Community Wealth Ventures, Inc.

Achieving Impact and Sustainability through Market-Based Approaches

DISCUSSION HIGHLIGHTS

A CONVENING SPONSORED BY COMMUNITY WEALTH VENTURES, OCTOBER 27, 2007

Community Wealth Ventures, Inc.

Community Wealth Ventures emboldens and equips leaders to innovate, grow, and sustain organizations that build a better world.

We provide consulting services to nonprofits, foundations, and corporations to build their capacity and leverage their assets to create sustainable social and financial wealth. Founded in 1997, CWV is a wholly owned subsidiary of Share Our Strength; profits generated from CWV's consulting services return to Share Our Strength to support its anti-hunger mission. In this sense, CWV is an example of what we teach our clients.

On October 27, 2007, Community Wealth Ventures gathered together 40 philanthropic leaders for a day-long summit in Washington, D.C. with the goal of exploring how to make use of market strategies to fulfill the missions of nonprofit organizations. Our intent was to provide a forum for discussion and sharing about the successes, challenges, and lessons learned by nonprofits and grantmakers that have pioneered market-based approaches to social change.

Many people made this event possible, including Alfred Wise, who provided leadership and facilitation, and the Case Foundation, which provided a comfortable meeting space conducive to information sharing and dialogue.

This report is a summary adaptation of the presentations and discussions of the day.

EXPLORING MARKET-BASED SOLUTIONS

BILL SHORE, FOUNDER, COMMUNITY WEALTH VENTURES

The issue is not lack of discovery, or inability to develop a new solution. The difficulty is in taking a solution that we already know about, and finding a way to make it affordable, replicable, or sustainable.

ONE OF OUR GOALS AT COMMUNITY WEALTH VENTURES is to probe how the philanthropic sector can be involved with market-based approaches to creating social change.

When we talk about markets, it's not because we are so enamored of everything about the business sector. We believe that to solve social problems on the scale that they exist, most of us are going to have to find ways to use all of the different resources at our command, regardless of whether it's the philanthropic sector or the economic marketplace or the political marketplace.

When we think about what nonprofit organizations specifically need to do, and the ways in which foundations can support them, we often talk about *market-based* or *market-directed* strategies. That doesn't always mean starting a business venture, which is something that Community Wealth Ventures has helped a lot of organizations to do. Market-based solutions can take a variety of forms.

Impractical is Better than Impossible

Just recently in Rockville, Maryland, I attended a gathering honoring two pioneers in vaccine development. One was Dr. Ruth Nussenzweig, who, in 1968, came up with a new vaccine for malaria, a disease that has plagued humans for thousands of years. Even now, 40 years after her discovery, malaria afflicts up to 500 million people at any given time. The only vaccine known to be 100 percent effective is this one discovered by Dr. Nussenzweig. "Unfortunately," she wrote at the time she discovered it, "it's entirely impractical to create this vaccine."

Let me explain this impracticality. Malaria parasites are transferred by mosquitoes. In order to make Dr. Nussenzweig's vaccine, mosquitoes must first be zapped in a microwave or an x-ray. Once irradiated, their salivary glands must be dissected in order to remove the parasites and create an injectable serum. Understandably, Dr. Nussenzweig was skeptical about being able to dissect enough of those salivary glands to produce a useful quantity of vaccine.

That's where Dr. Stephen Hoffman, the other pioneer, comes in. He spent his entire career in tropical health, most of it trying to develop a malaria vaccine. One failure after another, for 30 years, led him to conclude that impractical is better than impossible.

When I started to do some research around this issue, a lot of people I met with would tell me what was going on in the vaccine world. Then they would add, "And then there's that crazy thing Steve Hoffman's doing." Crazy, because it is hard to picture a bunch of people bent over their desks dissecting mosquito salivary glands. But that's exactly what they're doing. When I met Steve, he had boot-strapped it up with money raised from friends and family. In December 2006 at the White House conference on malaria, the Bill and Melinda Gates Foundation announced that they'd granted Hoffman through the Malaria Vaccine Initiative $29.3 million. Many believe this could be the single most effective malaria vaccine.

Steve Hoffman points out that, in many scientific cases, the issue is not lack of discovery or inability to develop a new solution. The difficulty is in taking a solution that we already know about, and finding a way to make it affordable, replicable, or sustainable.

Most everyone affiliated with a grantmaking foundation has had experience with programs that work. There's no question in our minds about the wonderful impact they've had on a family, or a community, or a region. Yet, effective programs tend to be expensive. And, they have a tendency to remain unreplicated. We just don't have the same go-to-scale incentives in the nonprofit sector as we have in the for-profit sector.

