channeled, has the potential to encourage efficiency and innovation. For-profit organizations generally are driven to maximize every dollar of investment and minimize expenses incurred in creating and delivering value. At the same time, they have incentives to discover innovative, cost-effective ways of achieving their objectives.

Leveraging scarce public and philanthropic resources. The presence of for-profit providers can also be seen as a way to leverage scarce social resources, allowing philanthropic and tax dollars to be directed to where they are most needed. For-profit social ventures, if sufficiently profitable, can tap into private capital markets for investment funds. Some of them will also draw on private revenue sources to fund at least a portion of their activities. By occupying niches and serving markets for which the profit potential is high, they can free public and philanthropic resources to focus on those niches, segments, and programs that need subsidies.

Responding quickly to demand. Researchers have reported that for-profit organizations are more responsive to fluctuations in market demand than are their nonprofit counterparts. As Henry Hansmann (1996) points out,

> The empirical evidence indicates fairly clearly that, when demand increases rapidly in the human services, nonprofit firms respond by entering or increasing their capacity only slowly; for-profit firms are much quicker in entering or expanding to fill the gap.... Similarly, nonprofit firms appear to be slow to reduce their output, or to withdraw from an industry entirely, when demand for their services contracts. (p. 249)

This market responsiveness can be an advantage for spreading innovations in a timely manner, re-allocating resources when appropriate, and dealing with social needs that are expected to vary over time.

Improving access to skilled personnel. For-profit social ventures also have the potential to expand the labor pool by attracting people with skills that are also highly valued in business. Nonprofit and public sector organizations often have a difficult time competing with the business world for managerial and technical talent, and talented individuals often leave the sectors out of frustration or when their family obligations grow more onerous. By custom, nonprofit and governmental salaries are traditionally lower and cannot be augmented by the potential upside associated with equity ownership. For-profit social ventures can appeal to skilled personnel who might otherwise leave or fail to consider working in the social sector because of the limited financial rewards or other perceived limitations associated with working in nonprofit or government jobs.

Note that we did not mention the popular notion of financial "sustainability" in our list of benefits. We see no compelling evidence that for-profit organizations have greater chances of survival than nonprofits or public agencies. Business failure rates are relatively high, and we have no reason to believe that for-profit social ventures will be immune to the forces and factors that lead so many business ventures to fail. However, the potential benefits outlined above may provide compelling reasons for social entrepreneurs to adopt a for-profit structure.

5. Challenges of Combining Social Purpose with a Profit Motive

Of course, for-profit structures bring with them potential problems that may offset their benefits. Market forces and potential incentive problems can lead even the best-intentioned social entrepreneurs astray. Successful social entrepreneurs need to understand and address the challenges of combining the profit motive with social objectives in a way that still preserves at least some of the benefits that make the for-profit structure attractive in the first place. In attempting to do so, for-profit social entrepreneurs should be particularly aware of the additional complexity that arises when combining two different, sometimes divergent, objectives, as well as the potential pressures to compromise one or both of their objectives.

5.1. Complexity of Combining Two Very Different Kinds of Objectives

Making decisions and building an effective organization are inevitably more complicated with two objectives rather than one, particularly when they are different in some fundamental ways.

Differences in metrics and measurability affect management decision-making and external credibility. Though some social benefits can be converted into purely dollar terms,[4] many important social purposes defy this kind of economic translation, making direct comparison of financial and social performance difficult. Furthermore, not only are financial and social objectives often incommensurable, but social objectives are also much more difficult to measure. Social benefits are often intangible, hard to quantify, difficult to attribute to a specific organization, best evaluated in the future, and open to dispute. This measurement problem plagues the nonprofit sector and is equally confounding for for-profit social ventures where entrepreneurs and managers are attempting to make bottom line decisions based on both economic and social impact. This imbalance presents obstacles to making optimal managerial decisions, while also making it difficult to produce compelling evidence of social impact.

It is extremely hard to make strategic decisions about resource allocation or practical cost/quality tradeoffs when the social impact of these decisions is nearly impossible to measure in an efficient, timely, and reliable fashion. It can become all too easy to focus too heavily on the more familiar, tangible and straightforward economic measures of success. At the same time, uncertainty around demonstrated social impact makes it especially difficult to assess how much to invest in pursuing a particular means of creating social value or achieving a certain quality of social goods or services.

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4. The best work on converting social benefits into dollar terns is the "social return on investment" work done by the Roberts Enterprise Development Fund, see http://www.redf.org. However, even this work captures only "system savings" and does not include other important dimensions of social benefit.

