SUPPORTING NONPROFIT SOCIAL ENTERPRISE IN APPALACHIA

PRODUCED BY BRODY WEISER BURNS

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EXECUTIVE SUMMARY

The Appalachian region is a land of great scenic beauty, rich natural resources and a unique cultural heritage. It is also a land of enduring poverty. Although much progress has been made in reducing economic distress, there is still a pressing need to generate jobs and income for low income individuals in Appalachia. This is made more challenging by the slow economic growth in much of Appalachia, especially Central Appalachia, and the difficulty of connecting to mainstream markets in the rest of the country. In addition, there is not an entrepreneurial culture in many areas in Appalachia, adding to the difficulty in the start-up and growth of businesses.

Social enterprise is a promising approach for helping nonprofits to address these challenges. A "social enterprise" is an organization or venture that advances its social mission through entrepreneurial, earned income strategies. "Earned income" consists of payments received in direct exchange for a product, service or privilege.

Social enterprise can enable nonprofits to successfully expand market-based activities that generate jobs and income for low income people. It also can help them to increase their sources of revenue and attract new funders. It can help nonprofits to spur the growth of an entrepreneurial culture, and can also help build markets for local products and for authentic Appalachian culture and craft. Through these outcomes, it can enable nonprofits to both become more financially sustainable and also to increase their ability to achieve their mission.

Social enterprise can create benefits for the region as well. Because the economy is not growing rapidly in much of Appalachia, creating jobs and income requires new entrepreneurial activity. It requires building on existing cultural, natural, and community resources to attract new customers to the region and to connect existing businesses to new markets. It will be difficult to create the job growth required just by working with existing businesses and markets. Social enterprise can be part of developing new markets and attracting new customers.

Research and experience have shown that the successful development of social enterprises requires more than just funding. There are six key requirements for the successful creation and operation of social enterprise in nonprofit organizations across America:

1. *Clarity of purpose and strong Board commitment*
2. *Experienced management*
3. *Reliable market access and in-depth business planning*
4. *Intensive business coaching*
5. *Patient financing*
6. *Support for employee training and counseling*

In Appalachia, particular attention is required for three of these requirements: market access, experienced management and patient financing, all of which are more challenging in this region than in many others in the US.

Ensuring that social enterprises are provided with these key requirements will require the development of a supportive organization or infrastructure. To this end, Brody Weiser Burns proposes for discussion the creation of a *Social Enterprise Accelerator* for Appalachia.

The *Social Enterprise Accelerator* would assist nonprofit organizations in Appalachia to develop social enterprises. It would focus primarily on nonprofits in rural communities that are seeking to increase jobs, income and assets for low-income individuals. The Accelerator would target its services to the most distressed parts of Central Appalachia. It would raise grant, loan and investment funds, and then use these funds for grants, loans and technical assistance to nonprofits in this area. It would be very much of a hands-on funder, working with a small and select number of nonprofits very intensively to move them rapidly toward self-sufficiency and scale. Although it would serve nonprofits of all sizes, it is expected its typical client would have a budget of less than $1.0 million, and ten paid staff or fewer.

Preliminary estimates of the financial scale of the *Social Enterprise Accelerator* show it providing $500,000 - $1.0 million per year in loans and investments, and $1.0 - $2.0 million per year in grants and organizational support. This would enable it to serve 10-20 organizations intensively at a time. This financial scale would require the Accelerator to have a loan fund capitalized with $5.0 million of grants or long-term, low-interest loans, plus the ability to raise $1.0 - $2.0 million per year in grant funding.

There is a strong case for philanthropic, private and public sector investment in social enterprise. It can create benefits for nonprofits by helping them to become more financially sustainable, and to tap new sources of funding for their operations. It also can help them to better achieve their missions by creating jobs and entrepreneurial opportunities for residents.

Social enterprise can help funders who currently support organizations in Appalachia to achieve their goals as well. It can help them attract new funders and investors / financial partners to the region, because its appeal goes beyond the borders of Appalachia to tap interest in this work in a variety of settings. Social enterprise can help raise funds from high-net-worth individuals with business backgrounds who see enterprise as an important tool for creating jobs, income and social change. It also can help reduce the requirement for ongoing funding for existing grantees, as it helps them to become more financially sustainable.

Social enterprise is not a panacea. It doesn't always work. But when it is successful, it offers a unique ability to help create sustainable ventures that achieve social goals. The *Appalachian Social Enterprise Accelerator* design is based on best practices in the social enterprise field today. It has the potential to help enable nonprofits to be more financially sustainable and to better achieve their missions, and to help improve the economies of the communities in which these nonprofits work. We look forward to an in-depth discussion of the Accelerator, as well as other models, at the Convening in Washington. We also welcome additional ideas and suggestions on how to best achieve the goal of creating generating jobs and income for low-income individuals in Appalachia.

While this entire White Paper provides useful background, readers who are pressed for time may wish to focus on the sections on Potential Options (pp. 27-32) and Key Issues (p. 40).

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SOCIAL ENTERPRISE IN THE US

This section presents an overview of the field of social enterprise and a framework for understanding the different kinds of social enterprises. It illustrates the framework with examples of social enterprises, and provides a cautionary tale as well.

OVERVIEW OF THE FIELD

Social enterprise is rapidly growing in the US today. The Social Enterprise Alliance, which is the national association for social enterprise, defines social enterprise as follows:

> A "social enterprise" is an organization or venture that advances its social mission through entrepreneurial, earned income strategies. "Earned income" consists of payments received in direct exchange for a product, service or privilege.

Social enterprise is a practice with venerable roots. The Salvation Army thrift stores, for example, are social enterprises, and the Salvation Army has been running them for generations.

The growth in social enterprise was spurred in the early 1990's by several coinciding trends. The first was the steady drift in government spending away from support for the needs of low income individuals, particularly in housing and job training. This placed increasing pressure on nonprofits to expand other sources of income. The second was the steady growth in the economy from the early '90's forward, making venture operations more attractive. The third was the growing interest among funders in supporting a more entrepreneurial stance among nonprofits, and a desire to help nonprofits increase their financial self-sufficiency. These three trends, together, helped propel a dramatic increase in the interest in nonprofit entrepreneurship, particularly in social service organization providing training and employment services for individuals who were homeless, formerly addicted, or ex-offenders. The Delancey Street Foundation in San Francisco provides an excellent illustration of social enterprises created by a social service organization.

DELANCEY STREET FOUNDATION, SAN FRANCISCO

Delancey Street Foundation began as a San Francisco-based residential treatment facility for substance abusers, former felons and those whose lives had "bottomed out". Since its founding in 1971, Delancey has "graduated" over 14,000 individuals who are successful taxpaying citizens living legitimate and productive lives.

As part of the solution to helping its residents move on the path to success, Delancey established enterprises that simultaneously serve as training centers and sources of additional support for the Foundation. The Foundation is so committed to this approach that replication has resulted in programs located in southern California, New Mexico, North Carolina and New York.

Delancy Street's enterprises include a restaurant, café and bookstore, moving company, transit service, automotive service, furniture company, and pottery and art objects mail order business. These businesses contribute 60% of the funding and growth of the organization. More importantly for Delancey, these enterprises have resulted in more than 2000 homeless people moving into permanent housing; 10,000 gang members into active non-violence, and 10,000 individuals with high school equivalency degrees.

There are a wide array of types and sizes of social enterprises. One source of information about the current practice of social enterprise is the database of social enterprises, hosted jointly by Community Wealth Venture and the Social Enterprise Alliance.[1] An analysis of the 480 business ventures listed in this database shows that the majority are in five categories: retail, light manufacturing, education and training, restaurant/cafes, and consulting. The full range of ventures is illustrated in the following table:

Non-Profit Ventures by Type
Community Wealth Venture/Social Enterprise Alliance Database, July 2004[2]

Retail	84	Agricultural	12
Light Manufacturing	53	Construction	10
Education & Training	48	Information Technology	10
Restaurant-Café	47	Wholesale	9
Consulting	38	Landscaping	9
Thrift Store	30	Recycling	7
Staffing Service	29	Heavy Manufacturing	6
Janitorial	19	Home Heath Care	5
Property Mgmt.	15	Housing Rehabilitation	3
Clerical	13	Packaging/Distribution	3

DEFINITIONS AND FRAMEWORK

There are several different types of social enterprises, and the terminology for these different types is still in flux. For the purposes of this paper, we will distinguish three types: *mission-related ventures, revenue-generating ventures, and double-bottom-line businesses*. The first two types are typically structured as nonprofits, either as a program of a larger organization, or as a stand-

[1] Database is available on-line at http://208.254.27.232/.
[2] This table is taken from "*Social Enterprise: The Rise of Non-Profit Entrepreneurship",* a paper currently in draft form from The Democracy Collaborative, University of Maryland.

alone organization. The third is typically structured as a for-profit business, sometimes owned by a nonprofit.

A *mission-related venture* is a business venture that is undertaken by a nonprofit primarily to achieve its mission. The key goal of the mission-related venture is enabling the nonprofit to increase its mission achievement. As social ventures, mission-related ventures are funded to a significant extent by earned income. However, many mission-related ventures that are successful are partly funded by grants as well. They are considered successful by nonprofits and grant-makers because their earned income enables the nonprofit to attain higher levels of mission achievement for a given level of grant support than it otherwise could. The Manchester Craftsmen's MCGJazz venture is a good example of a mission-related venture.

MANCHESTER CRAFTSMEN'S GUILD, PITTSBURGH

The Manchester Craftsmen's Guild, founded in 1987, is a subsidiary of Pittsburgh-based Manchester Bidwell Corporation. The goal of this corporation and its programs is ignite youths' imaginations through deep immersion in the arts so they will experience emotional and intellectual growth, develop a commitment and connection to their community and experience an awakening of their own initiative to create a positive future.