Instead, it's actually quite common for grantmakers to come across an excellent, efficient program—a maternal-and-child health clinic, an education program, a workforce development program, or a mentoring group, for example—that is languishing in its own uniqueness. Of course, the successful program is not languishing in terms of serving its current client base, but at the same time it can be seen as squandering the potential to share its good services with the wider population that badly needs them.

Which brings me back to the work we do at Community Wealth Ventures. We are always eager to learn from people in philanthropy about other market-based approaches. Our shared goal is to find programs that work and get them to scale. One question for us to examine is this: "Are there things that the philanthropic sector is doing that *only* the philanthropic sector can do?"

The answer to this question has to do with taking risks that build a bridge between social need and access to market capital. The nonprofit sector doesn't have the resources sufficient to do all it needs to do—not to the degree that grantmakers can do what only grantmakers can do, which is take risk. We want to look at all the investment and risk absorption in the philanthropic community and identify where our interests overlap.

Today's discussion features several experts in various market-based approaches who will share their part of this world with us.

CREATING A SYSTEM OF SELF-GENERATING WEALTH

JENNIFER VANICA, PRESIDENT AND CEO, JACOBS FAMILY FOUNDATION/ JACOBS CENTER FOR NEIGHBORHOOD INNOVATION, SAN DIEGO, CA

Could we, in fact, build self-generating systems of wealth creation that were controlled at the neighborhood level?

WHEN I MET JOE JACOBS AND HIS FAMILY, I saw they were ready to try something different. This was long before such phrases as double-bottom line, or social entrepreneurs, or venture philanthropy even existed in the vernacular. Joe was a great entrepreneur and a great thinker about the free market system. He had a constant mantra, which was, "Talk to your markets, understand your markets." He'd say, "Look at the dynamic of the marketplace. How can we link up supply and demand?"

His daughters, on the liberal side of the house, emphasized self-determination. They believe that most people are very creative and, given the opportunity, can solve their own problems. In truth, I think that what the daughters were saying about self-determination was not very far from Joe's, "Talk to your market."

At the time, welfare reform was underway, and I was trying to figure out if there was a way to build skills, to diversify the capital base, and to leverage sustaining resources into the private sector rather than the public sector. Could we, in fact, build self-generating systems of wealth creation that were controlled at the neighborhood level?

"Can't Grant Our Way Out of This"

After six or seven years of doing nonprofit capacity building, three things became clear to me. One was that there is a disconnect between the funders of services and the receivers of services. We had been defining our market as nonprofits, not those they sought to serve. We thought it was important to do something about this disconnect and to hear directly what residents wanted. So, we targeted San Diego's southeastern neighborhoods, moved in, and began extensive "community listening."

Two, there's great potential in harnessing the economic value of land in disinvested communities, so long as you can get its benefit into the hands of the residents. We saw that opportunity existed in blight.

Three, because we were a small foundation at the time, we latched onto the retail leakage in this particular San Diego community. There was about $60 million of retail leakage in a one-mile radius of an area known as the "four corners of death." With the combination of long-term disinvestment and the intersection of gang territories, nobody wanted to do business there. We were thinking, "We can't grant our way out of this," but if we could find a way to capture that $60 million and invest it back into the neighborhood, then maybe we would be on to something.

When we asked people what they wanted, they said, "a grocery store." As a charitable foundation, we never would have been asked to fund the establishment of a food store through normal channels. This idea of listening moved us to create resident teams that involved residents in rebuilding their own community.

Recycling Benefit through Ownership

We ended up developing an abandoned industrial site into Market Creek Plaza, a 10-acre commercial and cultural center planned, designed, built, leased, and operated by residents of the area. We strongly believed that the project needed full community participation and ownership. That ownership became our focus.

By being owner-builder, we were able to capture 70 percent of the construction and service contracts and get that benefit back into the neighborhood. We also found a way to capture over 80 percent of the 200 jobs for local residents.

There is another big piece to Market Creek Plaza worth noting. People strongly felt there needed to be a balance in the project between community benefit and individual benefit. The ownership structure was actually designed around that. For residents, it wasn't all about wealth creation. It was about being able to control land decisions into the future. They had seen how people far outside their neighborhood were making decisions that led to blight. The ownership design also provided for a group to keep its eye on the project staying true to its social purpose and recycling profits back into community benefit.