The absence of clear and reliable social impact measures also makes it difficult to demonstrate convincingly to key stakeholders the social benefit of a particular venture. This uncertainty may breed distrust on behalf of stakeholders, potentially exposing the venture to criticism. Without adequate information on social impact, customers and the general public may fear that for-profit providers will favor their personal profits over quality services. In fact, the contract-failure theory of the nonprofit firm argues that nonprofits enter the market precisely to mitigate the profit incentive and ensure that quality is not sacrificed in these situations (Hansmann, 1980). In some cases, the lack of uniformly accepted social impact measures might also provide grounds for dispute. Indeed, in the early years of the relationship between Baltimore City Schools and for-profit education management company Education Alternatives, Inc. (EAI), the teacher's union published negative reports on educational performance and expenditures that differed greatly from EAI's self-reported results. Each side repeatedly claimed the other was misrepresenting data, leaving the public confused (Dees & Elias, 1995). Moreover, once it became clear that EAI had published misleading results, given their profit motivation, there was greater stakeholder skepticism about whether they had done so intentionally or by mistake.

<u>Combining objectives from two different fields makes it difficult to build an integrated organization</u>. For-profit social ventures blend objectives that have been associated with two different fields of endeavor, business and the social sector. This combination makes organizational development a much greater challenge.

Hiring employees who can function well in both worlds is challenging. While increasingly individuals with nonprofit backgrounds and interests are seeking MBAs and getting business experience, this pool is still relatively small. Furthermore, there is no easy way for most social ventures to identify the rare candidates with the dual expertise they need. Community development financial institutions seek people with banking and community development expertise. Eco-tourism companies want to attract individuals who understand both ecology and the travel industry. A partner with Heidrick & Struggles International executive recruiting firm characterized the situation facing for-profit higher education companies this way:

> Companies are certainly nervous about hiring executives without educational experience, but they're also apprehensive about hiring managers directly from colleges and other nonprofit organizations for reasons they generally feel should be obvious. Namely, nonprofit executives tend not to appreciate the dynamics of making a profit. While this is a generalization that often proves inaccurate, it is equally matched by a tendency for those executives with backgrounds in higher education to minimize the challenges faced by emerging businesses (Haberman, 2001).

Because the combination is so rare, many for-profit social entrepreneurs build their teams by bringing together people from each side. However, this approach also has its challenges. Attracting people with skills valued in the business world can be difficult. In practice, the financial rewards available in a for-profit social venture may be better than those in typical nonprofit or government jobs, but they are generally still going to be less than those associated with traditional for-profit ventures. At the same time, individuals with the necessary social sector skills may be skeptical of the profit motive and thus more comfortable in a nonprofit or public sector environment. Even if social entrepreneurs can attract strong mixed teams, managing cultural differences may be difficult. Business-oriented employees are generally more used to taking risks, working in fast-paced environments, and setting clear, measurable goals and objectives. Individuals from the social sector are often more consensus-driven, passionate about a particular cause, and focused on responding to needs rather than anticipating or creating them. Establishing a culture and operating environment that values and thus successfully retains employees from both of these worlds is no easy task (Flannery & Deiglmeier, 1999).

5.2. Market Pressures to Compromise on Social Value Creation

In addition to the complexities of having dual objectives, competitive market pressures may drive out social preferences that are not economically efficient. Additionally, capital or customer markets may provide incentives to compromise on social value creation.

<u>Competitive markets may drive out inefficient social preferences</u>. Many economists argue that when a conflict between profits and social preferences arises, profits will dominate or the entrepreneur will be driven out of business. Milton Friedman (1962) makes this point forcefully:

> A businessman or entrepreneur who expresses preferences in his business activities that are not related to productive efficiency is at a disadvantage compared to other individuals who do not. Such an individual is in effect imposing higher costs on himself than are other individuals who do not have such preferences. Hence, in a free market they will tend to drive him out (p. 110).

Interestingly, Friedman is using this argument to make the case that markets will drive out racial discrimination. However, as illustrated more recently by William Baumol, the same reasoning applies to positive social preferences as well as negative ones. Baumol (1991) asserts, “Voluntary [socially-concerned] action leaves the business firm exposed and unprotected against the competitive advantage enjoyed by enterprises with less concerned (less ethical) managements" (p. 22). Moreover, taking social objectives seriously is likely to create at least opportunity costs by limiting the firm's choices.

Friedman and Baumol may overstate the case since real markets are not as competitive as those in economic models. Competitive markets did not drive out discrimination and may not completely drive out positive social objectives either. However, they do have force and generally do not reward or even tolerate substantial inefficiency. Thus, social objectives that create incremental costs for a venture may be difficult to sustain.

Consider the example of Community Products, Inc. (CPI), the original producer of Rainforest Crunch candy. CPI planned to source nuts from a Brazilian rain forest cooperative that harvested the nuts in an environmentally friendly way and employed rain forest residents. CPI promoted this aspect of its social mission extensively. However, CPI soon found that the cooperative could not meet the rapidly growing demand for the nuts and that some of the nuts received were spoiled and others were contaminated with bacteria. Without another socially comparable nut supplier, CPI had to make a choice. It could slow growth and incur the costs of helping to improve the quality of nuts from this supplier, which would significantly limit or even eliminate its profits. Or, it could bow to market pressures and buy nuts on the open market. CPI went with the market. This move undermined an important aspect of CPI's intended social impact and was a great embarrassment when it became public knowledge a few years later (Welles, 1998).