The Manchester Craftsmen's Guild originally created MCGJazz to achieve a program goal: presenting and preserving the indigenous American art form called jazz to benefit youth and future generations. MCGJazz is housed in MCG's Arts Education, Performing and Visual Arts vocational center that includes a state-of-the-art studio. From 1995 through 2000, MCGJazz produced over 250 concerts that it recorded with artists such as the Count Basie Orchestra, Joe Williams and Spyro Gyra. Over 60,000 customers paid for performances.

Each of these concerts was recorded providing MCGJazz with a unique and important documentation of music history. Equally important, performing artists "donated" their performance to MCGJazz creating a "catalog" of one-of-a-kind recordings. But, through 2000, MCGJazz was a largely subsidized activity with expenses exceeding revenues on the average of $400,000 a year.

The Manchester Craftsmen's Guild decided to turn MCGJazz into a social enterprise. After two successful marketing research and business planning processes, MCGJazz was able to enter the market for CD sales successfully. In 2004, it was able to secure a major breakthrough - a commitment by Wal-Mart to start selling three of its sampler CDs in more than 1,000 stores as part of a new jazz category in the store's music section. This distribution deal, in conjunction with another with Telarc International (600-label independent record company), provided MCGJazz with the distribution channels that it needed to reach large audiences and develop profits that it can contribute toward supporting the organization's mission.

Currently, business income accounts for 10-15 percent of the $7.5 million annual budget of the Manchester Bidwell Corporation, the parent nonprofit of the Manchester Craftsmen's Guild.

The MCGJazz venture is a social enterprise because the Manchester Craftsmen's Guild is seeking to generate revenues from the MCGJazz's activities. It is a mission-related venture because the activities of the venture – showcasing live jazz performances – is core to the Manchester Craftsmen's Guild's mission. This can be seen clearly in that the Manchester Craftstmen's Guild first undertook MCGJazz as an activity that was primarily charitably supported. It was only after many years of operations that the Manchester Craftstmen's Guild decided to seek to expand the earned income aspect of MCGJazz. While MCGJazz has attained break-even, and no longer needs grant support, it was considered a success even in the years when it required grant support, because the earned income that it did receive enabled it to reach broader audiences and host more performances than it could have with its grant support alone.

A *revenue-generating venture,* in contrast, is a business venture that is undertaken by a nonprofit primarily to generate profits in order to subsidize its other activities. The activities of the venture are not intended to have much mission impact, if any at all. The success of the revenue-generating venture is measured primarily by the extent to which it generates profits to support nonprofit activities. For example, Platte River Industries in Denver owns four Auntie Anne's pretzel franchises, which offers a good example of a revenue-generating venture. The Auntie Anne franchises in total return approximately $250,000 per year to Platte River Industries.

The Auntie Anne's pretzel franchises are a social enterprise because Platte River Industries is seeking to generate profits for itself, which it will use in furtherance of its mission. It is a revenue-generating venture because the activities of the enterprise – in this case, the operation of the pretzel store – have little to do with the mission of the nonprofit. While it does create some job opportunities for Platte River Industry clients, its primary contribution to the mission of the organization comes through the profits it creates, not through its activities.

A *double-bottom-line business* is a for-profit business that has been started to achieve both profitable operations and also to achieve a specific social goal. It is only successful if it both achieves its social mission and also makes a profit. It has to achieve a "double bottom line" to succeed. The bakery business of the Greyston Foundation is a good example of a double-bottom-line business.

GREYSTON FOUNDATION, NEW YORK

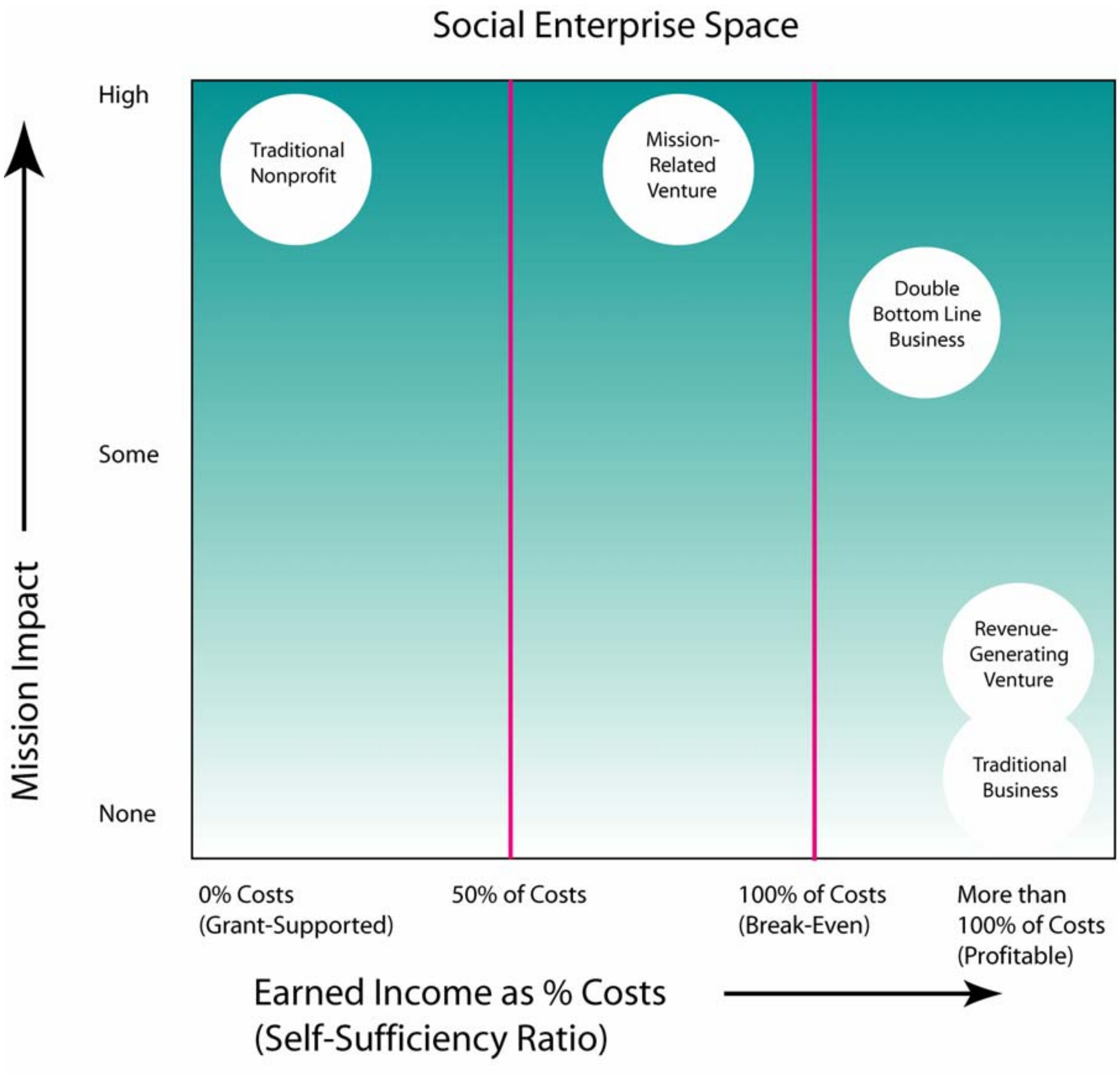
Located in Yonkers, New York, (bordering northern New York City) Greyston Foundation is an integrated system of nonprofit and for-profit organizations that offer a wide array of programs and services to more than 1,200 men, women and children annually. Beginning in 1982 as a small bakery to employ Zen Buddhist students, Greyston is now a $14 million organization of 180 employees (many entry level) that provides jobs, housing, social services and health care to low-income residents of southwest Yonkers and surrounding areas.

One of Greyston's biggest customers has been Ben & Jerry's. The Ben & Jerry's relationship was essential to providing a stable source of demand and revenue and has been the catalyst for supporting Greyston's name recognition throughout the nation as well as attracting other national buyers like Stonyfield Farm and World Yacht Cruise Lines, and positioning it to be able to expand to other products and markets like specialty cakes. These relationships allowed Greyston to expand the number of jobs and to attain higher levels of financial impact.

Core to its success is its commitment to its "double bottom-line": (1) achieve an operating profit that helps support the work of the overall service work of the Greyston Foundation, and (2) ensure that its employees develop skills that will sustain them as individuals and ensure personal success.

Greyston Foundation's bakery business is a social enterprise because it is striving to achieve a social mission and it also is seeking to make a profit. Its operations both are designed to be profitable, and to help Greyston's clientele attain the skills that they need to be self-supporting, gainfully employed individuals.

To clarify the distinction between traditional nonprofits, mission-related ventures, profit-making ventures, double-bottom-line businesses, and traditional businesses, it can be helpful to look at these ventures arrayed along two dimensions. The first dimension is the extent to which a particular activity achieves a charitable mission. The second is the extent to which a particular activity is supported by earned income. The chart below shows how traditional nonprofits, traditional businesses, and the three types of social enterprises are placed on these two dimensions.



The aspiration for the traditional nonprofit is to have a high level of mission impact, and it is expected to be supported by grants. Thus, it is located the upper left corner of the chart.

The mission-related venture seeks to have a high level of mission impact, and it expects to have all or a portion of its costs paid for by earned income. If it is not fully supported by earned income, the balance of its costs would be supported by grants. It appears in the top center of the chart.

The revenue-generating venture is seeking to generate profits from its activities. These profits are typically used to support other mission-related activities. The activities of this type of social enterprise may or may not have a high level of mission impact. As a result, the revenue generating venture appears on the far right side of the chart, typically in the middle-low range of mission impact.

The traditional business appears on the chart very close to the revenue-generating venture. It is formed with the primary purpose of making a profit. It may also achieve important social goals, but that is not the primary reason for the existence of most traditional businesses. The double-bottom-line business, in contrast, is formed with purpose of both making a profit and achieving a charitable goal. It thus appears toward the top right part of the chart.