Through this ownership design, a new investment vehicle was created that we called a Community-Development Initial Public Offering (CD-IPO). Through this public offering, residents were able to purchase shares in the company, giving community stakeholders a 20% ownership stake in the project. An organization called the Neighborhood Unity Foundation was formed by residents, raised its capital from the foundation world, and now owns another 20% of the company. Both groups will receive a 10% preferred return on their investments—recycling additional benefit back into the community.

Last year, Market Creek Plaza did $34.5 million worth of business, recapturing a significant amount of that initial retail leakage.

Maximizing Social Capital

When you're working in an area where people believe change isn't possible, and you don't see visible signs of hope, focusing on human capital is a necessity. One of the best things we did was pay residents, instead of outside consultants, to help do the work. We had very large working teams, and we paid subsets of those teams to implement the work that came out of the planning. The residents were extraordinary problem solvers. They knew their community and what would work. Their expertise was worth every penny. Not only did their involvement through the working teams make for a better plan, it also helped residents build skills and expertise.

We had to get a process moving that would bring neighbors to the table, get people focused on joint action, and inspire people to support local businesses and nonprofit groups. We said, "We're not experts on how to rebuild this community, but work with us and we'll figure it out together." Through the working teams, social networks were formed that are even stronger today. There is a belief system now that change is possible, and the ability to make things happen is right in their own community.

PUSHING TO CHANGE THE ECOSYSTEM

MARIO MORINO, FOUNDER, VENTURE PHILANTHROPY PARTNERS

THE WORK FOUNDATIONS AND SOCIAL ENTREPRENEURS ARE DOING TOGETHER will have repercussions going far beyond any specific current projects. That's because thoughtful change can affect the entire sector.

Let me give you some background about Venture Philanthropy Partners. Today we have $28 million dollars invested across 12 organizations with good, but varying, degrees of success.

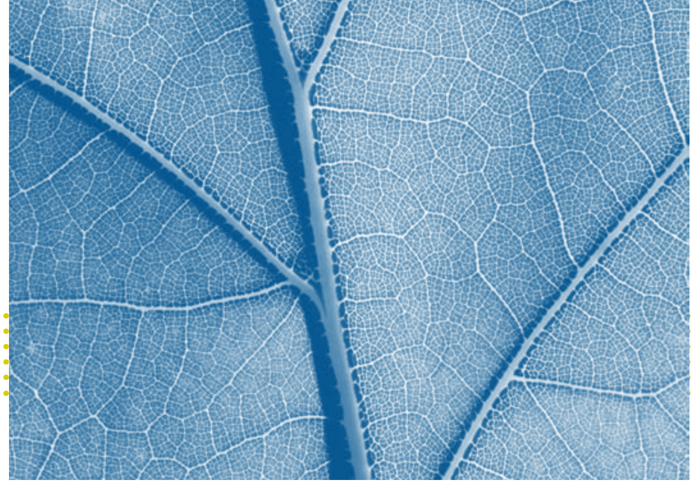
What I don't hear very often is talk about changing the source of the funding. Change has to start with the foundations. We all have to ask: How are we going to change *our* thinking, *our* culture, *our* staffing, and *our* skill set in order to function as an investor in the nonprofit sector?

In 1992, I left the software company I co-founded and decided then to learn what I could about the nonprofit sector. I spent 18 months traveling around, meeting individually with more than 700 individuals from all walks of life. Then, I had another six years of working directly with nonprofits, running our own, and supporting others. It became all too apparent, and please take this as a generalization, that the crux of the problem was the funding itself—philanthropic and public—as it motivated the very behavior and actions that many see as the ineffectiveness of the sector. More challenging, this situation becomes even more severe when nonprofits reach a certain size or scale and find the resources to develop and grow the organization are remarkably scarce or, for some, nonexistent. They get big enough to become victims of a dysfunctional funding system and a weak resource ecosystem.

If you've ever run sales forces or operations, you know money does set behavior patterns. I've seen remarkably competent people take a donor's money and spend it the way they think they need to. Then, they turn and tell the donor that they did everything the donor's way. Truly, a counterproductive, yet understandable, "dance of deceit."

Out of the Comfort Zone

Over the last several years, Venture Philanthropy Partners has demonstrated a theory of how we affect organizations with our investments, and this theory has influenced our investment approach. We get behind the executives and their teams that we have invested in. Then we push and encourage them (we hope, constructively) to move out of their comfort zones. And, when they do, they see better what is possible and have a much better chance to fulfill their potential.