<u>Investor expectations may undermine social value creation</u>. Managing and meeting investor expectations regarding profit levels, growth, and liquidity can be a major challenge for the social entrepreneur. For-profit investors typically want a competitive return, which is a function of profit levels, perceived risk, and growth prospects. They also want an opportunity for liquidity – the ability to convert their investments into cash within a reasonable period of time. While Jed Emerson (2000) has argued that investors should look for a total return that includes financial and social returns, this idea has not yet caught on with the vast majority of investors. Even foundations that have a clear social mission invest most of their assets with the objective of generating high financial returns that can then be used to fund their grants. Return-oriented investors may pressure social ventures into actions that could harm the social mission. For example, the leaders of two for-profit education companies, LearnNow and Explore, Inc., wrestled with the question of how to balance investor desires for growth and scale with their commitment to deliver a quality product and serve their target social markets. There was demand for their services, but the rapid growth that was deemed necessary to generate sufficient returns to some investors posed risks to their social mission (Dees & Anderson, 2001; Grossman, Austin, Hart, & Peyus, 1999). After wrestling with this tension, both of these companies were acquired, LearnNow by

publicly held Edison Schools, and Explore, Inc. by EdSolutions, Inc. The effect of the acquisitions on the social impact of these ventures remains to be seen.

Even customer preferences may lead social entrepreneurs astray. In most markets, customer pressure to deliver value is healthy. As Kenneth Arrow (1973) has pointed out, "On detailed analysis it appears the firm will find it privately profitable to reduce quality only if, in fact, quality reduction is a net social benefit, that is, if the saving in costs is worth more to the consumer than the quality reduction" (pp. 304-5). However, Arrow's logic applies only when the consumer is the payer, quality is transparent, and consumer value is commensurate with social benefit. In for-profit social ventures, frequently at least one of the following conditions holds, undermining the benevolent market logic described by Arrow:

- *Third-party payers have incentives that are not aligned with the firm's social mission or the interests of the firm's intended beneficiaries*.[5] Third-party payers are common in the social sector. Yet, often their interests do not perfectly align with creating the optimal social impact. For instance, political pressures on a public health agency may lead to lower payments for drug rehabilitation services than would be socially ideal. Firms competing to be the low cost provider may be pressured to compromise on social impact.

- *Relative quality is hard for paying customers to assess*. Given the difficulty measuring social value, customers often do not have adequate information to make decisions on the quality of social goods and services. Think of making a choice among different homeless shelters, social service agencies, or even nursing homes. Technology and third-party assessments are improving consumer decisions in some of these areas, but the quality of most social services remains far from transparent.[6] Thus, customer demand (or the lack thereof) is not a reliable indicator of whether social value is being produced efficiently or effectively.

- *Consumer value is not commensurate with social benefit*. Most social ventures intend to create societal benefits that go beyond what they might directly provide to the individuals they serve. In certain cases,

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5. Sometimes third party payers are actually in a better position to assess quality than direct beneficiaries because they have a broader perspective and better access to performance data.
6. This is the premise of Henry Hansmann's economic theory of the nonprofit firm. See his classic article "The Role of Nonprofit Enterprise," *Yale Law Journal*, vol. 89, 1980, pp. 835-901.

> the target community may resist the product or service being delivered because their adoption costs may exceed tangible benefits to them (Rangan, Karem, & Sandberg, 1996). Family planning services in developing countries represent a case in point. The market preferences of the potential consumers of these services are not a good indication of the social value of the services. Alternatively, high consumer demand need not indicate high social value. We may find a high level of demand for homeless shelters that serve alcoholic beverages, though this demand is no indication that these shelters are superior.

When any of these conditions hold, customer preferences (as reflected in market demand) will not serve as reliable indicators of social value creation. The prevalence of these conditions in any given social sector arena increases the risk that market pressures could lead even well intentioned social entrepreneurs into delivering less than optimal social impact.

5.3. Social and Political Pressures to Compromise on Financial Performance

Any enterprise that is openly driven by a social purpose may also find itself under pressure to severely limit profits. A declared social mission creates internal pressure to do more social good even when it may not be prudent, from a business point of view, to do so. Externally, cultural biases and political pressures can also work to inhibit earnings.

Commitment to a social cause may compromise profits. When one is committed to improving society, it is hard to say "enough." Social entrepreneurs may be tempted to plough potential profits back into good works or to take on unprofitable functions that would be more appropriate for nonprofits. Social commitments can weaken profits in many ways. Consider social ventures that employ or have as their customers disadvantaged populations. Serving those in the greatest need and doing it well can lead to decisions that have business costs. For example, Grameen Bank is world renowned for its micro-enterprise lending to Bangladesh's rural poor. In recent years, reported profits have declined about 85%, from $1.3 million in 1999 to just under $190,000 in 2001. Underlying this decline is a repayment problem, with reported loan-repayment rates falling well below the longtime, self-reported "over 95%" rate (Pearl & Phillips, 2001). Critics see this decline as raising serious questions about the model of a for-profit bank serving this market. While a 1998 flood and increased competition have contributed to these problems, another factor is the bank's commitment to its social mission. According to Grameen Founder Muhammed Yunus (2001),

> We can raise our repayment rates to 100% instantaneously by a simple decision to write off all our overdue loans. We have more money in our loan-loss reserve ($67 million) than the present overdue loans. But we chose not to go that way. We want to do it the harder way – by improving the repayment situation and recovering the overdue amount. We do not want to abandon our borrowers/owners by disqualifying them to remain within the Grameen fold. We want them to change their life with Grameen. We don't want to push them away with their problems. We never think of walking away from them.

