NeighborWorks®
PROGRAM

Entrepreneurial Community Development

Exploring Earned-Income Activities and Strategic Alliances for Community-Development Nonprofits

NeighborWorks® Campaign for Home Ownership 2 · 0 · 0 · 2

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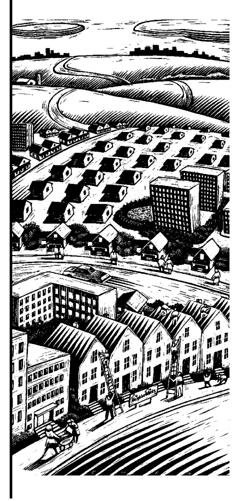
Ellen Stiefvater

Fellowship Program for Emerging Leaders in Community and Economic Development

November 2001



Joint Center for Housing Studies of Harvard University
Neighborhood Reinvestment Corporation

NEIGHBORHOOD REINVESTMENT CORPORATION

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These local organizations, known as NeighborWorks® organizations, are independent, resident-led, nonprofit partnerships that include business leaders and government officials. All together they make up the NeighborWorks® network.

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This paper was written under the support of the Neighborhood Reinvestment Corporation's Emerging Leaders in Community and Economic Development Fellowship, which provides opportunities for highly qualified professional students at Harvard University to research and publish applied analytical projects of interest to the community-development field.

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ABSTRACT

This paper examines social entrepreneurship from a community-development perspective. The target audience is community-development nonprofit organizations. The paper begins by contextualizing social entrepreneurship in community development and creating an analytical framework in which to think about efforts of organizations to integrate entrepreneurial and businesslike thinking. The paper presents key findings regarding both earned-income activities and strategic alliances as options for these organizations, as well as 10 key issues that arose as factors that impact their successful implementation. Information was gathered through a literature review, 29 interviews of practitioners, policymakers and academics and a survey of 59 community-development nonprofit organizations.

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EXECUTIVE SUMMARY

In an attempt to unbundle the complicated web of business and entrepreneurship ideas and jargon that nonprofits currently face, this paper identifies five strategies through which a non-profit might apply tools from the private sector. The first, "tightening up," is a catch-all for measures a nonprofit might take to increase its fiscal and operational discipline and level of accountability to stakeholders. These measures have been extensively covered in both business and nonprofit literature and include changes in accounting, human resources, planning and performance measurement. The remaining four strategies, collaboration, growth, diversification and consolidation, are ways in which nonprofits might apply entrepreneurial thinking, which is often identified with the private sector but is in reality abundant in both sectors. Each general strategy represents a way of better carrying out an organization's mission, which, in essence, is the business of a social entrepreneur.

Using this framework of five strategies as a backdrop, the paper then focuses on earned-income activities and strategic alliances, both currently popular methods for putting some of those strategies into practice.

Key observations regarding earned income activities are:

1. Earned-income activities have a history of mixed success in community development.
2. "For profit" does not necessarily mean that an activity generates income.
3. Earned-income and revenue-generating activities require constant balancing of "mission and money."
4. Community-development nonprofits cannot maintain values and make money in all lines of business.
5. Market-based activities involve some degree of unavoidable risk.

Key observations regarding strategic alliances are:

1. There is a spectrum of types of strategic alliances.
2. There is great potential for community-development organizations to build their existing relationships with the private sector into more strategic alliances.
3. Community-development nonprofits have assets that are valuable to a variety of for-profit companies.
4. Marketing and personal relationships are crucial to success.
5. Not every alliance with a for-profit is strategic.

A central theme that emerged from this research was the importance of the implementation phase as the real testing ground for both earned-income activities and strategic alliances. Therefore, a thorough implementation analysis emerged as an essential step before undertaking a new alliance or activity.

Ten major issues were most frequently cited by interviewees as determinant of an organization's likelihood of success with either an earned-income activity or a strategic alliance:

1. maturity of the organization,
2. policy and regulatory requirements,

3. operating reserves and capital,
4. human resources,
5. objective analysis,
6. leadership and board,
7. project-based cost accounting,
8. understanding of market forces,
9. sticking to core competencies, and
10. "being ahead of the curve."

