

Some nonprofits are not only thinking about the unthinkable, they're doing it – running a profit

By Jerr Boschee

Reprinted, with permission, from the March, 1995, issue of Across the Board, the magazine of The Conference Board

John DuRand had been running a traditional rehab center and sheltered workshop for more than a decade. On a sunny April evening in St. Paul, Minn., he asked his 11 senior managers to meet with him at a nearby hotel. He served them wine and cheese. Then he fired them all.

A few moments later he passed out applications. "Starting tomorrow," he said, "we no longer have clients or patients -- we have employees. Starting tomorrow we are no longer clinicians -- we are business people. Starting tomorrow we are no longer a rehab organization -- we are a business. If you can get your minds and hearts and souls around that change, I want you back. If you can't, I'll understand and I'll help you find new jobs."

DuRand had become convinced that the best way to enhance the self-respect of the people he employed was to give them more respect. That meant establishing work conditions typical of a corporation (normal work hours, the use of appropriate technologies, and so on), market-driven benchmarks -- he actually began firing mentally retarded employees who didn't perform -- training and development programs, competitive wages, bonus plans, and career tracks.

Nine of the 11 senior managers stayed, and today Minnesota Diversified Industries is a \$14 million nonprofit business with more than 50 corporate clients, 750 employees, and five plants throughout the state.

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Six hundred miles away, in the small Missouri town of Rolla, Margaret Cossette faced a different challenge. Starting with a \$4,000 grant in 1975, she converted a tiny public-sector program into a healthy nonprofit by providing an alternative to nursing-home placement for elderly people in rural communities. She grew from 16 initial clients to more than 1,000 -- but came to a crossroads in 1983.

For the first time, Medicaid dollars became available to pay for her services, but Missouri Home Care did not have the cash reserves to ramp up for hundreds of additional customers. When she went to her local bank for a loan, the bankers turned her down flat: no assets.

For a year, Cossette and her board of directors wrestled with alternatives. She could ignore the thousands of additional people who now had a source of revenue for her services, but that offended her sense of mission. She could ask her board members for personal loan guarantees, but they were reluctant to give them, and she didn't want to ask for them anyway.

Or she could convert to for-profit status.

"We agonized for a year," she says. "We knew we could continue to do the job if we abandoned our nonprofit status -- but could we continue to care?" Her comment reflects a common concern among social workers about the potential rise of a two-tiered service system, one that serves only those who can pay and ignores those most in need.

Taking the plunge, Missouri Home Care made the transition in 1984, and within weeks the bank changed its mind about the loan. The company, now serving more than 2,000 clients in 35 rural counties, has sustained seven straight profitable years. Revenue surpassed \$6.7 million last year; in 1993, 63 percent came from Medicaid patients. State officials frequently ask Missouri Home Care to step in and take over for other contractors, and it now employs more than 450 home-care aides who provide assistance with the activities of daily living, such as cleaning, cooking, and personal grooming. Many of the aides are farm spouses working 20 to 25 hours a week to supplement their incomes.

TACKLING THE TOUGHEST CHALLENGES

Traditionally, nonprofits have viewed the mixing of profit motives and moral imperatives with suspicion, even horror. But the challenges facing social-service providers today are daunting: Costs are escalating, resources are diminishing, and the number of people in need increases daily. In 1977 the average nonprofit had more than 27 percent of its annual operating funds in reserve; by 1989 the margin had dropped to 1.4 percent, according to INDEPENDENT SECTOR.

So, out of necessity, fears are dissipating; nonprofits increasingly are run by people with backgrounds in management rather than clinical work, and they increasingly resemble the corporations that help fund their work.

And social entrepreneurs such as DuRand and Cossette have begun adopting strategies that enable them to make services available to additional people -- and simultaneously make their organizations increasingly self-sufficient.

The ventures started by social entrepreneurs typically fall into one of two categories:

- * An "affirmative business" such as DuRand's is created to provide real jobs, competitive wages, and career opportunities and ownership for people who are disadvantaged, whether it be physically, mentally, economically, or educationally (affirmative businesses employ people who are mentally retarded or mentally ill, visually or physically disabled, recovering substance abusers, present and former convicts, members of inner-city minority groups, and others; the portion of employees who are disadvantaged is typically 60 percent or higher)
- * A "direct-service business" such as Cossette's is kids, battered women, recovering drug addicts, potential high-school dropouts, hard-to-place foster children, people who are terminally ill.

Some of the businesses started by social entrepreneurs are for-profits; some are nonprofits. Some are freestanding, some subsidiaries. But almost all of them emerge in some way from the nonprofit sector -- and they tackle some of the toughest and most intractable challenges around.

There have been failures--most often when a nonprofit starts a business it knows nothing about rather than building on its core competencies. But social entrepreneurs typically have one advantage over more traditional entrepreneurs: They are starting with programs already in place rather than something new.