For-profit social ventures often face strong cultural biases and political pressures against earning profits. Our society seems to find something repulsive in the idea of someone profiting from "doing good." Indeed, it is almost a paradox of American culture that we applaud entrepreneurs who make their fortune with frivolous products, such as the "Pet Rock," but chastise those who would make the same profit (or even a generous salary) trying to make the world a better place. Without reliable and timely social performance measures, profits may be perceived as excessive, a situation that reinforces this cultural bias against profits in the social sector. Even where social impact is clear, many people still have a problem with entrepreneurs and investors in social ventures taking out profits when that money could be used to do more good. Social ventures tend to be held to a higher standard than other businesses.

Public skepticism can have dire consequences, especially if the government is the main paying customer. For instance, when Education Alternatives, Inc. was attempting to secure contracts to manage some of the Washington, DC public schools, public opposition helped derail the effort despite the initial support of the school superintendent Franklin L. Smith. The *Washington Post* quoted one women at a community forum, "Why, Dr. Smith, did we give you the job of running our schools if you decided to give up 15 schools to people who not only don't look like us but are just in it for the money? ... Our slave seller, Dr. Franklin Smith, is selling our education to the highest bidding rich white owner" (Horwitz, 1994). Criticisms such as these prompted Smith to table the school privatization proposal on the eve of the vote (Dees & Elias, 1995). Public suspicion and political pressures presented serious challenges for EAI, contributing to the company's ultimate failure to survive.

6. Strategies for Meeting the Challenges

The challenges facing for-profit social purpose ventures are significant. Thus, it is not surprising that conducting business for the public good "is an affection, indeed, not very common among merchants," as Adam Smith put it. Those who choose this path have their work cut out for them. However, there are strategies they can use to increase their chances of success. Our advice can be summed up in eight points.

6.1. Avoid Strategic Vagueness Regarding Mission

It almost goes without saying, but for-profit social entrepreneurs must be clear and open about their missions, including both social and economic objectives. Many social ventures are launched with rather vague missions and objectives. Vagueness allows each stakeholder to see what he or she wants in the venture. While this ambiguity may make it easier to attract resources, it is a recipe for conflict down the line. A clear mission that is communicated effectively helps screen prospective investors, employees, and customers, forming an implicit contract with them and encouraging positive self-selection. It also helps guide key strategic decisions.

6.2. Craft an Integrated and Compelling Venture Model

Social entrepreneurs must integrate a plausible social impact theory with a viable business model. The social impact theory should be open to scrutiny by those who are knowledgeable about the field in which the venture is operating, and the business model must make the case that this venture can have its intended social impact and make a sufficient profit at the same time. A strong business model will be built around opportunities where there is potential for significant congruence between social and economic value creation.[7] While this alignment is not easily achieved and requires rigorous analysis, for-profit social entrepreneurs may develop profitable strategies based on cost savings, serving neglected markets, or targeting socially oriented customers.

Linking social cost savings to productivity improvements for customers. Reducing social costs can sometimes lead to lower economic costs or improved performance for potential customers. This effect was powerfully illustrated when corporations began looking for ways to be more environmentally friendly. Many of them found that being “green” could

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7. When a more natural form of congruence is not available, social entrepreneurs can create linkages through various pricing mechanisms, service guarantees, and performance-based contracts. This approach can also help overcome fears of exploitation and profiteering. For example, a for-profit education company selling an innovative math curriculum could agree to be paid based on the number of students who achieve a certain proficiency level by the end of the program. A venture promoting a new, environmentally sustainable technology could offer a partial refund if the performance does not match or exceed the existing method of production. Of course, these types of policies are risky and may raise concerns for investors, but they can make customers more comfortable trying something new while explicitly linking income to social performance measures.

actually save them money by reducing materials and energy consumption as well as waste disposal costs (Hart, 1997). In 1995, a group of socially minded scientists formed Micell Technologies to capitalize on their CO_2-based technology that is designed to eliminate the need for toxic solvents without sacrificing precious water. Having had success applying its technology to the dry-cleaning industry, Micell continues to develop new applications and "prioritizes its development efforts by choosing CO_2-based applications where it can not only make an environmental impact, but where such processes provide a tangible performance benefit as well."[8] Merging a social purpose with cost and productivity considerations may help some social entrepreneurs identify viable new business opportunities.