There are many talented leaders working in the nonprofit community who don't have the resources to grow into the true leaders that they could be. The ecosystem doesn't allow or support them to think that way. As funders, we too often don't step up and offer the money they need to grow their organizations for greater social impact. We all know that the greatest asset in the field is not financial capital; it's the human capital talent of the executives and staffs of these organizations.

There are so many wonderful phrases about how to be "business-like," "run like a business," and other classic nonsense. I used some of these myself—a few years back. We all hear the platitudes, but you have to break it down to make it understandable. For instance, it's less about being "business-like," and more about, as author Jim Collins notes, being "disciplined."

There is much talk of the "social capital" funds being raised, with VPP as one of them. And, there really is good progress. But, in the context of the entire sector, it remains extremely small. It has more of an impact by its example than by its numbers.

What I don't hear very often is talk about changing the source of the funding. Change has to start with the foundations. We all have to ask: How are we going to change *our* thinking, *our* culture, *our* staffing, and *our* skill set in order to function as an investor in the nonprofit sector?

MEASUREMENT IN A NON-MARKET

SEAN CLOSKEY, PRESIDENT, TRF DEVELOPMENT PARTNERS, THE REINVESTMENT FUND, PHILADELPHIA, PA

In the traditional for-profit world, there are clear evaluation techniques. They're done through a set of pricing mechanisms. In the nonprofit world the evaluation piece can become a little bit murky.

THE REINVESTMENT FUND was set up about 25 years ago as a community development financial institution, or CDFI. We invest through traditional housing, charter schools, community facilities, and businesses to reclaim and transform neighborhoods. When we go into a community, we keep a few main principles in mind.

First, we have to be *aware*; that is, stay attuned to what we're hearing in the community. Second, we have to be *informed*, which is a step well beyond aware. It means understanding why a transaction happens or doesn't happen, what fails to create a pathway to wealth, and what specific intervention needs to occur. Third, we have to *evaluate*. In the traditional for-profit world, there are clear evaluation techniques. In the nonprofit world, the evaluation piece can become a little bit murky. At TRF, we ask, "How do you evaluate in a non-market sense?"

Gathering and Using Numbers

My first experience with TRF and this evaluation process occurred during the 1990s when I ran a community development corporation, St. Joseph's Carpenter Society, a local home restoration group in Camden, New Jersey. Based on St. Joseph's early success with a few homes, TRF helped the program grow by providing the financing needed to do larger-scale developments. We told TRF that we wanted to gather some data in order to measure the impact of what we were doing in the community.

We did a full inventory of every house in the neighborhood. We attached a value to each house. We noted which houses were vacant, which were in poor condition, and which did not have any visible signs of deterioration. Then, we aggregated them. We learned that the houses in this one neighborhood had a market value of about $35 million in 1992. Four years later, that market value was about $55 million.

Keep in mind that we are talking about one of the poorest communities in the country. In Camden, the real estate market slid 40 percent during the same time the East Camden market—the one that TRF invested in—increased in value by 42 percent. Based on those numbers, we thought, "All right, we're on to something." We definitely have a neat little idea in this one little spot. Next, we asked, "Is it scalable?" And we don't know that yet.

Evaluation is a Circular Process

In the Camden example, our program worked because TRF and its partners had the right infrastructure in place, the right financial capital, and had the balance sheet between the two entities to get the job done. That's the formula we want to replicate, and we need to identify similar circumstances and resources. In essence, we had a working theory of change and now we need to identify investors/partners to advance it.

In the process of action and evaluation, I can get frustrated by the existing allocation process. I think we, or anyone else, are crowding out the field when we stay in line for additional capital when our work is not having the right effect, or we don't even know what effect we are having. You must be aware, take action, and then be reflective and then take action again. Evaluation is a critical part of this process but it is a circular process, legitimated only when action, evaluation, and modification are completed.

When we look at evaluation, one difficulty in this industry is that there's no clear buyer of our services. In traditional market situations, if a transaction satisfies both parties, it is repeated. In a non-market or subsidized transaction, this exchange is less clear. There's the foundation or government entity that's paying for the services, and then there's the actual end user. How do you create a system that can evaluate whether or not you are being a fair steward of those resources for all concerned?

We have looked at what we could do to replicate our Camden work. We deployed patient and flexible capital based on quality market analysis. We believe that this combination of capital, time, and information will actually cause a market to move. We think that we have a solid baseline, because we documented thoroughly when we first got started. We have a clearly delineated set of objectives. Over the next several years, we will continue to go through this process to see what is working, and our evaluations will tell us to go differently or not.

