

A. Charity or Tax-Exempt Business? Sustainability through Social Enterprise

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Yes, But Can You Sustain it?

Getting Started on Social Enterprise

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Social Enterprise Ventures



Founded in 2006.
National training
company.
Social enterprise trainers
since 2003.

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What is Social Enterprise?

- It is **unrestricted renewable** income that creates the path toward sustainability and enhances your mission.
- It is generated through sales, payment for services or other business opportunities.
- It is yours to use as your organization sees fit.
- It should not replace fundraising – it is a new tool in your organizational tool kit.

More Money = More Mission!

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- It's not about turning your nonprofit into a business....
- It's about applying sound business principles to your tax-exempt business.



Traditional Funding

- Grants, special events, donations, sponsorships, etc.
- You work hard to get it, use it up and have to go back for more.
- There are strings attached: grantors require reports to ensure you have met their funding requirements, donors at a special event want to have a good time, enjoy the food, etc.
- Traditional funding is usually restricted in some way.



Myths about Social Enterprise

- Nonprofits can't make a profit. *You do now – you just aren't paying taxes on it!*
- It's a quick fix – *We can do this tomorrow.*
- If we earn money, we will lose our nonprofit status – *Nope. Not likely.*
- What if we have to pay tax? *Well, what if?*

Why Consider Social Enterprise?

The funding marketplace is changing:

- Corporate giving is now directed toward investing for the long term rather than buying tables for one night!
- Government funding is diminishing and being redirected.
- Donors are tired of giving to organizations that operate with a poverty mentality.

What does this mean for your agency?

- It means a shift to earned income instead of relying on a "hand out."
 - **Nonprofit is a tax designation, not a business plan!**

Assessing Organizational Readiness

- Board and Staff leaders are willing to invest in change from *charity-think* to *sustainability!*
- Board and Staff are open-minded.
- Board and Staff create a dedicated team to learn social enterprise.
- Board and Staff are willing to invest the time and dollar resources into learning social enterprise.

Typical Outcomes

- Fundamental and systemic changes in the way you manage your nonprofit business.
- A business plan for an earned income social enterprise venture.
- Enhancement of current programs and services by providing value added benefits that create new income sources from new payer markets and customers.
- An objective method to evaluate current and future programs, services and income opportunities.



What is Involved?



We have learned that seven basic skills are involved in the journey to become a successful social entrepreneur.



The Steps and Skills

- 1 – Organizational Focus
- 2 – Assets and Opportunities
- 3 – Market Research: The Customer(s)
- 4 – Market Research: The Competition
- 5 – Costing and Financing
- 6 – Sales Planning
- 7 – Business Plan



Let's Get Started on the Road to Sustainability!

Start With a Common Understanding of the Basics

Step 1 - Organizational Focus

- **Mission, Vision and Core Values** - *The groundwork for social enterprise.*
- **Internal and External Forces** - *What motivates your organization to develop earned income?*
- **Mission and Dollar Goals** - *How will you measure success?*
- **Stakeholder Communication** - *Who are they? What are their concerns? How will you communicate with them?*

Exercise – Driving Forces

Internal Forces:

- 1.
- 2.
- 3.

External Forces:

- 1.
- 2.
- 3.

Exercise – Expected Outcomes

Mission Outcomes

- 1.
- 2.
- 3.

Dollar Outcomes

- 1.
- 2.
- 3.



Who Should Be Involved?

- Board – oversight is critical
 - Discussion
 - Board committee
 - Board vote(s)
- Key management staff
- Legal counsel
- Outside consultant(s)
- Other stakeholders

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Exercise – Stakeholder Communication

Page 7 from Road Trip© Workbook

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Build an Inventory of Assets

Step 2 – Asset Inventory

- Core Competencies
- Physical Assets
- Technical and Knowledge
- Relationship Assets

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Core Competencies

What You Do Extremely Well (e.g. your products and services)

Example: The Red Cross responds to disasters in two hours. That response is a product or service. The core competencies include volunteer management, fleet management, communication, supplies management, etc.



