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Charities Venture Into Business

Yale contest draws hundreds of plans for for-profit enterprises

By Nicole Wallace

In Washington, a day-care network that has the staff and equipment to prepare far more meals than it needs runs a catering service. Two Minneapolis theaters that own thousands of costumes have joined forces to create a costume-rental service. An autism charity in North Haven, Conn., now allows other organizations to consult with its staff experts for a fee.

In each case, the ventures are designed to supplement the money the charities bring in through donations. The businesses were also among the eight that won top honors in the first National Business Plan Competition for Nonprofit Organizations, which concluded here this month and was sponsored by the Yale School of Management, the Goldman Sachs Foundation, and the Pew Charitable Trusts.

The contest demonstrated that such ventures are beginning to play a significant role for nonprofit organizations, and showed a growing diversity in the types of charities involved and in the businesses they are trying to get off the ground.

Organizers of the competition had hoped to get about 200 proposals, but, in a sign of the interest in such ventures, more than 650 nonprofit organizations submitted plans in the hopes of winning a share of the $500,000 in prize money offered. Even more proposals are expected as the competition heads into its second year.

The trend is part of the nonprofit world's increasing reliance on earned income. Fees that charities charge for their services accounted for 47 percent of the growth in nonprofit revenue from 1977 to 1997, according to Lester M. Salamon, a Johns Hopkins University scholar. And while no definitive statistics show how many nonprofit groups operate business ventures, an online survey commissioned by the Pew Charitable Trusts in 2000 suggests that the number could be significant. Of the 519 charities that participated in the survey, 217 said that they run an earned-income venture, and another 28 reported having run ventures in the past.

Jed Emerson, who has been a leader in the social-enterprise movement since the early 1990s, says the "parade" of business ventures starting up today follows in the footsteps of charities that pioneered the strategy many years ago. "While parts of that parade have been marching for a long time, a lot of those parts have been on side streets," says Mr. Emerson, senior fellow at the William and Flora Hewlett and the David and Lucile Packard Foundations. "What we're seeing now is that folks are feeding from the side streets onto Fifth Avenue and marching down. For the first time, you can actually stand on a corner, look up the avenue, and see the array of different approaches, different bands, and even different music that's in play."

Mr. Emerson and other experts, however, caution that business ventures carry many risks. They often don't break even for several years, and some may never turn a profit, or may even fail.

Little Foundation Support

The interest among charities in starting businesses has yet to be accompanied by a rush of foundation money to help get projects off the ground. Few foundations support such efforts, although there are indications that this could be starting to change.

The Goldman Sachs Foundation made a two-year grant of $1.5-million and the Pew Charitable Trusts is contributing $3-million over three years to sponsor the awards, which they hope will encourage other grant makers to get involved.

Some 90 representatives from corporate and private foundations --including the Atlantic Philanthropies and the Annie E. Casey and Robert Wood Johnson Foundations -- attended an invitation-only session for grant makers at the awards meeting for the business-plan competition. And this week, leaders of 55 foundations are scheduled to meet in Sundance Village, Utah, to discuss ways that grant makers can support nonprofit organizations that run businesses.

Foundation officials at the business-plan competition said that, compared to traditional grant making, financing nonprofit business ventures requires different tools and a different way of thinking. Among the approaches discussed were program-related investments --loans that foundations make to charities at below-market interest rates -- and recoverable grants, which nonprofit organizations agree to pay back in a set number of years, but for which foundations do not charge interest.

Supporting a business venture is "very different from writing an award letter that says, 'Here's $100,000. Good luck and goodbye, and let us know in a year how you did,'" says Stephanie Bell-Rose, president of the Goldman Sachs Foundation. "To actually take a stake in the financial future of an organization is going to take a very different mindset, a mindset that relates to the economic return of the venture, as well as the social benefits."

No Quick Source of Cash

Even the most ardent supporters of charity business ventures caution that such efforts should not be seen as a quick source of cash.

J. Gregory Dees, faculty director of the Center for the Advancement of Social Entrepreneurship at Duke University, says he worries "that earned income's going to become a fad, that everybody's going to see earned income as a solution to their financial problem." He adds: "The truth is that running a business that actually spins off cash for you to use for other purposes is very, very hard to do."

While charity businesses do have the potential to make money and expand an organization's reach, they can also put a strain on a group's charitable programs and even damage its reputation. Some ventures take years to earn a profit, while others may never produce a surplus.

Mr. Dees notes that some ventures, however, do not need to turn a profit to be deemed a success. For example, he says, a charity that provides job training might decide to subsidize a for-profit business because it is the most efficient way to offer clients real work experiences, even if it costs the organization money to operate.

Business Planning

Careful business planning for such ventures is crucial, because nonprofit organizations need to think through their ideas, analyze the ventures' potential financial and social benefits, and understand what they're getting into before they take the plunge, says Mr. Dees.

But as the experiences of the participants in the business-plan competition illustrate, taking such steps successfully can prove far harder than it sounds.

Many of the nonprofit organizations that entered the competition had very good ideas, but had trouble translating those ideas into a financial model, says Sharon M. Oster, a management professor at Yale and faculty director of the Partnership on Nonprofit Ventures.

Particularly important is figuring out how much customers are willing to pay for a product or service, and how much it really costs to deliver it, she says. If not calculated correctly, a nonprofit group could wind up subsidizing the business venture at the expense of its charitable programs.

Some participants say the experience of entering the competition and refining their business plans helped them pinpoint weaknesses in their plans, while others say it pushed them to expand their vision. Following is a sampling of the lessons learned by finalists in the competition:

A Child-Care Group

Nation's Capital Child and Family Development, which runs 25 day-care centers in Washington, started its business --Make a Difference Catering --after other day-care centers started asking the charity to provide meals for their students. The charity has a central kitchen that prepares 1,780 meals per day for its own children, and has contracts with eight additional social-service groups to prepare 753 more meals.