<u>Serving neglected labor or customer markets</u>. Because of their social purpose, social entrepreneurs may be able to identify new markets, products, or services that have been overlooked by traditional businesses but provide opportunity for linking profit and social impact. For example, Voxiva is a voice and data solutions provider dedicated to bridging the digital divide by extending the reach of voicemail and automated business applications to anyone with access to a telephone. Operating in 20 Latin American companies, Voxiva provides solutions for health, finance, commercial, government, and small business operations that need to reach people who are beyond the reach of the Internet, do not have access to training, and may be illiterate. This business exemplifies the types of opportunities Stuart Hart and C.K. Prahalad (2002) describe as existing at "the bottom of the pyramid." According to Hart and Prahalad, the 4 billion people with less than \$1500 annual income represent a multitrillion-dollar market. This market is "wide open for technological innovation" if companies will reexamine their current assumptions and adopt strategies focused on creating buying power, shaping aspirations, tailoring local solutions, and improving access for those currently left out of the global economy. As evidenced by Cooperative Home Care Associates' success employing low-income women as home health care professionals, similar arguments can be made with regard to neglected labor markets.

<u>Targeting customers who value the kind of social impact you intend to create</u>. If a for-profit social venture can develop a reputation for its social performance and deliver goods or services whose cost and quality are deemed on par with competitors, some customers may prefer their products due to their credible commitment to social impact. For example, though the success of Newman's Own all-natural food products certainly cannot be disassociated from Paul Newman, the fact that all of the profits are donated to charity likely attracts some customers when they are deciding amongst other comparably priced, similar quality, natural food products. This customer preference is not

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8. Retrieved from <u>http://www.micell.com/default.asp?PID=2, 5/22/2002</u>.

necessarily limited to retail products. For instance, demonstrated social commitment may be a deciding factor when school systems award charters, purchase curricula, or hire education management companies. CitySoft, an Internet applications provider committed to hiring its staff from inner city neighborhoods, provides another interesting example of this approach. In order to more effectively link its social mission to its business model, CitySoft recently decided to narrow its customer focus to "common interest enterprises," namely associations, foundations, non-profits, educational institutions, government agencies, and activist businesses. Notably, several of its clients are for-profit ventures mentioned elsewhere in this paper, including Shorebank Corporation, LearnNow, Stonyfield Farm, and Sustainable Jobs Fund. Of course, social entrepreneurs must be careful in assuming that customers will value their social commitments, especially if their business model requires charging a premium because of its social mission. Despite the opinion polls, most people still focus on cost, convenience, and quality. Relying on socially oriented customers may threaten the viability of the business by dramatically limiting its customer base. Moreover, even a credible social mission cannot compensate for other shortcomings in the customer value proposition.

6.3. Measure Performance Creatively and Test Assumptions Rigorously

Armed with a clear mission and venture model, the social entrepreneur should translate this information into quality standards, profit requirements, and performance measures. Since consumers and third-party payers cannot always be relied on to ensure quality, social purpose ventures must assume this burden themselves by committing to certain standards publicly and holding themselves accountable.[9] Likewise, they should determine minimum profit levels necessary for sustainability and track them, as well as social performance, closely.

While measuring social impact will always be a challenge, a social purpose venture should do its best to develop meaningful and credible measures. Social and economic goals can be broken down into specific, measurable process and outcome objectives, even if that means relying on indirect or leading indicators.[10] For example, an after-school program might have the following as two of its objectives for second quarter performance:

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9. Setting clear standards should not be confused with providing the highest quality goods or services – after all, not every car is a Mercedes nor does every drug rehabilitation facility need to be a Betty Ford Clinic. Adding capacity and increasing access at lower quality and cost levels can be a valuable social service. See Dees and Anderson (2003).
10. For ideas about the right kinds of measures see Twersky, F., (2002) and Sawhill, J. & Williamson, D. (2000).

1000 students will have participated in our program at least three times a week, and by the end of the quarter, 75% of them will have increased their reading skills to the national average for fifth-graders. While the outcome measure is the true reflection of social impact, process measures are also important for understanding and tracking how the impact is being achieved. Similar metrics should be developed for financial progress. All of these targets and goals will provide a basis for managerial decision-making, communicating with stakeholders, and ongoing planning and development efforts related to product or service delivery.

An internal measurement system is critical for maintaining focus and guiding decision-making. However, social ventures should also periodically seek out independent, external evaluations. Few social ventures have the expertise in-house to conduct a rigorous and systematic evaluation of social impact. Outside evaluations can go beyond easy-to-track internal measures to examine cause and effect. They can also look across multiple organizations operating in the same arena to set benchmarks and detect larger patterns. Voluntarily submitting to this degree of scrutiny is risky, but the risk of receiving negative results is precisely what makes this process a valuable tool for both improving performance and enhancing credibility.

Finally, but perhaps most importantly, all of these measures and systems should be designed to test the underlying assumptions of the venture model, especially those that drive the links between social and economic performance. A social purpose venture should begin with a clear understanding of how both social and economic value will be created, but the strategy will likely need to be continuously refined and redefined as critical assumptions are put to the market test.[11]

6.4. Maintain Control in Sympathetic Hands

For profit social entrepreneurs need to pay particularly close attention to issues of ownership, investment, and control. Mary Houghton, the CEO of community development bank Shorebank Corporation, expressed her sentiment that given Shorebank's commitment to serving a public purpose, "ownership is really stewardship, not investment ownership" (Dees & Remey, 1994). The best stewards of the social and business purposes should own and control for-profit social ventures.