CAUTIONARY TALE

While there are many examples of success in the social enterprise field, there are also some examples of failure as well. Social enterprises, when done well, can help increase a nonprofit's financial stability, and also increase its mission impact. When done poorly, they can harm both. The following short case study provides an example of just this problem.

"AGENCY A" SILKSCREENING BUSINESS, SAN FRANCISCO

"Agency A" is the story of a social enterprise funded by REDF (formerly the Roberts Economic Development Fund). The name of the organization has been withheld by REDF as part of their agreement with Agency A to permit the publication of the case study. [3]

Agency A is an organization dedicated to promoting peace and nonviolence in the Chicano neighborhoods near San Francisco. The Executive Director is a visionary and charismatic man who has personally overcome significant obstacles in his own life. He lost two of his brothers to violence and counts 25 relatives in prison.

Agency A had long had as part of its program activities the silk-screening of T shirts with inspirational messages. The Executive Director decided to expand this program into a business that would both earn a profit and also achieve program goals by providing jobs for the youths that they organization served. The organization received a $100,000 grant from REDF in 1996 and hired a Business Manager to create the T-shirt business. Initially, the business did well, with sales climbing rapidly. But it was soon confronted with a number of difficulties. The first was that the organization couldn't generate timely financial information, so the Business Manager didn't know when the business was losing money. Secondly, the Executive Director and the Business Manager disagreed over the proper course of action to take when some of the youths that the organization served didn't perform well on the job. The Business Manager wanted to be able to fire them, but the Executive Director wanted the business to work to improve their performance and keep them on the job. Finally, the organization had a hard time holding onto Business Managers, because it was paying a salary for

[3] This case study is drawn from "Enterprises Gone But Not Forgotten" by Fay Twersky and Laura Lanzerotti. The document is available on the REDF web site, www.redf.org.

that position that was considerably below industry average. The salary was high compared to what other staff people at Agency A were making, but it wasn't anywhere near market level for managers in similar shops.

After two years of operation, it was clear that the T-shirt business was not succeeding as a business. It had been through three Business Managers. It was losing money, draining funds from Agency A rather than providing profits to the organization. And Agency A was in a constant battle with the Business Manager over what to do about youths who weren't performing well on the job.   Agency A reorganized the business, making it considerably smaller. As of 1999, the Executive Director was still considering whether or not to change the T-shirt operations back into a funded program, aimed primarily at providing youth employment opportunities. By making it a grant-funded program which also had some earned income from T-shirt sales, Agency A could focus on its primary mission. As a funded training program, the T-shirt shop could provide young people with skills development and experience without the worries about covering overhead and breaking even.   As a business it couldn't achieve a double bottom line successfully.

REQUIREMENTS FOR SUCCESSFUL SOCIAL ENTERPRISE

This section examines the requirements and elements for creating and operating successful social purpose ventures. It looks in detail at the challenges facing social enterprises. It then describes the six factors that help to create success in social enterprises.

CHALLENGES FOR SOCIAL ENTERPRISES

Social enterprises are seeking to achieve both a social mission and a business mission. They have both the challenges that nonprofits face and the challenges that businesses face, in addition to the challenges of balancing the two missions. They face challenges in each of the five following areas:

1. *Mission.* Many nonprofits that run social enterprises face continuing tensions between the need to make their venture more profitable and sustainable, and the desire to run the venture in ways that increase mission impact. As the case study of Agency A shows, when a nonprofit sets up a social enterprise that is intended to both make money and also to be a source of employment for individuals it is serving, it is likely at times to experience a tension between these two goals. There are likely to be moments when the best way to make money and the best way to provide jobs for the clients are not in alignment.

2. *Marketing.* Getting access to market, and understanding in detail market demand for specific products and services, is often a challenge for nonprofits. When an organization is accustomed to giving away its services, or charging far less than a market price, it doesn't need to worry much about marketing. When it wants to charge market rates to a mainstream clientele, the issues of marketing become extremely pressing, and can strain its capacity.

3. *Management.* Nonprofits often find it hard to hire and retain experienced managers with the operational and financial knowledge sufficient for effective and efficient service planning and delivery. Nonprofit pay scales are often below those in the private sector, and the organizational supports (information technology, capital equipment, etc.) are typically nowhere near as complete as experienced business managers expect.

   In addition, because social enterprises aim to achieve dual (and sometimes conflicting) goals, the job of managing a social enterprise is more complex than the job of managing a typical for-profit business. Because there is often an ongoing tension between the business goals and the social goals, the managers frequently are required to make complex trade-offs between these competing goals. These factors can make the venture manager position a revolving door.

4. *Staffing and Operations.* Nonprofits can often have difficulty creating business operations that are as efficient, capital-intensive, and customer-focused as their for-profit counterparts. They rarely have the same levels of capital, and they can have cultures and missions that put serving their mission ahead of serving fee-paying customers.

In addition, many social enterprises seek to provide work experiences for individuals who have limited levels of work experience, or who have significant challenges in their lives (felony convictions, homelessness, drug addiction, low levels of educational attainment, domestic violence, etc.). The time and effort needed to address these challenges, and to provide training and counseling to the workforce, can be a significant burden on the business, driving an otherwise profitable business into insolvency.

5. *Financing*. Nonprofits, especially human service nonprofits, often do not have access to the same types and levels of financing as their for-profit counterparts. A recent survey released by Johns Hopkins University's Listening Post found that although nonprofits across America face a growing need for investment capital, most report widespread obstacles to accessing it. While 91% of the survey respondents reported a need for investment capital for information technology in the prior three years for example, only 37% were able to access that capital.[4]

5 Enduring Myths About Social Enterprise

Myth 1: The ultimate goal of a social enterprise is to generate funds.
Reality: Mission impact is the ultimate goal. Even if a particular social enterprise requires some grant support, it may be valuable if it enables significantly increased mission impact.

Myth 2: Social enterprise is always more sustainable than donations or grants.
Reality: Sustaining a social enterprise requires significant time, energy, vigilance, and luck.

Myth 3: Social enterprise is always a good thing because it helps to diversify your funding base.
Reality: Diversification alone is not valuable if the new sources are more subject to variation than the existing ones.

Myth 4: The best way to create a social enterprise is to start a totally separate, unrelated business dedicated to profit-making.
Reality: Most successful strategies build on assets and competencies an organization already has.

Myth 5: By creating a on social enterprise, your organization exposes itself to valuable market discipline.
Reality: Market discipline is only useful if the market demands are well aligned with the organization's social mission.

(Adapted from Emerson, Dees and Economy, Strategic Tools for Social Entrepreneurs, John Wiley & Sons, 2002)

[4] The Johns Hopkins Listening Post Project, Communique No. 5, **http://www.jhu.edu/listeningpost/news/pdf/comm05.pdf**

Our research has identified the following factors that help ensure the success of social enterprise:

1. *Clarity of purpose and strong Board commitment*
2. *Experienced management*
3. *Reliable market access and in-depth business planning*
4. *Intensive business coaching*
5. *Patient financing*
6. *Support for employee training and counseling*

1. Clarity of purpose and strong Board commitment

Although it may seem surprising, in our work with social enterprises we often find that nonprofits start social enterprises without being clear about the core purpose of the venture. They often have not resolved the balance that they seek to strike between the goal of having a direct impact on their mission on the one hand, and generating a profit to support other nonprofit activities on the other. This means that when the inevitable tension arises between these two goals, management and staff aren't always clear on how to make what can be difficult choices.

This clarity of purpose must start at the Board level. The nonprofit Board is responsible for setting or approving the vision for the organization and/or venture, which paints a picture for the future that the organization is aiming to achieve. This vision can help management and staff to understand how to respond when they are confronting decisions about how to best balance multiple goals. Ideally, the Board will have one or two champions for the social enterprise, who will contribute time and resources to helping to ensure the success of the venture. The Board also needs to set clear targets and provide supportive oversight, and help sort out the difference between the needs of the nonprofit and its enterprise.

2. Experienced management

It's a truism in the world of venture capital that management is the most important ingredient in the success or failure of every venture. When venture capitalists evaluate whether they want to invest in a firm, they typically look at the track record of the management team. Have they successfully run a venture similar to the one that they are proposing now? If not, the venture capitalists typically will not back the firm – or they may make adding experienced managers to the management team a requirement for the investment to go forward.

Experienced and skilled management is just as important in a social enterprise. And unfortunately, it can be even more difficult to attract and retain good managers to the social enterprise than to a venture-backed firm. The job is as complex, and the pay is much less.

If a social enterprise can't attract a management team with deep experience, then it is important to provide the existing team with intensive business coaching and technical assistance – discussed in point 4 below. The Board can also be a source of advice, technical skills and access to a business network, which can help support the management team of the venture. In our experience, this is particularly true for financial management knowledge and expertise.

3. Reliable market access and in-depth business planning

One of the key elements of success for social enterprises is being able to get reliable access to the market. Can the social enterprise get its products in front of qualified and interested customers? Can it differentiate its products from the competition, and attract repeated sales? We often find that social enterprises that succeed often build on access to markets that they have already obtained through their regular nonprofit activities – the constituency that they serve or the communities in which they operate.

Business planning is an important tool for helping to identify a social enterprise's market challenges and strategies. As part of the business planning process, it can be very helpful to have a market analysis that includes focus groups, customer surveys, and pilot tests to understand the customer response to the features and benefits of the product or service, and to plan out pricing, distribution and promotion strategies. It is also important that the analysis show an understanding of all types of competition, both competitors offering similar products, and also substitution from different products. All of this may be new to the nonprofit, and technical assistance again can be quite important.

Business planning also can help the Board and management team to identify key strengths that the social enterprise can leverage, and to note problems or challenges that must be addressed. It can also be used to sharpen the understanding of the tensions that will need to be addressed in managing the business, and of the key risks that starting the business will create. This "stress testing" of the venture can enable Board and management to develop approaches and systems for identifying and managing the tensions and reducing the risks, thereby providing a level of confidence that will satisfy themselves and lenders or funders.