As the venture was getting started, the organization decided whether to accept new business based on how close a potential client was to one of its delivery routes, says Travis Hardmon, executive director of Nation's Capital. But in going through the business-planning process for the competition, which included free consulting help from nonprofit-enterprise experts, Mr. Hardmon says the organization realized that it wasn't taking a close enough look at the cost of providing the meals.

"Since we were preparing the meals for our own children, we weren't really looking at our costs as carefully as we should have, in terms of what does it actually cost to service a contract, and what is the profit margin with that contract," says Mr. Hardmon.

While the organization had always factored in food and labor expenses, he says, it didn't consider things like the cost of the kitchen space and the cost of delivering the meals. But by taking into account all of the costs associated with preparing and delivering the meals, Nation's Capital was able to develop what Mr. Hardmon says is a much more realistic analysis of its costs per breakfast, lunch, or snack per child.

Nation's Capital, which won $25,000 in the competition, learned that its biggest profit margins were on lunches, and that, depending on the contract, it was breaking even or losing a little on breakfasts and snacks. With more-accurate information on the cost of providing the meals, the organization found that its ideal customer was a child-care center or other social-service group that needs 50 or more meals per day.

"We started looking at our target market differently," says Mr. Hardmon. "If somebody called us, and said, 'Well, we have 20 kids, and we want you to do our meals,' we realized that it wasn't cost-effective for us to do those 20 meals."

School for Autistic Children

Officials of Benhaven --a charity in North Haven, Conn., that runs a school for children with autism --say the competition's planning process helped them realize that the fixed costs associated with the consulting business they were starting had implications for how quickly the business would have to grow to become profitable.

In recent years, public-school districts in the state have been turning to the organization, which started 35 years ago, for help in learning how to educate autistic students. The requests were so numerous that providing the advice was taking staff members away from Benhaven's own programs.

So last summer the charity started a consulting company, Benhaven's Learning Network, with the dual goals of providing in-depth assistance to public schools and generating revenue for the parent organization.

When Benhaven started the venture, officials just assumed that the business would pay for itself because demand for the service was so high, says Larry Wood, executive director of Benhaven, which won $25,000 in the business-plan competition.

When Benhaven completed the financial-forecasting section of its business plan, the organization realized that to cover the venture's fixed costs --such as office space, an administrative assistant, and a share of the organization's administrative overhead --the consulting group would have to expand its current roster of six consultants to 13 by the business's third year of operations.

"We never expected that we would need to become so large," says Mr. Wood. "We would have been completely oblivious to that, and it could have gotten us into some trouble."

The charity now plans to add four consultants during its second year, and another three the following year. Having made those adjustments, the organization expects to break even next year, and generate approximately $98,000 in its third year of operation.

Costume-Rental Business

When the Guthrie Theater and the Children's Theatre Company, both in Minneapolis, started to talk about forming a costume-rental business together a year and a half ago, their financial goal was modest: to simply break even. By covering its own costs, the rental business would allow the theaters to put the money that they would have spent on costume storage into programs, says Maribeth Hite, costume director at the Guthrie Theater.

The theaters anticipated other benefits as well. They would have access to each other's costumes at no cost. And employees paid by the business venture could take over some tasks that at the time fell to the theaters' already busy costume departments. The workers would return costumes to storage at the end of a play's run and locate costumes for the theaters' secondary projects, such as teen theater programs and actors working in the schools.

But going through the steps to work out a detailed business plan has prompted the theaters to think bigger.

CostumeRentals got off the ground last year, when the theaters moved into an 18,000-square-foot warehouse their combined collection of 17,000 costumes, as well as associated hats, shoes, and masks.

Working on the business plan helped the theaters realize that the market for the venture, mostly schools and other theaters, but also individuals and corporate customers, was larger than they had thought.

"We didn't know what a good idea this really was," says Ms. Hite. "I mean, we thought it was a great way for the theaters to cover their costs, but working with our board members, who are members of the business community, we discovered that this could really be a profit center for the theaters."

To figure out how big the market might be, the theaters sent a postcard to 1,200 schools and theater groups, asking them if they would be interested in learning about CostumeRentals. Nine percent responded yes.

With the returns from the postcard survey and other research about the costume-rental market and competing businesses, the theaters arrived at a financial forecast that predicts that the venture will break even in its second fiscal year and return $34,000 in proceeds the third year, which will be split between the two theaters.

Ms. Hite says that working with consultants and others through the business-planning process proved critical in helping the theaters break out of their nonprofit mind-set -- which she describes as "cover your costs; don't be a liability" --and start to think more like businesses. The costume venture won one of four top prizes in the competion, receiving $100,000.

Before CostumeRentals, the Guthrie ran a small costume-rental operation of its own. "We did no marketing; it was all word-of-mouth," says Ms. Hite. "We were too afraid of having expenses to make income."

Technology Group

CompuMentor, a nonprofit organization in San Francisco that provides technology assistance to other charities, started its business venture, DiscounTech, in January 2002. One of the competition's $100,000 winners, the online service allows nonprofit groups to purchase donated software and hardware for a low fee.

Members of the team that developed the DiscounTech business plan say the process helped them better understand the financial underpinnings of the venture and articulate its goals.

Bennett Grassano, the organization's associate director of development, says he also now realizes how important it has been to bring together everything various staff members had learned during DiscounTech's 16 months of operation into a single document. He says that before the planning process, too much of that information resided only in people's heads.

That's a problem, Mr. Grassano notes, "because the people who own those heads can go off to other positions, other responsibilities, and even other organizations."