Four concluding reflections are offered regarding the future of social entrepreneurship in community-development:

1. "Improving the Dialogue" discusses the frequent and inconsistent use of jargon that makes these issues seem out of reach to many organizations. More careful definition of terms and better use of everyday language for clearer communication would improve the usefulness of this dialogue for practitioners.

2. "Sharing the Responsibility" raises the issue of who, besides nonprofits themselves, must share in the work of both increasing the use of appropriate business discipline and encouraging a spirit of entrepreneurialism in the field of community development.

3. "Customizing Social Entrepreneurship to Fit the Organization" suggests that because community-development nonprofits vary so widely in their capacity, maturity, focus and goals, entrepreneurial thinking and business discipline cannot be uniformly prescribed. Organizations instead can take what is useful from this discussion to increase their social impact.

4. "Realizing the Limits of Nonprofit Self-Sufficiency" questions the appropriateness and feasibility of nonprofits becoming independent from traditional funding sources.

PREFACE

This paper is geared specifically toward nonprofit organizations involved in community development. Many of these organizations began during or evolved from the community development corporation (CDC) movement and the War on Poverty, but they vary widely in form, size, maturity and focus. Many work toward the provision of affordable housing. Many focus, either solely or in addition to housing, on economic or workforce development. Selected ideas will also apply to a larger group of community-based organizations (CBOs). The common thread is that the majority of these organizations center their work around economic inequalities and focus their work on a specific population or geographic area.

The purpose of this discussion is to bring into the spotlight two ideas currently popular among nonprofit organizations: earned-income activities and strategic alliances. There is currently great pressure from funders, society and communities for nonprofits to become more self-sufficient and less reliant on traditional funding sources. To do this, it is necessary to navigate through the rhetoric of social entrepreneurship and business. "Businesslike" and "entrepreneurial" thinking are emerging in the rhetoric as the keys to self-sufficiency. Initial research found a great need for untangling this rhetoric to find out where earned-income activities and strategic alliances fit into the discussion. Further investigation found a lack of coverage in the literature of these topics from the perspective of community development. Finally, interviews revealed a large skill and capacity gap among nonprofits when it came to actual implementation of the strategies and methods being discussed.

Methodology for this paper includes a review of nonprofit, community-development and business literature. Primary qualitative data was then collected through 29 interviews, largely with practitioners, some with academics and policymakers. This topic is sorely lacking in quantitative data, partly because of the nonuniformity of nonprofit accounting, measurement and reporting systems. Therefore, the author conducted a survey of practitioners to provide some snapshot quantitative data.

A survey of 59 community-development organizations was conducted to provide some snapshot, quantitative information on the use of earned-income activities and strategic alliances. This survey was administered at the Neighborhood Reinvestment Training Institute in Washington, D.C., in August 2001. The complete survey and results can be found in Appendix B.

I. CONTEXT

Shifting Sectors

In 1994, Greg Dees wrote, "the world of social enterprise appears poised for significant change." He pointed to shifting norms about the appropriate roles of the public, nonprofit and private sectors, characterized by four trends:

1. **Increasing privatization of government services:** Disappointment in the quality of public-service provision and skepticism of government bureaucracy has led to increased contracting with the nonprofit and private sectors to take over provision of some services. Dees predicted that this trend would favor social entrepreneurs "who are politically astute and adopt more businesslike practices."

2. **Increasing financial pressure on nonprofits to be less dependent on donations:** Due to the growing number of nonprofits, competition for grant funds is getting tougher. Dees cites the rise of "program-related investments," social-purpose business ventures and social-venture capital funds as evidence of this trend.

3. **Increasing concerns about the efficacy of traditional charity:** The persistence and growth of social problems have caused suspicion that many social programs have been somehow self-defeating. The frequency of disappointing results may be due in part to the unintentional effect of pricing goods and services below cost, stimulating excess demand for subsidized services.