In evaluating a business plan, one of the questions that we typically ask is "Does this plan build on the assets and competencies that the nonprofit already has?" Assets can include relationships, clients, location, knowledge, and reputation. Competencies can extend to the full range of activities that the nonprofit performs. In our experience, ventures that build on existing assets and competencies have a greater chance of success than those that are completely divorced from the core activities of the nonprofit parent. Building on existing assets and competencies does not guarantee success, but the success rate is higher than starting a completely business that is completely foreign to the nonprofit.

Having said this, it is also worth noting that it is possible to spend too much time engaged in business planning. The plan does not need to address every issue and every eventuality. To attempt this would drive most nonprofits into "analysis paralysis". Instead, the business plan must cover the critical issues that are central to success or failure, and analyze the key strengths, weaknesses, opportunities and threats. It should lay out a plan for moving forward that builds in opportunities for marketing testing and clear milestones that enable management and Board alike to understand the progress. This then permits management to make the adjustments to the plan based on market feedback and experience. We've never seen a venture in which everything went according to plan. The hallmark of good management isn't that everything turns out exactly as predicted. Rather, it is that management has systems and guideposts in place so that they know when the venture is moving off course, and can take steps to correct it.

4. *Intensive business coaching*

Nearly all of the organizations that provide financing to social enterprises also provide for intensive business coaching as well. Some of them provide the coaching directly, whether in the form of the technical assistance that a community development finance institution (CDFI) may provide to its borrowers, or to "venture philanthropy" provided by a foundation. Others provide grant support to the nonprofit to enable it to purchase technical assistance, or provide grant support directly to technical assistance providers to be able to work with a network of potential ventures. Whatever the method, they have all recognized that capital is not enough: capacity building support is equally important. The existing staff at most nonprofits are not ready to manage a venture and/or large infusions of capital, and it is hard to attract an experienced manager. Providing a large infusion of capital in this case without providing technical assistance is simply helping the organization to fail faster and more spectacularly than it could on its own.

The specific type of coaching provided covers a wide range, including help with management team functioning, human resources, marketing planning and sales management, financial systems and controls, Internet sales, information technology, operations and inventory control, ISO certification, and lean manufacturing processes.

5. *Patient financing; ongoing subsidy*

Ventures require financing that is long-term and patient. The most appropriate form of investment for a start-up venture is one in which the repayment amount and terms are determined by the success of the venture. In the for-profit world, this type of investment would be termed "equity", and new ventures attract it from friends, "angel investors", and venture capitalists. Debt capital – capital that has a fixed repayment schedule and a fixed interest – is typically much less useful for ventures in their start-up modes, because their initial cash flow is usually uncertain, and it can take time – perhaps years – before they are making enough money to repay debt.

Equity investment (as legally defined) is not available for ventures structured as nonprofits, because it involves owning a portion of the venture, and no one can own a nonprofit. But even for social enterprises structured as for-profit subsidiaries of nonprofits, market-rate equity investment is usually inappropriate. These ventures are almost never intended to make the kind of profits that market-rate equity capital requires.

Accordingly, the type of capital that is appropriate may be grants or very long-term, forgiveable loans with interest-only payments. Whatever the structure, the key requirement is that the social enterprise not have to repay the bulk of the investment for a long time – often seven years or more.

Some social ventures are not intended to break even. For example, a charter school is a social enterprise that intends to achieve an important social mission, and that intends to raise a significant portion of its revenues from fees for services and from government contracts. But there are many charter schools that are started with the clear intention of raising a portion of the funding required for ongoing operations from annual donations. In this case, a grant may be the most appropriate way to fund the start of operations. Debt may be useful for supporting a building or remodeling existing space – but it is not appropriate as the sole source of funding for startup of operations.

It is also important to note that for many social enterprises, there is little in the way of fixed assets (such as a building or machinery) that can be used as collateral for a loan or investment. This is particularly true of social enterprises that deliver a service, such as training or consulting. Again, this makes debt less appropriate as the sole source of capital.

6. Support for employee training and counseling

Many nonprofits that operate social ventures seek to provide opportunities for individuals with significant challenges to employment. We find that in order to succeed in creating social enterprises while serving this population, nonprofits typically create partnerships with other programs or organizations that provide social services and employment training services. There typically is a clear division of responsibility, with the venture staff responsible for making and implementing business decisions, and the social services and employment training staff responsible for providing employment supports and training. The employment training staff focus on helping the employees to learn the technical skills and the soft skills – teamwork, time management, conflict management, and workplace culture – required to succeed at work. The social services staff focus on case management of issues such as transportation, housing, child care, substance abuse counseling, parole conditions, and domestic violence. This frees up venture management to focus on making the business successful. It is important to note that the social services and employment training services are almost never funded directly and fully by the social enterprise, whether the services are provided by another program of the parent nonprofit or by another organization entirely. Instead, these services are typically funded from other grant sources. The services often are critical to the venture's success, but most ventures simply cannot afford to pay for them out of their operating revenue.

This section of the paper discusses Appalachian social and economic conditions which both create the need for social enterprise as well as specific challenges for it. It then describes the landscape of social enterprise in Appalachia.

APPALACHIAN SOCIAL AND ECONOMIC CONDITIONS

Appalachia is a region of stark contrasts. It has a beautiful landscape, plentiful mineral resources, and a rich cultural heritage. At the same time, it also has concentrated poverty, low educational attainment and enduring social isolation. These conditions both create the need for social enterprise, and help to create unique challenges for the successful operation of social enterprises[5].

- *Poverty:* Appalachia's poverty levels significantly exceed those of the US as a whole. In 2000, the US average poverty rate was 12.4%, while the Appalachian rate was 13.6%. In most of the counties in Central Appalachia, the poverty rates were more than 50% higher than the national average.

- *Educational attainment:* Educational attainment is an important factor in increasing wages. Research has shown that there is a dramatic increase in wages associated with the completion of a bachelor's degree. For example, one study looking at white males found that in 1992, white males who completed a bachelor's degree earned 50% more on average that white males with just a high school degree.[6] In 2000, the US college completion rate was 24.4%, while the Appalachian rate was 17.7% Again, most of the counties in Central Appalachia had college completion rates less than half of the US average.

- *Unemployment:* In 2003, Appalachia had slightly lower levels of unemployment than the US: 5.8% for Appalachia as a whole in 2003, versus 6.0% for the US. But this masks the fact that there were parts of Appalachia, including much of Central Appalachia and the Delta region, which had unemployment in 2003 that was 50% or more higher than the US average. This is due, in part, to the decline of the major manufacturing and mining industries in the Appalachian region, as well as to the cyclical nature of the tourism industry.

- *Geographic isolation:* Although the network of roadways in Appalachia has been dramatically improved over the past forty years, many parts of Appalachia are still geographically isolated. This is particularly true for the smaller mountain communities. For many of these communities, it is still difficult to get products shipped out to market

[5] The data economic and social conditions are drawn from Appalachian Regional Commission documents and studies. More information is available at the ARC web site, www.arc.gov.
[6] Pierce, Brooks, and Finis Welch. *Changes in the Structure of Wages.* Chapter 4 in Improving America's Schools. Board on Science, Technology and Economic Policy (STEP).

and to get products from the market shipped in. There is both a penalty in time and cost incurred for transportation. This adds to the difficulty of creating viable social enterprises that are able to tap markets outside of Appalachia. It also slows the potential growth of jobs and income in these areas.

- *Population Decline:* Not surprisingly given these factors, most of Appalachia is not gaining population as fast as the rest of the US, and there are parts of Appalachia in which the population size is actually shrinking. In the decade from 1990 – 2000, the US population grew by 13%, while Appalachia grew by 9%. And there are parts of Central Appalachia which lost population during this period, some losing as much as 20% in the decade.

- *Low Levels of Philanthropy:* In many communities across the US, charitable foundations are an important resource for helping to create and support programs that improve educational attainment and increase jobs and incomes for low-income individuals. This is particularly important in the current funding environment, where state budgets are being overwhelmed by health care costs, and funding for economic development programs at the federal level are facing their most significant challenges in decades.

  But Appalachia faces significant challenges in this arena as well. The Appalachian region as a whole had 22.8 million inhabitants in 2000 – 8.1% of the population. Yet it received only 4.6% of the total US foundation funding – just slightly more than ½ as much as the average US region. And if we omit Pittsburgh, home to several large foundations, the situation is even more grim. Leaving aside Pittsburgh, counties in Appalachia had roughly 1/3 of the foundation funding per capita of the rest of the US.

These challenges highlight the importance of social enterprise for Appalachia. The enduring poverty and unemployment shows the continuing need for creative programs that can help create jobs and income for low-income individuals. This is an area in which social enterprises have been particularly active across the US. They have stepped in to fill the gap that the private market has not been able to fill, and that government funding has not been sufficient to fill.

The low level of philanthropic support also highlights the need for social enterprise. Nonprofit organizations cannot expect that philanthropy will be able to provide the grant support required to meet all the needs. The limits on philanthropic funding means that developing more sources of earned income to sustain programs and expand their mission impact is critical. Again, this is where social enterprise can bring unique value to the nonprofit organization.

The section above noted five challenges that confront social enterprises across America. Three of these five challenges are particularly noteworthy for social enterprises in Appalachia: marketing, management and financing.

- *Marketing:* Much of Appalachia does not have easy access to large markets. The used clothing store operated by Housing Works in Manhattan has access to hundreds of thousands of qualified and interested potential buyers. The same store in Berea, Kentucky would be lucky to have access to a few thousand. Finding qualified buyers, and enabling the buyers to easily find social enterprises, is much harder in much Appalachia than it is in major urban markets. Shipping costs and transport times are also higher, making it less convenient for buyers in a time when many are used to next day service.