We feel this type of discipline works.

Investment Partners and Trust

I'd like to offer a thought on which is more important: sufficient money or quality people. I think most of us would say that people matter most. But even if you have the right people and they are highly technically skilled, you also need to have partners who act like investors.

It's like going to the doctor. I'm not paying for the doctor to do exactly what I tell him to do. I say to the doctor, "You're the specialist, tell me what approach will make me healthy."

Often, when we're receiving foundation dollars, the foundation says, "I'd like you to do it this way." This type of prescriptive investment is not how market-based investors behave and it is not very helpful in community development. Either you trust the quality that's there or you don't invest with that organization. When TRF is looking for foundation partners, we can show our track record, our processes, and our staffing, and then after that, they have to trust in our investment process.

ENTERPRISE-FRIENDLY PRACTICES FOR MISSION-FOCUSED ORGANIZATIONS

CLARA MILLER, PRESIDENT, NONPROFIT FINANCE FUND, NEW YORK, NY

IN THE FOR-PROFIT SECTOR, as the saying goes, "You lose a buck on every widget but you make it up in volume…" And the joke is, of course, that you'll never make it up in volume. Small losses will simply turn into larger losses when the ill-fated widget business grows. So, you fold the business, learn from the experience, and live to fight (or make cheaper, better widgets) another day.

In the nonprofit sector, the economics are no different, but the rules are. When you lose a buck on every "widget" (i.e., each child you shelter, or home you construct, or scientific breakthrough you make), you don't make it up in volume, either. The difference is that you stay in business, because that's what missions require. More to the point, taking care of vital but unprofitable activities is the nonprofit sector's commercial function as well as its social calling. That's why nonprofits are tax-exempt: it's society's way of acknowledging the need for a private sector that helps fill these gaps, and provides a way for them to be made whole—"profitable," in fact.

If we are asking a nonprofit to do "more," we are asking the nonprofit to build the enterprise. Such an undertaking is long-term—and requires equity-like capital.

Tax-exemption helps nonprofits manage around a basic financial reality. *Any* functioning enterprise, for-profit or nonprofit, needs "profits" or "surpluses" in order to provide good-quality products and service over time. Much of the challenge of managing in the sector is rooted in that reality. Most of the conundrums of growth and effectiveness can be traced there.

What is the "economic proposition" that leads us to have a nonprofit sector? First, the nonprofit sector exists to fix a gap or a malfunction in the for-profit economy. When those gaps are not filled, "civil society" as we know it begins to break down. While there are doubtless many such gaps, here are three generic ones.

First, the nonprofit sector helps provide services (such as shelter, food, medical care) to people who don't have the money to pay for them.

Second, it provides services where qualitative considerations make commercial scale difficult (or impossible) to attain. Think about education. If you have 200 five-year-olds in a class with one teacher you may have a profitable enterprise. However, this would not lead to a quality outcome for the kids. To limit classrooms to 15 or 20 children and hire more teachers would require parents or government to pay more than is affordable. Hence, the commercial flaw: it's either poor quality, or unaffordable. Nonprofit tax status is one of the incentives available to help solve that problem.

Third, the nonprofit sector finds a way to do things that have no predictable commercial return whatsoever—like basic research in science, environmental advocacy, or the civil rights movement—but turn out to be fundamental to civil society.

If the for-profit sector is doing the job, nonprofits ordinarily retreat from the market. Where gaps persist, it's the nonprofit sector's job to fill them, reliably. Often the nonprofit sector can make use of the commercial intelligence and tools deployed by for-profit enterprises—NFF, among others, does so by providing debt financing for nonprofits' growth and operations. Still, the basic commercial assumptions in the nonprofit sector are usually the opposite of those in the for-profit sector. That's why it's so important to avoid mixing up the two.

Built institutions know that the services they provide cost more than they can charge for them. Take Harvard, for instance. Even at a price to each student of $50,000, one year of high-quality education loses—let's say—$200,000 on every student. Harvard employs 400 souls in its development department to work diligently to provide a reliable source of revenue to make sure the enterprise—the platform on which education and research is delivered—is strong. And it took "equity investment" or "build capital" to do it, and proportionally more than a for-profit would need.