Before their venture models have proven to be sufficiently profitable, social entrepreneurs would be wise to target socially oriented investors. While

11. See McGrath and MacMillan (1995) to learn more about an approach to planning that begins with what you want to accomplish and then incorporates assumptions, milestones, testing, and refining as you learn.

this approach does limit the pool of potential capital providers, offsetting some of the potential benefits of the for-profit structure, it nonetheless ensures that its core investors share the dual commitment of social impact and profitability, providing some insulation from pure capital market pressures. While socially-oriented investors will usually expect a financial return, they are more likely to appreciate the complexity and experimental nature of the undertaking, to place equal or greater value on social performance, and to be patient while the venture tests and refines its model. Shorebank Corporation, for example, raised its initial funds from church groups, foundations, and socially committed individuals. According to one member of its founding management team, "One of the ways that we have achieved success was that our shareholders never wavered on why they invested. They invested because they believed that a business approach to development can work. They did not invest to get a market return" (Dees & Remey, 1994, p. 13). Of course, attracting socially oriented investors may not be a simple process, as different investors require different levels of financial return and liquidity, operate on different timetables, and place different value on the social return. However, targeting socially oriented investors should provide the venture with greater flexibility, especially in the early stages.

As the venture proves sufficiently profitable to attract more financially oriented investors, money can be raised from diverse sources, as long as *control* remains in the hands of those attuned to the mission. Some mechanisms for raising funds without threatening control include debt offerings, limited partnership shares, as well as forms of common and preferred stock with diluted or no voting rights. For instance, Shorebank has used private placements of preferred stock as well as common stock with no voting rights to raise capital while maintaining control in sympathetic hands. Teacher and worker cooperatives provide another example of using ownership as a means of holding a venture accountable to both social and financial performance.

Even some major corporations with strong social values maintain their social commitments by retaining control in the right hands. Levi Strauss & Company, which has a long history of social responsibility, became a public corporation in 1971 and included a statement of values in its prospectus. However, in 1985, family members repurchased the public stock, taking the company private to regain control and assure ongoing commitment to the company's core values. The company now uses high-yield debt instruments to raise capital. Other family-controlled firms with strong social values, such as The Timberland Company and The New York Times Corporation, have managed to tap into public equity markets without giving up enough control to jeopardize their social commitments. Timberland is well known for its strong values, progressive relationships with nonprofit organizations, and commitment to community service, social justice and environmental sustainability. The Swartz family, along with their trusts and foundations, own 55% of the stock and control 80% of the voting shares.[12] And despite the intense profit pressures on media companies in recent years, under the stewardship of the Salzburg family, *The New York Times* manages to attract top journalists, operate with high integrity, and deliver award-winning journalism to the public year after year. Of course, raising money from the public creates a fiduciary obligation to look out for the interests of those shareholders, but if the dual mission is clear in the public offering documents and *control* remains in sympathetic hands, the social purpose of the organization should be safe.

6.5. Invest Time and Energy in Creating a Committed Team

It is widely acknowledged that people are the most important factor in any new venture's success. As venture capitalist Ruthann Quindlen puts it, "People are to a business what location is to a restaurant" (2000, p. 33). This is doubly true for for-profit social ventures that must blend skills and values from two different fields. While attracting or building the necessary skills is critical, values should drive personnel decisions as much or more than skills. When trying to create a high-performance team, investing in selective hiring, appropriate performance-based compensation policies, training opportunities, and a balanced advisory board will significantly increase the chances of success (Pfeffer, 1998).

Considering the relatively small pool of candidates likely to already possess the desired combination of business and social sector skills, social ventures should cast a wide net when recruiting new team members. Finding the right team members can serve not only to build organizational skills, it can also send a signal to outsiders. Professionals with personal reputations or the right credentials can add credibility to the venture. When Chris Whittle hired Benno Schmidt, then the President of Yale University, to join him at Edison Schools, he was sending a signal that this was not to be just another profit-seeking business venture.

Though skills, credentials, and experience will be important, especially early on, ultimately selection should be based primarily on cultural fit, shared values, and a commitment to pursuing social impact via business methods. Successful screening on these factors depends not only on reviewing a large pool of applicants, but also on engaging in a lengthy hiring process that involves multiple interactions with a wide variety of existing employees and key stakeholders. This process requires some patience and a willingness to

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12. Retrieved from http://www.hoovers.com/co/capsule/0/0,2163,12390,00.html, accessed 05/24/02.

invest time and money into recruiting, and it may mean growing at a slower rate. It may also require investing in training opportunities to develop needed skills. Whether developed in-house or provided by outside contractors, both hard skills and soft-skills training may help bridge some of the cultural and practical differences that will inevitably be present if hiring from a diversity of backgrounds and experiences in both the business and social sectors. In addition to training, once credible measurement systems are in place, social entrepreneurs should also explore the creation of bonus plans that are tied both to profit and social value objectives. It may even be useful to create financial and other incentives that reward innovative approaches to both social and business problems, especially those that help the organization align the dual objectives more closely.