- *Management:* Social enterprises in Appalachia draw from a much more limited labor pool than those in major markets. This is a particular challenge when it comes to finding management team members with the ability to focus on both business and social goals. This is a difficult task even in large markets, and can be next to impossible in thinly populated rural areas.
- *Financing:* As noted above, the funding environment for non-profits in general has been less vigorous in Appalachia than in other parts of the US. Since funding for social enterprise is typically a fairly small percentage for all funding for nonprofits, having to find that small percentage from among a pot that is diminished to begin with can be quite challenging.

SOCIAL ENTERPRISE IN APPALACHIA

Although social enterprise does face unique challenges in Appalachia, there nonetheless is a growing social enterprise movement here. It is not quite as vigorous a movement as in some parts of the US, but it is has taken root and is growing.

There is a wide range of social enterprises in Appalachia. The majority are focused on finding ways to capitalize on the existing assets of Appalachia, particularly the cultural and natural resources. The social enterprise landscape in Appalachia has relatively few nonprofits engaged in the type of social enterprise we termed “revenue-generating ventures”. Rather, most social enterprise in Appalachia is of the type we termed “mission-related ventures”. These are ventures that are undertaken primarily to achieve mission rather than to make money. In addition, many of the ones that are the most successful are ones in which the whole organization is the social enterprise.

The following provides some examples of social enterprise in Appalachia that show the range of approaches to economic development. Some are very locally focused, while others cover a broad geographic area. Some are quite small, while others have reached significant scale. But all use social enterprise in important ways to achieve their mission.

APPALACHIAN SUSTAINABLE DEVELOPMENT

Appalachian Sustainable Development’s (ASD) mission is to catalyze and help create ecologically sustainable, locally rooted economies in central Appalachia. To accomplish this, ASD engages in educational activities and advocacy and the operation of two core enterprises: Appalachian Harvest organic produce and Sustainable Woods. ASD’s ventures use a market-based approach that focuses on building the economic capacity of limited resource farmers, loggers and landowners and the ecological restoration of forests and farms.

The Sustainable Woods program operates a wood-processing center that supports local production of environmentally friendly lumber, harvested through the use of ASD's sustainable forestry standards. Appalachian Harvest is a network of certified organic family farmers in southwest Virginia and northeast Tennessee who have come together to make locally grown, organic produce available in area supermarkets. In FY 2005, ASD reported sales revenue of approximately $200,000 from its ventures. **www.appsusdev.org**

CENTER FOR ECONOMIC OPTIONS

The Center for Economic Options (CEO) is a nonprofit organization in West Virginia that promotes sustainable entrepreneurial activity by supporting a network of small scale manufacturers and artisans who produce a wide variety of home décor items, fine arts, traditional craft products, furniture, bath and body care items, music, publications, textiles, jewelry, and gourmet and specialty foods.

Besides hands-on technical assistance, a primary support for CEO's clients is to provide markets and market-related services. In 2000 CEO established a market for these "Made Right Here" products within the Charleston Town Center Mall by opening a retail store called Showcase West Virginia. In April of 2005 CEO moved Showcase West Virginia to downtown Charleston as part of an emerging boutique shopping village featuring a variety of locally-owned shops, galleries and restaurants. In 2005, CEO reported approximately $450,000 of sales from local entrepreneurs. www.centerforeconomicoptions.org

MOUNTAINMADE FOUNDATION

The MountainMade Foundation is a non-profit organization that operates several programs to create an expansive and vibrant mix of the arts, provide arts education and business expertise that nurtures artists, expand art participation and stimulate economic development in West Virginia. One of the key program activities that MountainMade operates is the MountainMade website, an e-portal that enables artisans to sell their work world-wide over the Web. The initial website design was created by the Robert C. Byrd National Technology Transfer Center at Wheeling Jesuit University, and was taken over by MountainMade in 2001. With the assistance of the U.S. Small Business Administration, and program income generated by the sales of artisan works, the MountainMade Foundation is able to support and develop the West Virginia arts and crafts small businesses by assisting them with effective marketing of their work, expanding their businesses and increasing demand for their work, to promoting awareness of the distinctive artistic resources West Virginia has to offer. In FY 2004, MountainMade reported sales of approximately $400,000 in sales from local artisans through its web site. www.mountainmade.com

TAMARACK

Tamarack is a statewide collection of handmade craft, art and cuisine showcasing the "Best of West Virginia". Tamarack employs a rigorous jurying process to ensure product quality and authenticity. As with MountainMade, Tamarack's start-up and initial operations were made possible by significant public sector support.

Tamarack focuses on selling directly to tourists and visitors at its fine arts gallery, theater, and retail store. Six resident artisans work daily in observation studios to demonstrate textiles, glass, metal, wood, pottery, and jewelry. Throughout the year artisan demonstrations and food tastings engage visitors in new experiences. The fine arts gallery offers a glimpse of the current art scene. Live musical, theater, dance and storytelling takes place in Tamarack's theater. Tamarack reports that craft sales have totaled $44.7 million since it started operations. www.tamarackwv.com

ORGANIZATIONS THAT SUPPORT SOCIAL ENTERPRISE AND SMALL BUSINESS DEVELOPMENT

An important feature of the social enterprise landscape in Appalachia is that there are a range of nonprofits that are very effective in providing technical assistance for small business development and social enterprise development. They play a significant role in helping to improve the economy and to create jobs and income for low income residents of Appalachia. In addition, even though many of them focus primarily on for-profit small businesses, the same approaches can be used to help support social enterprise as well. The following is an illustrative list of the various categories of organizations and the types of support that they provide. It is worth noting that some organizations do provide services in multiple categories.

Technical Assistance Providers

These organizations provide in-depth business training and help ventures get access to markets. They may also provide financial assistance as well as help ventures to locate and train staff. Examples include:

- *Hand Made In America* - focuses on developing economic solutions that emphasize the craft industry, enhance opportunities in the marketplace, and develop entrepreneurial strategies for the region's crafts artisans. It provides business and financial support for craftspeople involved in traditional mountain crafts as well as public education.

  Hand Made in America has also started a number of social enterprises. For example, in collaboration with the Blue Ridge Resource Conservation & Development Council and Mayland Community College, Hand Made in America started the EnergyXChange Incubator program, which supports entrepreneurs in starting, managing, and operating new businesses in crafts (glass and clay) and horticulture. The clay kiln and glass furnaces are fired with landfill gas at no additional cost to the residents with a projected savings over the life of the project estimated at over a million dollars. www.handmadeinamerica.org

- *Pittsburgh Social Enterprise Accelerator* - supports emerging social enterprise ventures and helps accelerate their development through implementation and financial support, knowledge sharing and connections with key organizations. The Pittsburgh Accelerator currently serves 10 counties in southwest Pennsylvania. The Pittsburgh Accelerator's model includes:

- Working with a limited number of social enterprise ventures to provide focused, one-on-one coaching to help them plan for growth and overcome barriers to success.
- Introducing these ventures to appropriate service providers, funding sources, corporations, university programs, public sector agencies and other key stakeholders that can contribute to a venture's long-term success.
- Providing seed funding, when appropriate, to finance venture growth strategies and help offset the cost of service providers.
- Developing tools to support nonprofits with defined and emerging social enterprise ventures and, as applicable, providing relevant information for nonprofits that are just beginning to consider social enterprise www.pghaccelerator.org

Loan and Investment Funds

These organizations provide loans and investments, primarily to small businesses. We include them in this section because some of them may provide loans and investments to social enterprises, and because their experience in financing small businesses will provide an excellent roadmap of both the challenges and the solutions for best financing social ventures. Examples include:

- *Kentucky Highlands Investment Corporation* - provides venture capital investments in start-up and expanding enterprises located in twenty two counties in southeastern Kentucky. Its mission is to provide and retain employment opportunities in southeastern Kentucky through sound investments and management assistance. It makes equity investments and loans from as small as $500 to investments well over $5,000,000 and can also assist businesses in developing financing packages. www.khic.org

- *MACED* - provides business development and financing for businesses that are committed to building sustainable and vibrant local economies in Appalachian Kentucky. MACED's loan products include equipment and real estate loans, working capital, operating capital term loans and lines of credit. It combines investment capital with one-on-one technical assistance tailored to meet the needs of entrepreneurs where they work. www.maced.org

- *Mountain Microenterprise Fund* - a non-profit organization that provides business training, loans, and one-on-one support to people throughout Western North Carolina who want to start, expand, or strengthen a small business. These individuals increase their entrepreneurial capacity and self confidence by developing their basic business skills and increasing their knowledge of their particular industry and potential customer base. Their chances of business success are increased by accessing MMF's small business loan pool and by networking and problem-solving with their business peers.