Physical Assets

What You Have That is Underutilized

Example: A community action agency has its offices in a large building, one-half of which is vacant. The vacant building is considered a useable physical asset. Consider things you have with excess capacity: land, buildings, vehicles, equipment, etc.



Technical & Knowledge Assets

What You Know (e.g. training)

Example: A community action agency slightly modifies its financial literacy training for the for profit sector. Identify what you and your staff and volunteers know that others might want or need.



Relationship Assets

Who You Know That Can Help With Social Enterprise

Example: An advocacy agency has strong relationships with local and federal legislators. Consider who you know that can help you in the future.




Exercise – Identify Your Assets

Page 10 from Road Trip© Workbook



Set Objective Evaluation Criteria

- Set parameters to evaluate potential earned income opportunities.
- Narrows the field to serious potential opportunities.
- Prevents WHO HOO!




Example – Objective Criteria

- Fits with mission, vision and core values.
- Will have less than \$_____ start up costs.
- Will have no impact on current staff.
- Won't detract from current programs and services.
- Will enhance agency image.
- Has income potential of \$_____ within _____ years.
- Allows for collaboration with other agencies.
- Demonstrated customer interest based upon defined market research.
- Starts with something we already do and know.
- Builds organizational capacity to deliver more services.
- Has demonstrated growth potential.
- Is not dependent on volunteers.
- Has no initial capital investment.

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Exercise – Criteria

How Will You Evaluate Opportunities? Develop Your Criteria Now

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Brainstorm Opportunities

Leverage Your Assets into Earned Income

- Service Opportunity
- Knowledge Opportunity
- Product Opportunity
- Employment Opportunity
- Unrelated Venture Opportunity

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Service Opportunities

Delivers a Service to a Current or a New Market (nonprofit or for profit)

Example: A human service agency bundles current and new programs for seniors, promoting to their adult children and caregivers.



Knowledge Opportunities

Delivers Your Knowledge to Current or New Markets (nonprofit or for profit)

Example: A CAP agency modified financial literacy training program for small businesses.



Product Opportunities

Produces or Delivers a Tangible Product to Current or New Markets

Example: A food bank expands its product line to include non-food items.



Employment Opportunities

Provides Employment to Current or Future Customers or Clients

Example: An agency serving persons with disabilities expands its greenhouse program into the organic market.



Unrelated Venture

May or May Not Be Related to Your Current Assets

Example: An agency brings its car donation program in house, expands into the wholesale and retail car market.



Does the Venture Fit Your Mission?

- Review your organization's mission
 - Articles of incorporation purpose statement
- Analyze the mission of your proposed venture
 - Does it fit within your CAA's mission?
 - Does it support your CAA's mission?
- Consider effect of venture on your CAA's mission
 - Does it support or detract from your CAA's mission?
 - Nonprofit CAAs must be organized and operated primarily for 501(c)(3) purposes
 - Limited amount of unrelated activity permitted – too much can lead to loss of exempt status

Does the Venture Fit Your Mission? (cont.)

- Must serve public, rather than private, benefit
- No "private inurement"
 - Transactions with insiders must be at fair market value (FMV), negotiated at arm's length
 - Compensation paid to insiders for services must be reasonable
 - Be alert for conflicts of interest (especially with insiders) and follow IRS rules (26 U.S.C. § 4958) and other applicable rules to address them

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Evaluate Opportunities

- Rank and score the opportunities.
- Use objective criteria.
- Select those with highest initial potential to reach mission and dollar goals.
- Begin Market Research & Feasibility.

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Exercise – Rank & Score

Page 19 from Expedition© Workbook

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Market Research & Feasibility

Step 3 - Venture Market Research Part 1

The Customer(s)



Market Trends

- What affects your agency now?
- What trends do you foresee?
- How can you capitalize on the trends?
- Question – what market trends will affect YOUR future?



Target Market Planning

- How large is the target market?
- Who will **pay** for the venture?
- Who will **use** the venture?
- What motivates the *Buyer?* The *User?*
- Buyer profiles and User profiles



Push vs. Pull

Are you **PUSHING** or **PULLING**?



Features vs. Benefits

Benefits – Defined by the customer.

Features – How you deliver the benefits.



Exercise- Features vs. Benefits

Bilingual Counseling

- Features?
- Benefits?