The True Capital Gap

George Overholser has illustrated, in his writings and seminal work as founder and managing director of NFF Capital Partners, that the most important capital gap in the nonprofit sector is a nonprofit equivalent of for-profit equity. The nonprofit sector lacks an equivalent of both equity capital (funds used to *build* the enterprise) and the equity investor (people who protect the enterprise from overexploitation). Overholser draws an important distinction between builders and "buyers." Most nonprofits experience only the latter—buyers—in their world.

Nonprofits are surrounded by people who want more. They're people who care passionately about social mission, and they tend to think that doing *more* and doing it *now* is the single most important use of revenue. They—it's really "we"—include government, foundations, the board, the staff and management, and the people receiving services. How can any of us ignore a vulnerable person who needs help today?

All buyers try to exploit, and sometimes overexploit, the "enterprise." If there's a sale at Macy's, I love it that they're selling boots at 25 cents on their dollar of cost. But nobody says to nonprofits, "Wait, that's too low! You're burning people out! If you don't operate based on healthy enterprise principles, you can't stay in business!"

That's where the equity stakeholder comes in.

Equity stakeholders are the ones in the for-profit world who say, "If we keep selling for 25 cents on the dollar, we'll go out of business. Then we won't be around to make money (or social benefit) any more." Equity holders protect the enterprise from overexploitation.

The government, as a buyer of nonprofit services, used to reimburse costs at, approximately, 70 cents on the dollar. In many instances, that number has dropped close to 40 cents on the dollar. Government is the key buyer for people who can't afford services. And most buyers—including foundations, individual givers, managers, service users—don't get too complicated about details.

Compare "The boots are $22.50? I'll take them!" to "You'll keep providing services to abused children even at 40 cents on the dollar? Great, that's so wonderful!" The difference is that, unlike boots, where quality problems are annoying but not fatal, quality of services to vulnerable people—abused children, for example—make a life or death difference.

Thus, the role of the "equity stakeholder" and "equity capital" becomes critical. All of us who would be stakeholders in high performing nonprofits and social enterprises should ask, "Are we conditioning support on the premise that the organization will do something more than they are now? Am I asking them to get better results? Am I asking them to count what they're doing and tell me whether it's effective or not? Am I asking them to protect *more* children from abuse?"

What's Really Needed: More Equity

If we are asking for these "more" things, we are asking the nonprofit to *build* the enterprise. Such an undertaking is long-term, demanding, expensive—and requires equity-like capital. Some growth capital might be in the form of debt (and Nonprofit Finance Fund has long-term experience in providing this kind of debt to nonprofits). But the lion's share must be in the form of equity—in the form of grants—structured to build the power of the enterprise engine.

In the community development context, this need is particularly acute because the government is often the only funder, and sources of additional funds to fill the gap between operating revenue and full cost of services are few. The battle, most acutely, is for "subsidy dollars," not for market share. Put another way, the single most pressing need in our sector is capital to build the capacity of organizations that serve low-wealth communities to *generate reliable revenue* to augment the sub-marginal cost of government contracts. And if we are expecting growth and not just maintenance of existing services, naturally the need becomes even more acute.

Many times, in the excitement about new programs and new approaches, funders provide "buyer" money to do a "builder" job. Almost always this happens with the enthusiastic support of managers, boards, and other stakeholders in the enterprise. That, more than anything else, hollows out nonprofit enterprises just when they are growing. That's the "capital gap" we need to fill, knowledgably, and with tools built on reliable assumptions about the market and business at hand.

NONPROFITS NEED EQUITY, NOT JUST DEBT

JULIUS WALLS, PRESIDENT AND CEO, GREYSTON BAKERY, YONKERS, NY

COMPARED TO OTHER NONPROFITS, at Greyston we've been fairly successful. We've built Greyston Bakery, a business with $6.5 million in annual revenue, we've provided some $30 million of housing for formerly homeless people. We've opened up Greyston Health Services, a health care and housing facility for low income people living with HIV and AIDS. We've opened up a childcare center, for low income families, for up to 80 children. We're working in our community in an intense manner. The problem that we have at Greyston is not providing services. It is scalability.

Funding Obstacles

Here's one of the things we've bumped up against. We'll get funded, and then the funder will say, "We're with you one, two, or three years, and then it's 'see you later.'" The funders go off to find the next new thing. Funding like that is going to determine how well we relate to the marketplace.

I would hate for anyone to walk away from this meeting thinking, "Okay, it could be something other than money." I'm telling you, what's needed is money.

A few years ago there was a term that was used quite often. I don't hear it very much today. It's venture philanthropy. From the grantee perspective, it's another bad word, right after lobbying. Venture philanthropists were these people who came in and told you what to do and how to do it. A number of people took their money and were happy to have it, but they really didn't want the person who supplied the money to be hovering around.