In fact, the implications of entrepreneurship for nonprofits are considerable. Adopting entrepreneurial strategies enables an agency:

- * To analyze each of its programs -- and its entire portfolio -- from the perspectives of both mission and money
- * To focus on its most effective and needed programs, a strategy that leads it to dramatically reallocate its resources; to explore uncomfortable tactics such as collaboration with its competitors; and to do what Peter Drucker says is the toughest thing any nonprofit ever has to do -- kill a program
- * And, eventually, to become less dependent on government subsidies and corporate and individual philanthropy

This is not to say these nonprofits are abandoning their missions. If a nonprofit is the best or only provider of a critically needed service, regardless of its financial consequences, social entrepreneurs will continue to provide the service, even if it loses money. But they will try to balance that money-losing program with a second or a third program that generates excess revenue and makes the organization as a whole self-sufficient.

CAPITALIZING ON UNIQUE ABILITIES

The basic challenges faced by social entrepreneurs differ according to the type of business being started. Affirmative-business entrepreneurs must compete in the marketplace against companies that do not employ people who are disadvantaged; direct-service entrepreneurs must survive in a skewed market where the people receiving services (the clients) are usually not the people paying for them (the customers).

DuRand and others (the Affirmative Business Alliance of North America, an affinity group created in 1989, has more than 40 members) have proven that it is possible to operate successfully while employing the disadvantaged -- but only if the first priority is to run a viable business rather than a rehab agency. "Unless we can be profitable," DuRand says, "we won't even be around to argue the issue. It's the only way for us to grow -- and growth is the only way to create jobs for more and more people."

On the surface, affirmative businesses appear to be starting at a competitive disadvantage -- employees either have no work experience or are limited by their disabilities. But the pioneers in the field have been successful for two primary reasons: They refuse to underestimate their workers -- and they are doggedly market-focused.

Fundamentally, they are challenging their colleagues in rehab agencies and sheltered workshops to stop searching only for work their clients are already capable of doing, urging them instead to analyze the market, to find the most pressing needs, and to train their employees to meet them. The most successful among them are especially adept at redesigning a job's components to capitalize on their employees' unique abilities. For example, mentally retarded workers are particularly effective at performing repetitive tasks, frequently out-producing people who are bored more easily.

As for direct-service entrepreneurs, the gulf between clients and customers has long daunted social-service providers. But social entrepreneurs have repeatedly demonstrated an ability to identify and attract appropriate sources of third-party payment, ranging from government fee-for-service contracts (as opposed to government subsidies) to family members, insurance companies, corporations, and others.

Generally speaking, companies have become involved with social entrepreneurs in at least three ways:

- * They have turned to social entrepreneurs able to offer competitive services that help them improve productivity: Affirmative businesses have provided a new source of contract labor for tasks ranging from manufacturing and packaging through temporary-help and janitorial services; and direct-service businesses have helped human-resource departments provide employee-assistance programs and a wide range of specific services, including home care for the elderly parents of employees and rehabilitation programs for employees suffering from substance abuse
- * Corporate foundations have provided grants to support business development efforts by local nonprofits, reasoning that the corporations themselves cannot exist in a sick society -- and viewing affirmative and direct-service businesses as ways to rebuild their communities' human infrastructure
- * And, third, loaned executives and other volunteers have played significant roles in helping to plan and expand specific businesses, both through direct involvement by individual employees and through programs such as the National Executive Service Corps or the National Retiree Volunteer Center

Still, there are some in the corporate community who remain vaguely uncomfortable with the idea of social entrepreneurship. Somehow, making money seems to run against the historical grain of "nonprofit" activity. Does entrepreneurial success disqualify a nonprofit from future philanthropic support?

Most corporations have clarified the issue by distinguishing between the social-purpose business ventures and the organizations that spawn them. The businesses themselves no longer qualify for philanthropic assistance (although they may be the recipients of loans or seed capital), but the parent organizations are another matter. One of the greatest benefits of a successful entrepreneurial enterprise is the subsequent tendency for entrepreneurial principles to migrate from the venture to the parent. This leads in turn to a more effective, more efficiently run parent -- qualities held in high esteem by corporate funders as they search for ways to meet ever-increasing levels of human-service needs.

Starting a social-purpose business venture is not an easy task -- and it's not an appropriate strategy for every nonprofit. Nevertheless, the twin carrots of mission and money are attracting an increasing number of social entrepreneurs, and, when it works, everybody wins: The nonprofit involved becomes increasingly self-sufficient, more clients are served -- and the pressures on public and private subsidies are eased.

"There are so many problems out there," says DuRand, "so much for us to do. It's like sitting down at a table to eat an elephant -- the task just seems completely overwhelming.

"So there's only one thing to do. Sit down and take the first bite."