  Mountain Microenterprise Fund also runs a social enterprise --the Mountain Made retail store, which recently opened in October 2002 in the Grove Arcade Public Market in Asheville, NC. This store serves as a market access point for alumni producers of locally-made goods (especially crafts). In addition, the for-profit store trains those entrepreneurs who are considering a retail venture, and generates revenue to support the rest of its programs. www.mtnmicro.org

Business Incubators

These organizations provide a range of services for small businesses and social enterprises that are delivered primarily to organizations who are tenants in a specialized building or facility. Examples include:

- *Jubilee Project* – its mission is to help community residents in East Tennessee gain skills, experience and hope necessary to provide for their needs. Jubilee's Business Incubator is the primary vehicle for achieving these activities. The incubator provides access to fax, copier, computers, desktop publishing and assistance in locating markets for art and craft projects. The incubator also helped develop the Clinch-Powell Community Kitchens, which is a shared-use state-of-the-art commercial kitchen in which farmers and small-business people can create their own value-added food products. jubileeproject.holston.org

- *Technology 2020* - helps start and nurture technology-based companies in the Tennessee Valley corridor. It serves a region extending from Chattanooga to the Tri-Cities area of Tennessee. It provides business development and incubator services to technology companies and hosts the regional association for technology companies. Technology 2020 also provides financial capital to a wide range of technology companies, including those who need less than $35,000 in investment to those who need up to $2.5 million. www.tech2020.org

Educational Institutions

- *Berea College's Entrepreneurship for the Public Good* - focuses on helping students learn about entrepreneurship, leadership and community development in the context of Appalachian communities. Students learn how small businesses and nonprofit ventures are employing socially and environmentally responsible practices to provide jobs and build healthy communities. http://www.berea.edu/epg/default.asp

- *The West Virginia Entrepreneurship Initiative* - works to expand resources for entrepreneurs including widening markets, increasing sources and access to capital and documenting and disseminating successful programs and best practices. http://www.ruraleship.org/content/pdf/WV/wvpiece.pdf#search='West%20Virginia%20Entrepreneurship%20Initiative'

- *The University of Charleston Entrepreneurship Center* - offers entrepreneurs counseling and information services and has developed a network of specialists through the state and region who can support entrepreneurs. The Center partners with Adena Ventures to help provide equity capital and operational assistance in Central Appalachia.

http://www.ucwv.edu/current_students/entrepreneurship_center.aspx

- *Ohio University's Voinovich Center for Leadership and Public Affairs* - has developed the Appalachian Regional Entrepreneurship Initiative that has linked a variety of technical assistance and training programs to business and community development professionals in Appalachian Ohio. The services focus on promoting regional economic vitality for southeast Ohio. http://www.voinovichcenter.ohio.edu/arei/index.html

POTENTIAL OPTIONS FOR APPALACHIA

This section provides our recommendations for the design of the institution to support social enterprise in Appalachia. It discusses the purpose and constituency for the institution, and two potential designs, including the type of support to be provided by the institution and the geographic area it will serve. The Project Partners are willing to consider a wide range of potential options in addition to the two noted here.

Initially, we had conceived of this institution as a venture fund, which is why the initial invitations for this event were framed as a "discussion of a venture fund for social enterprise". But our thinking evolved as we conducted our research, and now we will present two options, an "accelerator" and a venture fund. Both of these options have the same purpose, constituency and products and services, but the fund design and strategy differ significantly.

PURPOSE

The purpose of the institution is to assist nonprofit organizations to develop social enterprises. These enterprises would both help nonprofits to become more financially self-sustaining, and also to better achieve their missions.

CONSTITUENCY

The institution's primary constituency will be nonprofit organizations in rural areas in Appalachia that are seeking to increase jobs, income and assets for low-income individuals. The institution would serve all types of nonprofits, both large and small. However, given the landscape of nonprofit organizations in Appalachia, our expectation is that its typical client would have a budget of less than $1.0 million, and ten paid staff or fewer.

The nonprofits would be seeking to create or expand social enterprises. These would include all types of enterprises, including mission-related ventures, revenue-generating ventures, and double-bottom-line businesses. Given the current landscape of ventures in Appalachia, it is expected that the majority of the ventures in the first years of the institution's operation will be mission-related ventures.

PRODUCTS AND SERVICES

The institution would provide both loan and grant funding, either directly, or through local intermediaries. We anticipate that the loan amounts would be modest, averaging $50,000 - $100,000 per organization supported in the initial round of financing. This might increase as high as $250,000 provided in multiple rounds of financing. This number can and should be refined through a more detailed business planning process for the Fund.

We anticipate that the Fund would provide grant support that would typically be between $50,000-$200,000 per organization. Again, this might increase in multiple rounds. This support might be provided in cash or in kind. It might be provided directly by the Fund, or it might be provided through intermediaries. This a rough estimate, and is based on a variety of analyses showing that effective development for social enterprises and micro-enterprises can require grant and organizational support of between $1-4 dollars for $1 loaned.[7]

The grants would be used both to fund operations at the nonprofits, and also to pay for the full range of supports that are required for social enterprises to succeed. Some of these supports would be provided directly by the Fund, while others would be provided by other organizations. It should be noted that the institution may provide grants to some organizations in a particular year even though it does not provide them with loans or investments in that year.

FUND DESIGN

We propose two alternative designs for the institution. The preferred option, which we will call "Social Enterprise Accelerator", focuses on a targeted geographic area inside the Appalachia region. It would raise grant and loan funds, and then use these funds to be a direct provider of grants, loans and technical assistance to nonprofits in its service area.

An alternative design, which we think is less attractive, we will call the "Appalachian Social Enterprise Fund". This Fund would provide loans and grants across all of Appalachia. It would seek grant and loan funds for social enterprise, and then re-grant and re-lend these funds to local partners. The local partners would make loans to nonprofits seeking to create social enterprises, and also provide them with technical assistance and management coaching.

Social Enterprise Accelerator

The Social Enterprise Accelerator would have a focused geographic service area targeting the most distressed portion of Central Appalachia. It would initially have one office in this region from which it would directly deliver loans, grants and technical assistance to nonprofits seeking to create social enterprise. It would be very much hands-on funder, meeting with its investees and grantees every month to provide assistance, advice and to help address problems and concerns. If successful, it might expand to two-three offices to be able to better serve a larger region. Experience from other accelerators and from the world of venture capital suggests that staff can only effectively serve nonprofits within a two-three hours travel time of the office.

The Social Enterprise Accelerator would be patterned after other "high-touch" funders such as New Profit, the Pittsburgh Social Enterprise Accelerator, and REDF (formerly the Roberts Economic Development Fund). Each of these organizations works intensively with

[7] "To Our Credit: A Two-Part Series for PBS on Microcredit and Microenterprise Development", **www.pbs.org;** Brody Weiser Burns, *WSEP Franchise Planning Study,* 1998; Brody Weiser Burns, *CDFI Phase II Study,* 2001.

a limited number of social enterprise ventures. The ventures are typically chosen through an intensive investment review process, and are deemed to have a high likelihood of being able to attain break-even and growth within 18-24 months.

The Social Enterprise Accelerator would provide grant and loan financing to the social enterprise ventures. It also would help ensure that each venture receives assistance in each of the six areas determined as critical for success in social ventures, with attention to the specific challenges faced by social enterprises in Appalachia:

1. *Clarity of purpose and strong Board commitment.* The intensive review process to determine whether the organization was ready for work with the Accelerator would be designed to help the management and Board of the organization grapple with what their goals for the venture would be, and whether they were ready to take on the challenges and risks of starting or significantly expanding a venture. The review process would be designed so that the insight and reflection would be useful to the organizations even if they are not chosen to work with the Accelerator. In fact, experience at other "high-touch" funders shows that a good review process can help an organization to understand how it needs to change and grow if it wants to start a venture, and that sometimes the organizations that are turned away in one review come back stronger and ready for investment two-three years later.

2. *Experienced management.* The Accelerator would play an active role in identifying and recruiting experienced candidates for management positions in its investees and potential investees. In this way, it would function much like the venture funds in the region, which actively recruit management team members for their investees.

   The Accelerator would address the specific challenge in Appalachia of the scarcity of management in several ways. It would work closely with universities and other institutions to ensure that there are educational programs targeted at producing entrepreneurs for social ventures. For example, the nationally-recognized program in Professional Crafts at Haywood Community College in North Carolina provides training not only in the techniques of crafts, but also in how to manage a small crafts business. Given the importance of crafts as potential earned income strategies, the Accelerator will work to ensure that graduates from these and similar programs are made aware of the opportunities at nonprofits, and that nonprofits are made aware of potentially attractive candidates. The Accelerator also would seek to develop networks reaching entrepreneurs who are currently located outside the region, but who might have roots in Appalachia, and might be persuaded to return to head up a venture. Developing and maintaining a network or database of potentially interested entrepreneurs would enable the Accelerator to help all of the enterprises in its portfolio to attract the right kind of management as they grow.

3. *Reliable market access and in-depth business planning.* The Accelerator would start working with the potential investee on market access and business planning as part of the review process. Even before it makes a commitment to invest in the new venture, the Accelerator may provide grant support for additional business planning, and for market research and analysis as part of the review process. The review process will be

determined in significant part by the business plan. The business plan is also a key document for both the Accelerator and management, because the Accelerator typically would not release its entire investment in the venture at the beginning. Rather, the investment would be divided into portions, or "tranches". Each investment tranche would be set to be released upon the achievement of particular milestones set forward in the business plan. The discussion around what realistic milestones are, and how much funding will be needed to achieve them, provides an opportunity for the funder and the management together to sharpen their understanding of the venture, the key risks that it faces, and how management will address these risks.

The Accelerator would help its grantees and investees address the specific Appalachian challenge in accessing markets and customers in a variety of ways. It would assist its portfolio organizations to create, manage, and publicize web sites that enable them to connect to markets outside of Appalachia, reaching new customers and developing new sources of revenue. It would help them to become part of nation-wide marketing and sales organizations, and connect them to manufacturers' representatives, which could carry their products as part of larger catalogues of products. It also would work with regional governmental and business organizations to create and implement strategies for attracting new customers and new funding to Appalachia.

4. *Intensive business coaching.* The Accelerator would use its monthly meetings with its investees and grantees to identify management and business issues, and either provide coaching itself, or help to secure this coaching on a pro-bono or low-cost basis from consulting firms, accounting firms, and business schools in the region.

   The business coaching could be offered through various settings including one-on-one counseling, peer networking, classroom-type lectures, and mentoring programs. The development of access to market services can include sophisticated training on marketing and sales concepts; development and distribution of joint catalogs; Internet access and e-commerce; participation in trade shows; and business, technology and commercial kitchen incubators.

   The Accelerator would also connect the venture to key organizations, including funding sources, corporations, university programs, public sector agencies and other key stakeholders that can contribute to a venture's long-term success.

5. *Patient financing.* The Accelerator will be the initial investor in most of the ventures. Depending on the nature of the venture, the initial investment may be made with grants, long-term loans, or a combination of both.

   The Accelerator will address the specific Appalachian challenge of the low level of investment and grant capital for social enterprise by seeking to develop additional financing from CDFIs, banks and government agencies for its investees. Debt financing will be particularly sought for property, plant and equipment purchases, and for the working capital required for expansion. Where appropriate, the Accelerator would assist its investees to pursue specialized financing programs such as the New Markets Tax

Credit program. The Accelerator will work to bring new grant, loan and investment capital into the region, as specified in the following section.