4. **Increasing calls for active corporate social involvement:** This call is not just for an increase in corporate philanthropy, but for more skills transfer from business to the social sector and more cooperative problem-solving. In response to this call, there has been growth in the number of cause-related marketing partnerships, relationships that serve strategic purposes for both parties.[1]

Operating in a World of Scarce Resources

Many papers of this nature begin by describing the shrinking resources available to the nonprofit sector. Bill Ryan, in his paper *Nonprofit Capital,* makes a good case otherwise. Yes, resources continue to feel scarce to nonprofits. But this scarcity cannot be explained simply by "shrinking resources." Nonprofit organizations in the U.S. have seen unprecedented growth in recent decades. Almost 60 percent of nonprofit organizations (excluding churches) were founded between 1971 and 1992.[2] Nonprofits experienced a 79 percent growth in revenues (adjusted for inflation) from 1977 to 1989.[3]

Foundation giving has grown more than two-and-a-half times since 1990. The real growth in private giving was 3.7 times the revenue losses the nonprofit sector experienced due to decreases in federal funding.[4] Also, in community development, government resources have actually

[1] Dees, 1994.
[2] Hodgkinson, et al., 1993.
[3] Salamon, 1992.
[4] Ryan, 2001.

increased and diversified in form. The Low Income Housing Tax Credit, for example, has had an enormous effect on the production of affordable housing.

Federal budget shifts from 1980 to 1997 did generally increase pressures on nonprofits (outside of the health field) to expand services while reducing their resources.[5] However, as these resources decreased, there was a rise in state and local spending to offset these federal spending cuts. When all these factors are considered, it is unclear whether overall public funding really decreased or actually increased.[6]

None of this is to say that resources are easy for nonprofits to get. There are many community-development nonprofits competing for the same funding. There are over 30 CDCs in Philadelphia alone — it would seem nearly impossible for all of them to find adequate grant funds. However, this "shrinking funding" paradigm is not the most powerful argument for nonprofits to become less dependent on these sources and more creative about finding support.

Arguments for Greater Self-Sufficiency

The following are stronger arguments that perhaps are actually behind the "shrinking funding" paradigm.

1. **Chronic shortage of operating capital:** Nonprofits are always looking for new sources of unrestricted income, because so often funding is attached to a specific program and cannot be used for operating expenses. Better access to operating capital can increase the self-sufficiency of a community-development nonprofit. Without it, the organization is unable to be attractive to partners in some cases or is unable to take on a new activity.[7]

2. **"One gallon of gas at a time"[8] grant cycles:** Many nonprofits would like to become less reliant on public and private grants, whose timelines and restrictions can decrease efficiency of operations overall. Organizations have much greater freedom to plan long-term, take advantage of windows of opportunity, respond quickly to evolving community needs or adequately invest in staff and technology if they have consistent sources of support and control the use of funds.

3. **Maximizing marginal social return:** Most community-development organizations seek to increase the amount of social impact they can make with the resources they have. In other words, any organization hopes it can maximize the ratio of impact or social return to the amount of resources invested. This ratio in most cases is not readily measurable, but rather a theoretical construct. In business, the ratio would simply measure revenues relative to costs and would be improved by increasing organizational effectiveness and reaching economies of scale that produce better marginal return. Many nonprofit entrepreneurs have a similar goal — reaching economies of scale in core competency areas to achieve greater marginal social impact.

[5] Abramson, Salamon, Steuerle, 1999.
[6] Ryan, 2001.
[7] Ibid.
[8] Shore, 1999.

Defining Entrepreneurship

The root word for entrepreneur means "one who undertakes." We commonly use the word to mean anyone who owns or runs a business. However, in the rhetoric of "social entrepreneurship" and especially in the increasingly widespread use of the word "entrepreneurial," common usage refers to creative people and new ways of doing things. Greg Dees incorporated this into his definition of a "social entrepreneur."[9] For the purposes of this paper, the author has taken a cue from common usage of the word "entrepreneurial" and uses it to describe new approaches and better ways of getting things done. Notably, this usage really has nothing to do with economics, profits or business discipline, but rather with creativity and problem-solving.