EIGHT STORIES: KEEPERS OF THE FLAME

Social entrepreneurs are typically nonprofit executives who pay close attention to market forces without losing sight of their underlying missions. The first four of these eight examples are affirmative businesses; the rest are direct-service businesses.

A BRONX TALE: Cooperative Home Care Associates

Nine years ago, Rick Surpin and his colleagues at a South Bronx community-development agency were facing a double whammy: They were trying to create permanent jobs for hard-to-employ Black and Latino women in their community -- and they were trying to do it in an industry with a reputation for low pay, high turnover, and inconsistent service.

Despite the obstacles, Cooperative Home Care Associates has grown from a startup to a \$5 million business employing about 300 women. The company provides home health-care services for people who are elderly and disabled, and it offers employees full-time jobs with above-average pay and benefits, career mobility, and profit-sharing. Wages, among the industry's highest, average \$7 per hour for new workers and \$8 for veteran workers, with annual bonuses ranging from \$200 to \$500. Six of the 10 seats on the board of directors are held by elected employees.

The company won the National Business Enterprise Trust award in 1992 and is expanding to four other cities.

AN OLD SAINT FINDS PROFITS: St. Vincent de Paul Rehabilitation Service

Charlie Graham took over a sheltered workshop in Portland, Ore., a decade ago and converted it from a \$1 million workshop 80 percent dependent on grants and other subsidies to a \$10 million nonprofit business generating 90 percent of its revenue from earned income.

Graham's first act was to redefine the organization's mission, shifting its focus from "creating jobs for people with disabilities" to "offering the highest quality products and services for customers."

Today St. Vincent de Paul Rehabilitation Service employs more than 600 people who have a broad range of physical and mental disabilities. The company provides temporary- and permanent-employment services for business clients (about 40 percent of its revenue) and industrial sub-contracting (manufacturing, assembly, packaging, and distribution -- about 45 percent of its revenue). Among other things, the company fabricates original metal and precision wood products; performs electrical soldering; and provides complete mailing-and-literature fulfillment services.

THE RECOVERY IS UNDERWAY: Delancey Street Foundation

In San Francisco and four other locations, Mimi Silbert has built a multi-million dollar organization utilizing only recovering drug addicts and former convicts. Residents live at Delancey Street for two to three years, run and operate the nonprofit's many small businesses/training schools, and are required to learn at least three marketable skills.

Delancey Street has taken not a dollar of government support since John Maher founded the organization in 1971. Maher, himself an ex-convict and ex-addict, started with \$1,000 borrowed from a loan shark. Silbert joined him shortly thereafter, becoming co-president in 1973, and has been the senior executive since Maher died of a heart attack in 1987.

Delancey Street considers itself a recycling center for people defined by society -- and themselves -- as rejects. More than 60 percent have been addicts for more than 10 years, 70 percent are multi-drug abusers, and 30 percent are alcoholics. The average resident has served five years in prison and returned to prison three or four times. Despite the residents' violent backgrounds, Delancey Street has never had an incident of physical violence, and no resident has ever been arrested. Approximately one-third of the residents are black, one-third Latino, and one-third Anglo; one-fourth of the residents are women.

During the past 24 years, more than 10,000 people have "graduated" from Delancey Street to permanent jobs, including lawyers, realtors, sales people, truck drivers, mechanics and garage owners, and general plumbing and electrical contractors, as well as many in trade unions, printers and business managers, a member of the San Francisco Board of Supervisors, and even a deputy sheriff.

Delancey Street's training schools/businesses generated about \$6.5 million in revenue last year, its residents' sole means of support. Training schools/businesses include a restaurant and catering service, car repair and maintenance, Christmas-tree lots, construction, a moving company, a print shop, and a craft shop. More than 1,000 people are in residence at any given time, about 500 in San Francisco and the rest in New York, New Mexico, Los Angeles, and North Carolina.

WORKING IT OUT: American Works

During a decade of operation, America Works has placed more than 5,000 welfare recipients into permanent jobs. The company pays, trains, and supervises workers through a probationary period within a client business and is paid through a combination of government funds and fees from the businesses themselves.

America Works is the brainchild of a husband-and-wife team, Peter Cove and Lee Bowes, who developed the model as a nonprofit demonstration project funded by The Ford Foundation in the late 1970s and early 1980s, then spun it off into a free-standing, for-profit business in 1984. The company currently operates in Hartford, Conn., New York City, Indianapolis, and Albany, N.Y. Revenues for 1993 were \$5 million.

All contracts for America Works are performance-based: The company is paid (about \$5,300 in New York) only after the client has completed a four-month probationary period with an employer and three additional months on the company's payroll. For its fee, America Works estimates that it saves taxpayers a substantial portion of the approximately \$23,000 per year it costs to keep a mother and two children on the New York welfare rolls. The average client has spent at least five years on welfare -- but more than four of every five clients who complete the America Works program are still in their jobs at the end of the first year. Companies save about \$2,500 per hire.