6. *Support for employee training and counseling.* The Accelerator will assist its investees to connect to organizations that will provide social services and employment training services for its employees. The Accelerator will not provide these services directly itself. It is anticipated that the services would be provided by a range of nonprofit organizations, including community colleges, workforce development programs, community-based job training organizations, and the like.

<u>Budget</u>

A preliminary estimate of the budget for the organization, based on the budgets of comparable organizations, would be \$500,000 - \$1.0 million per year in loans, and \$1.0 - \$2.0 million per year in grants and organizational support. This budget assumes no local match for grants. This would enable it to serve 10-20 organizations intensively at a time. Organizations would stay in the Social Enterprise Accelerator "portfolio" for two-three years. These organizations would "graduate" to other types of financing (such as banks), or to support from government entities for replication over a wider region.

Appalachian Social Enterprise Fund

In contrast to the Accelerator, which would have a narrow geographic focus, the Appalachian Social Enterprise Fund would seek to spur social enterprise throughout the entire Appalachian region. It would raise grant and loan funds for social enterprise from a wide range of sources, and in particular, seek to bring new funders into Appalachia.

Where the Accelerator would be a "hands-on" funder, working directly with its investees, the Social Enterprise Fund would work through intermediaries. The organization would make loans to local financial services intermediaries or Community Development Financial Institutions (CDFIs) such as community development credit unions, nonprofit loan funds and community development venture capital funds, which in turn would make loans and grants to social ventures in Appalachia. In addition, the organization would have its own "central fund", which would enable it to make a modest number of direct investments in special projects. This would enable it to meet the needs of projects in areas where there are no appropriate loan funds, or for projects that span a wide area.

The organization would provide grant funds for technical assistance and market development. These grants may be made to CDFIs, nonprofit community development organizations, community colleges, government agencies, or for-profit providers such as accountants and information technology firms. The grants would require a matching component in cash or in kind.

The organization would also retain a portion of the grant funds to create region-wide opportunities for training and networking. This would help to spur the transfer of best practices, and to enable the development of regional collaborations and partnerships.

The Appalachian Social Enterprise Fund could support organizations similar to the Accelerator across Appalachia. In this way, it is possible that the Appalachian Social Enterprise Fund might be developed after the Accelerator and build on its successes.

Budget

A preliminary estimate of the budget for the Appalachian Social Enterprise Fund is \$2-4 million per year in loans, and \$2-4 million per year in grants. The grants and loans that it provides would enable local organizations to serve 40-50 social enterprises across the Appalachian region each year. The grants would be matched on a one to one basis by local organizations. If this option is pursued, these numbers should be refined in a business planning process.

RECOMMENDED ALTERNATIVE

Our analysis suggests that the Social Enterprise Accelerator is the recommended choice for the design of the Venture Fund. It has a number of important strengths that make it more attractive than the alternative:

- Its smaller scale will enable it to get started and to achieve results more rapidly.
- Direct interaction with social enterprises permits greater control over outcomes, and allows for more rapid response to changing needs and requirements.
- Unlike the Appalachian Social Enterprise Fund, it does not rely on intermediary organizations to achieve results. This is an important advantage, because the network of intermediary organizations capable of providing loans and technical assistance does not cover all of Appalachia.
- It will provide directly, or coordinate the provision of, all the services required for social enterprises to succeed in Appalachia.
- Because all the money raised will be granted and loaned in Central Appalachia, it will be easier to raise money locally.

The Social Enterprise Accelerator does have one major weakness relative to the Appalachian Social Enterprise Fund. Because it will be raising money in part from local sources, and it will be a new organization (or a new program of an existing organization), it may be perceived as competing with existing organizations for scarce philanthropic funding. To overcome this weakness, it is critical for the Social Enterprise Accelerator to bring new funding into Appalachia. If it is simply tapping existing funds, it is likely to meet with stiff resistance. Bringing in new funding to Appalachia would position the development of the Accelerator as a win-win opportunity for both the supporters of the Accelerator and existing organizations in Appalachia.

This section provides an analysis of the Accelerator's financial requirements, describes potential types of investors, and discusses the case for investing in social enterprise.

FINANCIAL REQUIREMENTS OF THE ACCELERATOR

Products and Services
The types of support that will be provided to social enterprise determine the financial requirements of the Accelerator. The Accelerator will provide a range of support, including in-kind services, grants, loans and investments. The in-kind services will include the entire range of management and business support required by social enterprises. Some of these will be provided by Accelerator staff, and some by staff of other organizations on a pro-bono basis. The grants will typically be for operating costs and expenditures required for the social enterprise to expand and enter new markets. The loans that will be provided will be long-term (five-seven or more years in length), and will be subordinated to all other debt (such as bank debt for a mortgage, or working capital supporting accounts receivable). The loans may also have some kind of gain-sharing incentives. In other words, the loans may be structured so that the Accelerator gets an extra payment if the social enterprise does well financially. This can sometimes be referred to as an "equity kicker".

Capitalization
The Accelerator will require a loan/investment fund of approximately $5.0 million in total capitalization. This would enable the Accelerator to make investments of up to 20% of the fund in any given year. It also will provide enough interest and investment income to allow the Accelerator to support a loan/investment staff person. Given the nature of the proposed investment activities, most of the capital for the Accelerator will need to come from grants and pro-bono donations of services from foundations, government agencies, regional entities, business service organizations, educational institutions and individuals. A portion of the Accelerator's funding will also come in the form of loans, which will need to be long-term, and have a low interest rate. The Accelerator must have the ability to withstand a significant loss rate in its investments, and its capital should have a term that is at least twice the average term of the loans that it intends to make. Given that the average social investment may take five - seven years to be able to repay an initial investment, the capital in the Accelerator should have an average term of 10 - 14 years. This is very long-term capital in today's market.

POTENTIAL INVESTORS FOR THE ACCELERATOR

In order for the Accelerator to succeed, it must draw new funding into the Appalachian region, or create new sources within the region. The current sources of funds available for grants and for low-rate, long-term loans, is not sufficient to meet the current needs. Establishing in a new organization that hopes to spur the growth of social enterprise without also finding new sources of funding is likely to meet with failure.

Loans
The potential sources for loans to the Accelerator for a social venture fund fall into the following categories:

National CDFI Funds
There are several national financial intermediaries, primarily CDFI Funds, which are focused in part on meeting the financing needs of the social enterprises. Partners for the Common Good (PCG) will provide funding to established nonprofits that starting up new social enterprises; however, the sponsoring organization must have assets that it can pledge as security for the enterprise in order to meet PCG's underwriting criteria. The Nonprofit Finance Fund provides debt financing for social enterprises, though it tends to focus its activities to major cities. Calvert Social Investment Foundation provides financing to social enterprises, primarily those started by well-established nonprofit organizations. SEEDCO provides grants and technical assistance to social enterprises that fit within the criteria established in the grants that it has received for this purpose.

There are several CDFIs focusing on regional areas that provide financing to social enterprises on a regional or metro basis. While these are not potential investors in the Fund, they may be able to offer guidance on potential fund-raising and capitalization approaches. These intermediaries include Boston Community Loan Fund, The Reinvestment Fund, Cascadia Loan Fund, and Coastal Enterprises. The Community Development Venture Capital Alliance (CDVCA) has collected information and analyzed data on these funds.

In addition, there are a number of CDFIs that focus on rural areas. Again, while many do not work in Appalachia, their experience may be relevant to the Accelerator. Please see the chart at the end of this section for a listing of CDFIs that invest in rural areas.

Banks
Banks that invest in community development on a national level would typically only be interested in a potential loan to the Accelerator if it fell within their CRA or CDFI lending areas. These lenders would provide capital seeking non-market rates of return. The typical investment would be structured as debt with a seven to ten-year term and an interest rate around 5%. To use this capital, the Accelerator would have to be a certified CDFI. Moreover, although several banks provide this type of capital on a national level, the most likely partners would be those institutions that operate within ARC's footprint. The banks meeting these criteria include Bank of America, Wachovia, Key Bank, PNC and JPMorgan Chase. In addition, some bank regulatory entities such as the Federal Home Loan Bank Board may potentially be able to make grants or loans that would induce banks to invest in the Accelerator.

Outside of their CRA/CDFI lending activities, national banks have not explored social enterprises as a long-term investment strategy. Most banks assume that these ventures don't have a history of producing investment returns or of achieving exit strategies that would attract traditional capital. Moreover, most banks investors are not comfortable for the double bottom line objectives of social ventures.

At a local and regional level, banks may have a greater interest in supporting projects that create community benefits. Additionally, these institutions will likely have business relationships with the nonprofit organizations that create the social ventures. Fifth Third Bank, Regions Bank, BB&T, SunTrust and Sky Bank are the largest regional institutions that operate within ARC's footprint.

Moreover, there are local banks working in the Appalachian region that have experience in development finance investments. These institutions are investors in existing rural CDFIs and investments funds. For instance, Kentucky Highlands operates an investment fund called the Southern Appalachian Fund (SAF)[8]. The investors in SAF include several local banks that operate in Tennessee and Kentucky[9]. Kentucky Highlands is currently raising investments for a new fund, Meritus Ventures, which will focus on Central and Southern Appalachia.

Foundations

In addition to the national foundations (Ford, Heron, MacArthur) that have been active investors in development finance funds, the Accelerator might attract regional foundations active in the Appalachian region. As noted above, the Appalachian region has a limited philanthropic network. There are relatively few foundations that operate in this region and also have experience in making investments in economic development venture funds. However, there are a number of foundations, such as Babcock and Heron, that are moving towards investing their corpus as mission-related investments (MRI) with CDFIs; however, it is uncertain whether social ventures will meet the requirements for repayment rates and terms required for MRIs.