Coffee Shop Run by Clients

- Features?
- Benefits?



Competitive Analysis

Step 4 - Venture Market Research Part 2: The Competition



Direct Competition

- A nonprofit or for profit that offers the same product, services, or programs.
- Who is your competition today?



Indirect Competition

- A nonprofit or for profit that competes for your target market's money.
- Who is your indirect competition today?



Strengths & Weaknesses

- What makes your competition great?
- Where are they vulnerable?



Competitive Advantage

- What makes you different from or better than your competition?
- What is your competitive advantage?



Step 5 - Costing, Financing and Tax/Legal Issues

Costing Analysis

- Define All Costs
 - direct
 - indirect
 - variable
 - fixed
 - start up
 - recurring

Break Even Point

Break Even Point = *Profit Margin!*

Financing Options

Explore Financing Options from Banks,
Nonprofit Lenders, Foundations.

Unrelated Business Income Tax (UBIT)

- Tax on income from regularly carried on trade or business that is not substantially related to organization's tax-exempt purposes
 - Report annual amounts of unrelated business taxable income over \$1,000 on Form 990-T (available to public)
 - Tax on gross income, minus allowable deductions

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UBIT

- Too much unrelated activity can jeopardize tax exemption
 - Even if no income generated or no taxes owed
- If activities are unrelated, engage in planning to minimize UBIT and risk of jeopardizing exemption

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Regularly Carried On

- Activity engaged in frequently or continuously similar to comparable commercial business activity
 - For as often and as long as if operated by non-exempt org. and in way non-exempt org. would carry on
 - Annual event exception

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Trade or Business

- Any activity carried on for the production of income from sale of goods or performance of services
 - Broad definition
 - Similar to private for-profit activity?

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Not Substantially Related

- To be related:
 - Must contribute importantly to the accomplishment of organization's tax-exempt purpose
 - Financial contribution to CAA's other programs not sufficient

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It's Not Subject to UBIT If:

- Substantially all (>85%) work conducted by volunteers,
- Substantially all (> 85%) goods sold are donated,
- It's income from sale of products resulting from performance of exempt functions
 - If product sold in substantially same state as it was upon completion of exempt function
- It's a "qualified sponsorship payment," or
- It's income from activities carried on for convenience of employees, clients, members

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UBIT Exceptions for Passive Income

- Dividends, interest and annuities from investments; royalties
 - But not interest, annuities, royalties from controlled entities (dividends are OK)
- Rent from real property not financed by debt, not rented to controlled entity
 - Services provided must be minimal
- Debt-financed property, if > 85% of activities related to mission
- Gains from sale of stock or property

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Other Taxes

- Many states have UBIT
- Possible impact on local property tax exemption
- Sales tax
- State and federal employment taxes

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Determine Appropriate Legal Structure

- Program or division of CAA
- Single-member limited liability company (LLC)
- Nonprofit corporate subsidiary
- For-profit corporate subsidiary
- Joint venture (multiple-member LLC, or partnership)
- Low-profit limited liability company (L3C)

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Joint Ventures

- Require careful structuring and drafting to comply with IRS requirements – for example:
 - Venture must further (c)(3)'s exempt purposes
 - Documents must give priority to (c)(3)'s exempt purposes over maximizing profits
 - Degree of control by 501(c)(3) is critical
 - Transactions with joint venture partners must be at FMV, negotiated at arm's length
- Seek tax and legal advice
- Adopt a joint venture policy

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Keep Entities Separate

- If put venture into a separate entity, need to be sure to keep it separate from CAA:
 - Separate articles (for corporation), LLC filing with state
 - Adopt and follow bylaws (corporation) and/or operating agreement (LLC)
 - Separate boards, board meetings, minutes

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Keep Entities Separate (cont.)