I think there is a chance for a happy medium—donors can come in with some humility that they don't know everything. They know whatever the heck it is that made all those millions and millions of dollars. They don't necessarily know the other pieces. They can provide advice and counsel, not demands.

Clara Miller alluded to how much time nonprofits spend on fundraising. How inefficient is that? After we finished building a $10 million facility for the bakery, one grantmaker asked me if it was replicable. I said, "Well, yes, but only if you already have the bureaucracy that we have built." It took us a significant amount of energy and time pulling together our 11 funders, and this effort has to be accounted for somehow.

When I say funders, some were grantors, but grants were the smallest part of how we reached $10 million. The vast majority was debt. We had one guy walk out on us the day before closing and we had to close that gap in one day or the whole thing would fall apart. It did fall apart. We got it back together and we're still standing, but we are saddled with a significant amount of debt. Our mortgage prior to moving into the new facility was $50,000 per year. Now it is $50,000 *per month*. Now we're looking at that $50,000 per month for the facility and seeing that we are no longer able to dividend at the previous rate to do the other work that I mentioned earlier.

"We're Not Allowed to Fail"

When we talked to funders interested in Greyston, we had to tell them about all the success we planned to have. There was very little conversation about the possibility of failure. If we fail, the house of cards would tumble down. It wasn't just Greyston Bakery and our 50 jobs; it would include the rest of the Greyston Foundation because of the cross guarantees required by the lenders. If the bakery fails, we lose the housing, we lose the childcare center, we lose the healthcare center. We would lose everything that we have built.

So I had a conversation with my employees. I told them, "We're not allowed to fail." If we fail, who is going to come into this community and establish a business, hire people, give them an opportunity to learn and grow, and give them the opportunity to be the employees running this business? In the height of our season we'll have 65 employees. Of those 50 or 65, only seven of us were hired from the outside. Everyone else was hired at entry level, given the opportunity to train, learn, grow, and become leaders in our business. That's how we have become successful.

So, the other kind of capital that is an opportunity for us is our employees. At Greyston Bakery we lost three quarters of a million dollars in 2005. We then had a conversation about how we need to figure this out. Quite frankly, the employees figured it out. I get a lot of credit for figuring it out, but they figured it out. We went from a three quarters of a million dollar loss to a $180,000 profit in 2006. In the middle of that we gave a $300,000 price reduction to our number one customer. In all, it was a $1.2 million dollar turn around. The employees understood what we needed to do.

A lot of our success has been because of our employees. What I hope to do is continue the growth of the organization so that they can see more of a benefit than simply saying, "I have a job today." How do we, one day down the road, get these valuable employees to an equity position at the bakery, in their home community?

The Bottom Line

Bill Shore once said "that we nonprofits get credited with doing a lot with very little. The truth is, we can just do a little with a little. What we need is a lot *more*." Everything we're going to talk about besides money is just going to come back around to money. I would hate for anyone to walk away from this meeting thinking, "Okay, it could be something other than money." I'm telling you, what's needed is money. We need equity, not just debt. That's how it works in the general capitalist market. That's what we need in the nonprofit sector as well.

THE TRUTH ABOUT NEW VENTURES

GEORGE GENDRON, DIRECTOR, INNOVATION AND ENTREPRENEURSHIP PROGRAM AT CLARK UNIVERSITY, WORCESTER, MA, AND FORMER EDITOR, INC. MAGAZINE

WITH MY STUDENTS, I often talk about what makes a successful entrepreneurial venture. Uniformly, they believe that there's one formula. They think you go out and find a really cool, proprietary idea. They think that you create an elaborate business plan, and then go raise $10 million dollars in private equity. Once this is done, they believe, they will be guaranteed success.

The truth is, each year in the United States about one million new ventures are launched. In a really good year, about 3,000 of them are recipients of institutional venture money. Only a very small percentage of all companies, including the companies that go on to become the AOLs of the world, are recipients of venture money.

The overwhelming majority of companies, even the companies that go on to become household names, are started up with unbelievably modest amounts of capital. Usually it's $10,000 or $20,000 from personal savings and family friends. New businesses are often not ready for private equity until they're seven or ten years old, if at all.

As for having a really cool or original proprietary idea, almost all successful American entrepreneurs in the country will say their original idea was mundane. They'll tell you the business succeeded because of superior execution and market adaptation. They took a pretty ordinary idea, got it to market, responded to the market, and over time—not through any large scale innovations but lots of minor modifications—ended up producing an original and proprietary business.