[9] See definition in Glossary, Appendix A.

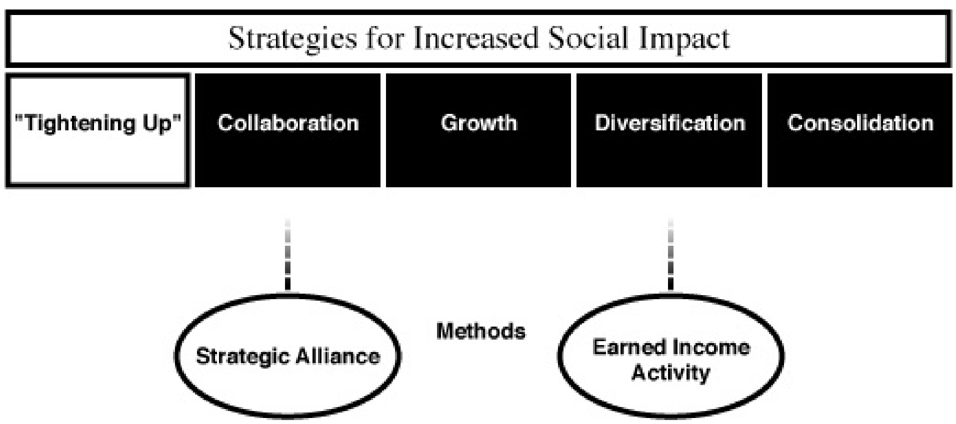
II. ANALYTICAL FRAMEWORK

Much of the current literature and discussion of social entrepreneurship is focused in particular on earned-income activities and strategic alliances. However, these discussions often fail to make some important distinctions:

1. Earned-income activities and strategic alliances are specific *methods* that can be used for carrying out larger *strategies* for increasing social impact.

2. There are several distinct strategies and many methods for carrying out these strategies; earned-income activities and strategic alliances are not the only choices for a social entrepreneur.

Exhibit A



A. Strategies

"Tightening Up"
This strategy is distinct from the others (as shown in Exhibit A) in that it is simply an application of concrete, businesslike principles. It is not about being creative or coming up with new ideas, but about applying all of those tools and principles from the business world to improve organizational discipline and efficiency. "Tightening up" is how many practitioners characterized this group of steps. All practitioners interviewed referenced this group of improvements as integral to an effective nonprofit operation. Some examples of what changes tightening up might mean are:

- getting a more sophisticated accounting system;
- developing a long-term strategic or organizational plan;
- developing business plans for each activity;
- identifying core competencies and investing most resources in those;
- improving training and division of work among staff to increase productivity;
- systematically calculating costs of each activity to include resources, staff time, overhead, opportunity cost, etc. (per hour of homebuyer education, per unit of housing, etc.);

- matching actual costs of each activity with organizational priorities (spend the most on the most important things);
- renegotiating contracts with vendors for better value;
- refinancing assets and debt for better value or source of operating capital; and
- putting in place performance and outcomes measurement systems.

Seventy-three percent of practitioners surveyed reported that their organization has done a business plan spanning multiple years. However, only 32 percent identified themselves as "very confident" that their organization's current accounting system could accurately calculate total costs for each of their activities (including staff time, overhead, etc.). These types of improvements have little to do with entrepreneurship and everything to do with discipline. This is one area where the nonprofit sector noticeably comes up short when compared to the private sector. However, the improvements listed above are widely covered in both nonprofit management and business literature. There are abundant resources for community-development nonprofits looking to make these kinds of changes to get the information they need.[10]

The remaining four strategies, or any other new initiative, can be more successful with the benefit of the knowledge and organizational discipline that comes from tightening up.