- Separate EINs, bank accounts, financial records, IRS/state filings
- For for-profit corporation:
 - CAA must adequately capitalize sub
 - Agreement for sale of stock
 - Issue shares of stock
- Separate websites
- Shared staff and facilities
 - Maintain and follow agreements
 - Allocate expenses
 - For staff, allocate time

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Federal Grant Law Issues

- Program income
 - Gross income directly generated by a grant-supported activity or earned as a result of grant award
 - Subject to same as "regular" grant funds
- Restrictions on use of equipment, facilities purchased with federal grants
- Allocation of staff time, use of facilities/equipment
- Federal interest requirements if facilities or equipment purchased or improved with grant funds

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Other Legal Issues

- For example:
 - Securities laws – if planning to seek investors in for-profit business, seek legal advice on securities law compliance
 - Licensing
 - Contracts
 - Protecting against other liabilities – discuss with attorney and insurance agent

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Sales Planning

Step 6 - Elements in a Sales Plan



Sales Plan Includes:

- **Customer Profiles** – *Buyers and End Users.*
- **Market Positioning** – *Jaguars or Chevrolets?*
- **Distribution Methods** – *How will you reach customers and end users?*
- **Pricing** – *High Price vs. Budget Price – sales volume issues.*
- **Promotion** – *How will you tell potential customers and end users about your social enterprise?*



Step 7 - Write a Business Plan



Elements in the Business Plan

- Pull everything you've learned into one document:**
- How does the venture support your mission?
 - What are mission and dollar goals for the venture?
 - Describe the target customers and end users.
 - What customer needs are addressed?
 - What will motivate customers to buy your venture?
 - Define your competition and your competitive advantage.
 - Pricing strategy.
 - Promotional strategy.
 - Start up costs.
 - Ongoing venture costs.
 - Annual financial projections.
 - Financing required.
 - Plan to repay financing.



Community Action Examples



Community Action Agencies

Tri-Cap, Jasper Indiana

- Completed training 7/10 with 4 agency teams looking at fee-for-service weatherization, lead abatement training, day care, family services programs.



Community Action Agencies

New York State Graduates 2009

- **Adirondack Community Action Programs** (supply patient meals at local hospital)
- **Mohawk Valley Community Action Agency** (nonprofit training center)
- **Regional Economic CAP** (fee for service weatherization)
- **Washington County EOC** (Residential Assessments and Services for Safety & Energy Efficiency)
- **Tioga Opportunities** (fee for service weatherization)
- **Tompkins Community Action** (fee for service weatherization)
- **Cortland County Community Action Program** (fee for service weatherization)
- **Wyoming County Community Action** (day camp program)



Community Action Agencies

New Mexico Graduates 2004

- **Community Action Association of NM** (promotional fee earned)
- **Community Action Agency of Southern NM** (real estate venture)
- **Economic Council Helping Others** (no new venture realized)
- **Mid-West Community Action Program** (day care program)
- **H.E.L.P. New Mexico** (several ventures but no longer a CAA)



Other Examples

New Uses/Markets for Existing Physical Assets

- An agency leverages its party supplies into a rental business.
- An agency revamps its thrift store to attract a higher-end market, adds special programs and services for that market.
- An agency remodels ineffective space, adds general support services and rents space to small businesses and other nonprofits.



Other Examples

New Uses/Markets for Technical/Knowledge Assets

- An agency opens its training classes to other agencies whose staff need required training.
- A counseling agency develops continuing education credit programs for psychologists and counselors.
- A nonprofit training agency develops training programs for small businesses, increasing training revenues by 50% in the first year.

Other Examples

New Ventures

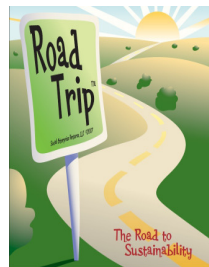
- An agency takes over management of its car donation program, previously operated through an out-of-state for profit company.
- An agency providing services for persons with disabilities opens a coffee kiosk, employing clients.



CASE STUDY – KID PREP



Training Programs



What Does Training Involve?

- A team of agency Staff and Board.
- Several agency teams trained at the same time (consider partner agencies in your community).
- Seven modules of classroom training.
- Consultation and guided homework over about 6-9 months, usually in 4-7 sessions.
- A comprehensive workbook.

What Does Training Cost?



Expedition training - only \$12,000 per agency, regardless of the size of your team.

Road Trip training - \$250 per person (minimum number required).

What's Next?

Let's Get Started!

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