Beyond appropriate hiring, compensating, and training of the venture team, it can be quite helpful to establish an advisory board with representatives from a wide range of experience, including careers in business, entrepreneurship, nonprofit organizations, and the public sector. For example, Voxiva's advisory board consists of social entrepreneurs with nonprofit and government backgrounds, experts in technology and the digital divide, a financial expert with experience related to emerging markets, and an attorney with expertise in international relations. This composition signals to staff that both financial and social goals are paramount, provides them with role models from different arenas, and helps to ensure that the organization's dual objective is present from the top to the bottom of the organization.

6.6. Anticipate Resistance and Develop a Strategy for Dealing with It

For-profit social entrepreneurs will likely encounter resistance and distrust. They need to anticipate potential sources of concern and develop a strategy for dealing with them. Politics are important to any new venture. However, given their controversial character, politics are potentially particularly important for for-profit social ventures. These ventures may expect to be held to different standards than other for-profit companies.

For-profit social ventures may head off some resistance by operating transparently, communicating effectively, avoiding excess, and acting as good corporate citizens. Sharing the venture's mission, its social impact theory, its business model, and its performance information actively and openly can reduce reasons for distrust. Giving key stakeholders a voice through regular interaction or even advisory board membership can also allay concerns. Moreover, like their nonprofit counterparts, social entrepreneurs would be politically wise to avoid what may be perceived as excesses in compensation, personal expenditures, office environments, and corporate perks. Additionally, contributing some portion of profits to charitable causes and participating in community service activities can help build goodwill and overcome public resistance. The founders of 4charity.com, an Internet applications company that serves the social sector, even set aside a substantial portion of their founding stock for nonprofit organizations.

Even with transparency, openness, and modest salaries and perks, social ventures may meet with formidable resistance. Collaborating with trusted nonprofit partners might also help a venture overcome both customer and public distrust. For example, the charter school firm LearnNow partners with local groups and organizations that have strong ties to the communities where LearnNow operates schools. These partnerships provide LearnNow with access to valuable local knowledge and expertise, while also giving the communities a voice in the educational process and affording the opportunity to build a trusting relationship between the company and the communities they serve.

In general, social entrepreneurs should assess the political environments in which they are operating and develop an appropriate strategic response. This process can begin with identifying key players. Who are potential critics or enemies? Who is likely to feel threatened? Whose cooperation is necessary for success? Once social entrepreneurs have identified important parties and assessed their motivations, they can explore options for dealing with potential resistance by co-opting the critics, building rapport with them, or forming coalitions to overcome them (MacMillan, 1992).

6.7. Develop a Brand Reputation for Quality and Performance

Over the long haul, it can be very helpful to develop a brand reputation that signals serious commitment to both social impact and business discipline. As a venture grows, the brand serves as the carrier of the venture’s reputation, representing a track record as well as a set of demonstrated values. Brand credibility can also be borrowed from and shared with other organizations. For-profit social ventures may find that forming strategic alliances with like-minded ventures could help them build credibility, signal their commitment to quality and social value, and access new customers. For example, Stonyfield Farm, producer of organic ice cream and yogurt, has formal relationships with other “earth-friendly” partners, including Newman’s Own, Recycline, and others. For participating companies, these alliances serve as endorsements of each other’s environmental practices and commitment, allowing each of them to build on the others’ brands and consumer trust while also gaining exposure to their environmentally oriented customer bases.

6.8. Recognize the Limits of What Can Be Done For-Profit and Use Nonprofit Partners or Affiliates to Provide Complementary Services

Strategic collaboration with nonprofits may help for-profit social ventures ensure profitability without sacrificing social performance. Creating social benefit is a complex process. When pursuing social impact, there are often complementary activities that would contribute to a social venture's success but cannot be done profitably. In these cases, it helps to have a nonprofit partner or to be operating in a hybrid organization that includes a nonprofit affiliate. Indeed, both Grameen Bank and Shorebank Corporation have operated as hybrid organizations with nonprofit affiliates for many years. More recently, soon after its launch, the leaders of CitySoft, a web development and management firm committed to hiring predominantly lower-income urban adults, realized that existing training programs were not effectively preparing urban adults for success in high tech careers. Thus, CitySoft spun-off a nonprofit called CitySkills to partner with training organizations and employers to create the necessary infrastructure and "labor pipelines" for recruiting, training, and placing inner-city residents in upwardly mobile information technology jobs. The Sustainable Jobs Fund (SJF), a for-profit community development venture capital fund that invested in City Soft and other companies, followed the same path, recently establishing the Sustainable Jobs Development Corporation, a nonprofit that provides additional technical and community development assistance to SJF's prospective and portfolio companies. Providing this service under the for-profit fund would potentially limit returns to investors. However, the provision of these services is important to achieving the kind of economic and social impact that SJF set out to create. As these examples illustrate, hybrid organizational structures and partnerships with nonprofits may allow a social venture to better serve its economic and social goals by ensuring the provision of complementary activities by organizations that are better positioned to subsidize these activities through philanthropic support.