GOURMETS TO GO: Bidwell Food Services

Four years ago, Bidwell Food Services was a break-even, in-house cafeteria program run as a not-for-profit by students in the culinary-arts program at the Bidwell Training Center in Pittsburgh.

Founded during the 1960s by the Presbyterian Church to help inner-city, economically disadvantaged residents develop competitive job skills, primarily for the construction and manufacturing industry, the

training center shifted its focus after Bill Strickland arrived as executive director in the 1970s. Pledging to concentrate on customized job training that reflected "the new Pittsburgh," Strickland led the agency into areas such as health care, data processing -- and food service.

As Bidwell's cafeteria program grew, so did its reputation for preparing gourmet meals -- and soon local consumers and institutions were asking the training center to cater their special events. Realizing they had a burgeoning business on their hands, Strickland and his staff converted the program into a wholly owned, for-profit subsidiary with sales exceeding \$1.5 million -- and this past summer, Strickland received the national Community Entrepreneur of the Year award from Partners for a Livable Community.

The company manages food services and catering contracts for a number of large, institutional clients, including the Carnegie Science Center, where it defeated Marriott's food-service business in competition for a five-year contract. Fifteen percent of the employees are economically disadvantaged women and minorities who are graduates of the training center's culinary-arts program.

CRUISING THE MALLS: American Red Cross, Kansas City

Throughout the 1980s, the Kansas City chapter of the American Red Cross found itself becoming increasingly marginalized in the public eye, partly because the buildings containing its services were located in sites that worked in the 1950s and 1960s but were no longer appropriate. As a result, only about 200 people a month came to each of the eight Red Cross service centers.

Then, in 1987, CEO Jim Monahan decided to start a retail store in one of Kansas City's perimeter shopping malls: The store would sell mission-related safety equipment and stimulate heightened community awareness, which would lead to increased donations of dollars and more traffic in the service centers.

The first store opened in 1990. Today there are three of them, all profitable, in three separate malls. Thirteen times as many people are visiting the service centers (an average of 2,700 per month per center) -- and the model is being duplicated by Red Cross chapters in other cities.

AN ALTERNATIVE FOR DROPOUTS: Ombudsman Educational Services

Two of the very first social entrepreneurs in the direct-service arena were Jim Boyle and Lori Sweeney of Libertyville, Illinois. Boyle spent 17 years as a teacher and administrator in the Illinois public school system and became increasingly frustrated because the schools were either unable or unwilling to help potential dropouts -- more than 50 percent of the children who start ninth grade in the Chicago public schools fail to graduate. Finally, Boyle and Sweeney, a teacher with considerable business experience, decided to open an alternative learning center -- and today 37 of them operate in seven states.

No new taxpayer dollars are needed to support the centers because the students involved have not yet dropped out of the school system. School districts retain whatever tax dollars the state allocates to them and use some of those dollars to pay for the services of the company.

Ombudsman Educational Services offers individualized programs in basic subjects such as math, reading, social studies, and science. In order to stay in the program, students must demonstrate mastery in each subject, and roughly 85 percent of the students do so -- meaning that the dropout rate for participating school districts has been substantially reduced.

The company exceeded \$4 million in revenues last year and has been profitable since its founding in 1975.

A FINAL GESTURE: Vitas Health Care Corp.

One of the more financially successful social-purpose business ventures started in 1976 when Hugh A. Westbrook, a minister, and Esther Colliflower, a nurse teaching at a Miami community college, developed an innovative curriculum in death education and started a hospice. They set up their first office in the basement of a church and started without any capital except sweat equity.

Today, Vitas Health Care Corp. is a \$150 million business offering palliative care for people who are terminally ill. The company has provided hospice services to more than 75,000 people and currently serves patients in nine states.

Most of the patients are visited regularly in their homes by an interdisciplinary team composed of a doctor, nurse, certified home-health aide, social worker, chaplain, and volunteer. Helping patients cope with both physical and emotional pain is typically the goal. For more complex cases, a patient may be admitted to one of the company's home-like inpatient facilities, where visiting hours are unlimited, surroundings are friendly, and families -- even pets -- are allowed to stay.

Although the company was initially structured as a nonprofit, Westbrook and Colliflower insisted it be run like a business, generating enough income from operating revenues to be financially sound. They also worked hard to enact key legislation. In 1979, Westbrook helped write and gain passage of legislation licensing Florida hospices. In doing so, he was a leading figure in establishing the first -- and still used -- standards of quality for the care of people who are terminally ill. That effort led three years later to passage by Congress of Medicare reimbursement for hospice services nationally -- and shortly thereafter Westbrook converted the business to for-profit status, primarily to secure the venture capital needed for expansion.