Eighty percent of successful business owners also report they had no business plan at all. They knew they wouldn't have access to institutional venture money, so why bother doing a plan? The point is that the most extraordinary companies that do manage to scale, and do manage to replicate, come from unbelievably humble origins. They do not start off with a blueprint that looks anywhere near what AOL looks like today, or Microsoft, or Apple. This pattern repeats itself over and over again, and has from 1980 on and really hasn't changed. The real key to success is superior *execution* and very rapid *adaptation*.

Remember, only a tiny fraction of successful companies ever scale. It requires an incredible confluence of the right idea, the right team, and at the right time. I would just be careful not to be too glib about scaling as if in fact it is an every day occurrence.

Success is Fueled by Not Succeeding

We now know some things we didn't know 20 years ago: the for-profit sector is largely driven by entrepreneurial companies, and it is fueled by failure.

Observers from other countries who come here to observe our economic model often come away scratching their heads, bewildered by how unbelievably elegant and simple it is. We make the system really easy to enter and really easy to exit. I say easy to exit and that's because it is very important to understand that failure in the entrepreneurial arena often carries no financial penalty whatsoever. The vast majority of businesses don't succeed, and yet the economy doesn't classify them as failures. According to an economist, a failure is a business that goes out of business owing people money. Not all of them do.

There are only about 35,000 bankruptcies a year and yet there are about a million businesses that go missing in action every year. Those, the missing, are what economists call closures. In some cases the business, has achieved breakeven but the toll is too great on the human talent to keep it alive, and those companies close the business without owing anybody money.

In a way, the U.S. economy is one huge market test. You'd be astonished by how many people come back for a second, third, fourth, fifth time. Since 1980 *Inc.* magazine has published a list called the 500 Fastest Growing Companies in the United States. We found that more than half of the 500 companies succeeded after two prior failures.

My point here is simply to restore a sense of context about the fact that when we take a look at fully materialized projects, I suspect that if you went back and reverse engineered them they, too, had very humble origins. In the retelling of these success stories we inadvertently create the impression that they are overnight sensations. Most of these success stories took enormous patience and decades of time to build. If we bring in 30 successful entrepreneurs who were in an early stage and you guys had an opportunity to listen to them, you would hear exactly the same conversation you heard this morning.

Remember, only a tiny fraction of successful companies ever scale. It requires an incredible confluence of the right idea, the right team, and at the right time. I would just be careful not to be too glib about scaling as if in fact it is an every day occurrence. Just a cautionary note.

Also, we should be careful in understanding what constitutes "small." Ask a private equity expert to give you a definition of a small company and you will hear, "maybe $100 million or $200 million." Most of the infrastructure out there is not made to support early stage companies. They're very much on their own; they end up substituting imagination and resourcefulness for financial capital.

In the end, what I'm saying is that we should understand that the genesis of great social ventures and great for-profit businesses have a lot more in common than we've been led to believe.

INVESTING IN THE NEXT "COOKIE IDEA"

Museums have gift shops, Goodwill has thrift shops, Paul Newman sells salad dressing, and Girl Scouts sell cookies. It's likely we will see an increasing number of nonprofits try out their own market-based strategies, all in the name of finding new revenue streams that will help further their humanitarian or educational missions.

Grantmaking foundations, corporations and individuals are becoming increasingly involved as well, by investing in and otherwise supporting the market-based strategies of nonprofits. These funders are, in many ways, pioneers. By sharing their real-world lessons learned, they encourage others in philanthropy to tap into the powerful potential of using grant money this way. As the discussion from the convening indicates, grantmakers are in a unique position to foster innovation and impact.

Sean Closkey of The Reinvestment Fund can tell you how business-minded data gathering and evaluation led to one low-income housing program's success and the revitalization of a community.

Clara Miller of the Nonprofit Finance Foundation can tell you how traditional funding strategies can be refocused and repurposed to support the building of the nonprofit enterprise.

Jennifer Vanica of the Jacobs Family Foundation can tell you about maximizing a community's social capital when other kinds of capital are hard to find.

And Julius Walls of Greyston Bakery can tell you about risk—and how funders can strengthen an organization by playing a role in managing risk absorption.

Community Wealth Ventures looks forward to engaging the grantmaking sector and finding ways to share more of these experiences and facilitate new collaborations. Let us know if we can help you move forward with your own "cookie idea."

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