Government

State and local governments in the Appalachian region, as well as other public sector or quasi public entities, could potentially be investors in the Accelerator. In general, the public sector has extensive experience in placing investments with venture funds that work in the economic development field. Most of the funds in which public sector agencies have invested, however, do not make investments within ARC's footprint.

At the federal level, there are a several potential options available for the Accelerator. Two potentially attractive options are the CDFI Fund and the New Markets Tax Credits. Additionally, the SBA, on behalf of USDA, will enable venture capital companies to offer access to capital to rural enterprises under a newly created business and jobs initiative called the Rural Business Investment Program (RBIP). Created by the 2002 Farm Bill, RBIP will license Rural Business Investment Companies (RBICs) to support up to $60 million in guaranteed RBIC debentures based on the Bush Administration's Fiscal Year 2005 budget.

Other Partners

There are several additional organizations and other entities that could play a role in identifying potential investors for Accelerator:

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[8] A $12.5 million venture capital fund that will provide equity capital and operational assistance to qualifying businesses in Kentucky, Tennessee, and the Appalachian counties of Georgia, Alabama, and Mississippi, and is one of six New Markets Venture Capital (NMVC) Companies in the country.

[9] Farmers & Merchants Bank, First Bank, National City Bank of Kentucky, and Tennessee Commerce Bank.

- Rural Policy Research Institute's (RUPRI's) Rural Equity Capital Initiative has contributed to the growing literature about the state of rural venture capital and the role of nontraditional venture capital funds in rural economic development.

- University of Kentucky's Appalachia Center has redesigned its vision for the next five years, and is launching some conversations about the venture capital needs of the region.

- Angel investors and other individual philanthropists might be a suitable source of capital for the Accelerator. For example, a network of angel investors in North Carolina is working with Hand Made in America to consider equity for businesses and social ventures within its region.

- Faith-based deposits might be a viable option, given the region's religious heritage. Some CDFIs have been successful with these sources; however, a social venture fund would have to compete with less risky investments in CDFIs for this capital.

- Utilities (such as Duke Power and Light) and quasi-public organizations such as the Tennessee Valley Authority may be potential investors in social enterprise projects if there is compelling evidence that the projects will spur economic development in their service area.

Grants and Donations

The support of social enterprise and a successful Accelerator depends on grants and donations. There are three potential sources for grants and donations for the Accelerator:

Foundations

Social enterprise has been supported by a range of foundations over the past several years. National funders who have made grants or investments in social enterprises include the Ford Foundation, Rockefeller Foundation, Heron Foundation, Skoll Foundation, Omidyar Foundation, Atlantic Philanthropies, and Kauffman Foundation. The difficulty facing the Accelerator is that none of these foundations currently has Appalachia as an area of interest for their funding of social enterprise. The Accelerator will need to develop a compelling case for why investing in Appalachia falls squarely within the program goals of these foundations in order to persuade them to provide it with grant funding.

There are a number of regional foundations which fund in Appalachia and which have an interest in social enterprise. This subject will be discussed in detail at the Convening, as many of these foundations will be participating directly in that discussion.

High net worth individuals
Initial conversations with individuals involved in establishing or trying to expand community foundations in Appalachia suggest that there is a pool of untapped wealth in Appalachia – individuals who have not yet started significant giving even though they have significant wealth. There are fewer of these individuals than there are in many urban areas in the US, but they do exist. In addition, relocation from the north, particularly of retirees, is bringing in a new potential source of income. Individuals with a background in business often find social enterprise to be an exciting prospect, and this may enable nonprofits to tap these new sources of donations. The opportunity here lies in the reality that few if any of these individuals have been pursued or "tapped" for funding in Appalachia to date.

Public sector organizations
The Appalachian region has a number of important public sector organizations, including the Appalachian Regional Commission, which have a focus on developing the economy in the Appalachian region. These entities are a potential source of grant funding for some aspects of the Accelerator. Similarly, state and local economic development agencies can potentially provide some funding to the Accelerator. The key to obtaining funding is to fit the program guidelines, and to present a clear and cogent case for how and why social enterprise can help create jobs and income for the residents of Appalachia.

<u>In-Kind and Pro Bono Services</u>
The experiences of the Pittsburgh Social Accelerator and of New Profit show the importance of finding in-kind and pro-bono sources of technical assistance. There are a wide range of potential sources in Appalachia, including community colleges, business schools, accounting firms, small business development centers, employment training organizations and CDFIs. All of these sources can be drawn on to help provide the suite of services required for social enterprises to succeed.

<u>Additional Types of Support</u>
In addition to loans, grants and in-kind services, there are a number of additional roles that it would be helpful for foundations and public sector agencies to play in helping the Accelerator and its investees to succeed.

Funders
In addition to providing grants to social enterprises, funders can play a critical role in building the field of social enterprise in Appalachia. First, they can publicize success. Foundations have access to media and public attention, and can help bring the best examples of social enterprise to public attention. Second, they can help to improve the state of practice in social enterprise in the region. They can help to identify best practices and promising approaches, and disseminate these findings broadly. They can build a community of practice, helping to bring together practitioners to share lessons learned and to work together to solve common challenges. Finally, they can help fund evaluations, which can provide important independent validation for social enterprise, and help clarify what's working well and what needs to change.

Public sector agencies
In addition to providing loans and grants directly, public sector agencies can play a critical role in shaping the environment in which social enterprises work. They can identify barriers for capital and knowledge, and help develop policies and programs that enable social enterprises to overcome these barriers. They can help assure that social enterprises continue to receive reasonable tax treatment, and are seen in policy and practice as providing an important public good. They can help develop loan programs that support social enterprise. They can help ensure that social enterprises have an adequate supply of skilled staff by helping to connect the enterprises to job training and education programs. Finally, they continue to work to overcome the isolation of Appalachia, enabling social enterprises as well as other businesses to tap markets in the rest of the US and across the globe.

THE CASE FOR INVESTING IN SOCIAL ENTERPRISE

There is a strong case for philanthropic and public sector investment in social enterprise. It can create benefits for nonprofits, for the region and for funders. It can create benefits for nonprofits by helping them to become more financially sustainable, and to tap new sources of funding for their operations. It also can help them to better achieve their missions by creating jobs and entrepreneurial opportunities for residents.

Social enterprise can create benefits for the region as well. Because the economy is not growing rapidly in Central Appalachia, creating jobs and income requires new entrepreneurial activity. It requires building on existing cultural, natural, and community resources to attract new customers to the region and to connect existing businesses to new markets. It will be difficult to create the job growth required just by working with existing businesses and markets. Social enterprise can be part of developing new markets and attracting new customers.

Social enterprise can create benefits for funders. It can help attract new funders to the region, because its appeal goes beyond funders who are interested specifically in Appalachia, to those interested in social enterprise in a variety of settings. In particular, social enterprise can be appealing to individuals with business backgrounds who see enterprise as an important tool for creating jobs, income and social change. It also can help reduce the requirement for ongoing funding for existing grantees, as it helps them to become more financially sustainable.

Social enterprise is not a panacea. It doesn't always work. But when it is successful, it offers a unique ability to help create sustainable ventures that achieve social goals. The *Appalachian Social Accelerator* design is based on best practices in the social enterprise field today. It has the potential to help enable nonprofits to be more financially sustainable and to better achieve their missions, and to help improve the economies of the communities in which these nonprofits work.

Examples of CDFIs That Focus on Rural Development

1. Publicly Funded, Publicly Managed Institutions
    - Small Enterprise Growth Fund (Augusta, ME)
    - Minnesota Technology Corporation Investment Fund/MIN-Corp (Minneapolis, MN)
    - Iowa Product Development Corporation/Iowa Seed Capital Corporation (Des Moines, IA)

2. Privately Managed Funds with Public Funding or Incentives
    - Iowa Capital Corporation (Des Moines, IA)
    - Colorado Rural Seed Fund (Boulder, CO)
    - Northern Rockies Venture Fund (Butte, MT)
    - Oklahoma Capital Investment Board (Oklahoma City, OK)
    - Partner Funds: Pacesetter and MESBIC Venture Funds (Dallas, TX)
    - Magnolia Venture Capital Fund (Jackson, MS)
    - Kansas Venture Capital, Inc. (Overland Park, KS)

3. Community-Level Equity Programs
    - Ames Seed Capital Fund, Inc. (Ames, IA)
    - Siouxland Ventures, Inc. (Sioux City, IA)
    - McAlester Investment Group (McAlester, OK)
    - Montana Rural Electric Utility Cooperatives

4. Certified Capital Companies (CAPCOs)
    - Louisiana CAPCO Program (Baton Rouge, LA)
    - Missouri CAPCO Program (Jefferson City, MO)

5. Community Development Venture Funds
    - Coastal Ventures Limited Partnership (Portland, ME)
    - Kentucky Highlands Investment Corporation (London, KY)
    - Cascadia (Seattle, WA)
    - Northeast Ventures (Duluth, MN)
    - Appalachian Ohio Development Fund (Athens, OH)
    - Sustainable Jobs Fund (Philadelphia, PA and Durham, NC)

6. Small Business Investment Companies (SBICs)
    - First United Ventures (Durant, OK)
    - North Dakota SBIC (Fargo, ND)
    - North Carolina Economic Opportunities Fund (Raleigh, NC)

KEY ISSUES FOR CONSIDERATION

This section identifies the key issues for discussion at the Convening.

We would encourage you to reflect on the following issues, which will be discussed at the Convening:

- Does your experience suggest that social enterprise can be a useful strategy for helping nonprofits both to attain their missions and to increase their financial sustainability?
- Do you believe that there are a sufficient number of nonprofits with the potential to successfully engage in social enterprise to make this strategy attractive in Appalachia?
- Do you agree that providing a combination of grants, loans and technical assistance is the right approach to supporting social enterprise in Appalachia?
- What do you think the potential sources of funding and pro bono assistance for social enterprise in Appalachia might be?

We look forward to discussing these with you at our meeting.