7. Concluding Thoughts

It may be feasible to marry a social purpose to a for-profit structure, but it is not easy. Even ventures such as Shorebank Corporation and Grameen Bank, which have withstood the test of time and received much acclaim, have encountered major challenges. Shorebank has not generated market rates of return for its investors (Esty, 1995). Other than one small dividend, its common stock holders did not have liquidity for over twenty years. Not surprisingly, the model has not spread very rapidly. Grameen spread rapidly in Bangladesh and has inspired similar programs worldwide, but its profitability has been overshadowed by its reliance on below-market rate capital. Duplicating Grameen's profitability has proven to be much more difficult than duplicating its approach to lending. And Grameen has recently encountered serious questions about its financial performance (Pearl & Phillips, 2001). It may have become a victim of its own success, as many mircocredit lenders have entered the market and created new competitive pressures that may limit Grameen's growth and reduce its profitability. And while some people may question whether Edison Schools is truly a social purpose venture, the company's failure to turn a profit and its current financial struggles raise serious questions about the sustainability and scalability of certain types of for-profit social ventures.

In fact, in many cases, it may be easier to achieve the same or greater social impact as a nonprofit. Many creative and entrepreneurial social ventures have been successfully launched as nonprofits. For example, North Carolina's Self Help Credit Union has a mission similar to Shorebank's but is incorporated as a nonprofit, with both nonprofit and for-profit subsidiaries. In 2000, Self Help's pre-tax income of $9.8 million more than quadrupled Shorebank's $2.3 million. We do not mean to be critical of Shorebank or to argue that SelfHelp has a better model. Rather, we merely want to demonstrate that profitability, business discipline, and an entrepreneurial spirit are not restricted to for-profit organizations. Thus, before adopting a for-profit structure, we urge social entrepreneurs to analyze which approach is best. While the nonprofit structure does impose some constraints on raising capital and distributing profits, many for-profit social ventures are also limited in their ability to take full advantage of the capital markets and produce significant profits and returns. And while some nonprofit cultures and norms are certainly not conducive to these types of ventures, strong and visionary leaders can overcome these biases. Additionally, nonprofit organizations do offer some benefits of their own, including access to philanthropic resources (cash, in-kind, and volunteers) and less inherent skepticism of their motives. We do not want to downplay the potential benefits of the for-profit firm, but we do encourage social entrepreneurs to make a well-informed, strategic decision regarding which structure will best serve their objectives.

If the nonprofit alternative is not appealing, social entrepreneurs should contemplate the benefits, challenges, and strategies outlined here and follow Amar Bhide's (1995) advice to complement "perseverance and tenacity" with "flexibility and a willingness to learn." We recommend for-profit social entrepreneurs be clear and perseverant about their social and economic objectives, but flexible about the strategies they will employ for achieving them. As long as they are clear about their social and economic goals, measure their performance rigorously, maintain control of the venture in the hands of the best stewards, and invest in hiring and developing the right people, for-profit social entrepreneurs should have the time and opportunity to identify where economic and social value can and cannot be aligned successfully, what strategies are most effective for overcoming criticism and political adversaries, and what complementary activities might best be accomplished by a nonprofit partner. Thus, if social entrepreneurs remain tenacious regarding their overarching social and economic ambitions, they can be flexible and adapt their strategies for achieving their objectives as they learn.

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There are two deadlines for applications for the Tamer Fund for Social Ventures: the fall application deadline is August 15 at 11:59 p.m. EST, and the spring application deadline is March 1 at 11:59 p.m. EST. Please click here to begin the application process. Funding will be made available to around seven ventures each year (three to four ventures each cycle).Â In general, social and environmental for-profit ventures produce products and/or services that either focus on addressing the needs of low-income communities or customers with an explicit purpose of increasing the welfare of these groups, alleviate a market failure and create significant public goods or benefits that are not wholly captured in the price charged by the business, or have attracted. For profit commercial ventures, social ventures with a purpose/objective of doing social good, and not for profit organisations with a clear intent of doing soci...Â There are different models and ways to deliver value to your target groups/audiences. For profit commercial ventures, social ventures with a purpose/objective of doing social good, and not for profit organisations with a clear intent of doing social good without making profits or ploughing back profits into the NGOs. The concept of social ventures or social entrepreneurship is of a more recent origin, may be a decade or so, have also attracted the attention of investment community and have got huge investments into this sector. PhilanTech creates innovative online tools to help organizations maximize social impact while minimizing environmental impact. The PhilanTrackÂ® online grants management system helps grantmakers and grant recipients streamline the grants administration process to focus more resources on program and service delivery, and ultimately greater social impact.Â The Pipeline Fellowship is shifting the gender balance in angel investing and increasing the flow of capital to for-profit social ventures. â€œThe Pipeline Fellowship is committed to increasing diversity in the angel investing community and training a new generation of angels to invest for good,â€ stated Pipeline Fellowship Founder & CEO Natalia Oberti Noguera.