Collaboration
At its most basic, collaboration is simply accomplishing more by working together than could have been accomplished by each collaborator working alone. Finding and constructing an effective collaboration is an entrepreneurial action because it is an example of finding a better way to get something done. Businesses and nonprofits alike use collaborations in situations where the value generated by the collaborative effort will be greater than the sum of the resources put in by each party. Businesses look for situations where they could collaborate to earn more money. For a community-development nonprofit, the challenge is to find collaborations that increase social impact.

Collaborations with other nonprofits or public agencies
This might mean forming a regional collaborative of CDCs to divide the region's community-development work by activity rather than by neighborhood. This is one way to reach some economies of scale and decrease the overall amount of resources the collaborative uses relative to the social impact. For example, a collaborative of eight CDCs in the greater Boston area manages a fund that financed an Athlete's Foot franchise project by one of the collaborative's

[10] Suggested resources include:
- Business Planning:
  According to Sharon Anderson of the Business Planning Practice Group at Neighborhood Reinvestment Corporation, the business-plan format organizations must use to become a Community Development Financial Institution (CDFI) is quite good. There are also tools available for creating a business plan for a new venture at www.enterprisefoundation.org. NRC's *Business Planning Guide and Handbook* is a guide for creating a business plan to fit into the larger organizational plan.
- Accounting:
  The Perfect Fit, Accounting Software for Community Development Corporations is a guide published by the Enterprise Foundation. In addition, The United Way, community colleges and consulting firms offer workshops and classes on accounting.
- Outcomes Measurement:
  Tools for quantifying social impact: Social Return on Investment (SROI) Reports, designed by the Roberts Enterprise Development Fund and available at www.redf.org, and Seedco's "Performance Management and Measurement" system, information available at www.seedco.org

members, Urban Edge. Because the fundraising effort was shared by these organizations, they were able to raise $2 million. The advantages of pooling resources in a large fund include earning more on the money as a lump sum than would be earned by each CDC having its own smaller account; being able to take on projects that any individual organization could otherwise not have financed; and attracting subsidies and partners for those larger projects which otherwise would not have been involved.

Collaborations with for-profit organizations
"Strategic alliances" between for-profits and nonprofits are increasing in popularity from the perspective of both the private and nonprofit sectors. Books like Bill Shore's recent *The Cathedral Within* and Jim Austin's *The Collaboration Challenge* focus on such alliances. Some are extremely successful and high-profile. Shore's organization, Share Our Strength (SOS), is well known for its success in partnering with corporations like American Express in large-scale, cause-related marketing partnerships that benefit both organizations. The "Charge Against Hunger" campaign, for example, in which American Express made a small donation to SOS for every charge made by a customer during November and December, pulled in millions of dollars for SOS and noticeably increased customers' use of their American Express cards. Value is created in this case because proceeds from the partnership allowed SOS to increase their social impact, and American Express to increase profit for its shareholders.

Community-development organizations are looking for ways to partner effectively with the private sector. It is important, going forward, that organizations are able to think strategically about what alliances might truly benefit them and to learn how to take an active role in building such alliances. Also, while corporate partners are very sought-after these days, there are still many situations where a savvy social entrepreneur will see that what may be most effective is a collaboration with another nonprofit or a public agency.

Finally, a collaboration cannot be truly successful in the sense that there is "co-production" of value unless the following basic things happen: (1) members jointly develop goals of the collaborative, (2) members share responsibility for achieving goals and (3) members work together toward achieving goals.[11]

Growth
Some organizations are able to acquire scale by simply growing their organization or a certain activity. However, not all community-development nonprofits will be able to do this, given the regional focus of community development and the stiff competition for resources.

Property management is an activity undertaken by many nonprofits where the size of the operation matters: some organizations have been able to make their property management business profitable, but usually it's a large organization that has reached a

> One example of successful growth of an activity is the loan fund run by Community Ventures Corporation in Kentucky (CVC). CVC fundraised intensely for several years, accumulating over $4 million for its lending program. Because of its substantial loan fund, it is able to lend directly rather than getting capital from a bank. Since it pays no interest on its money, it can charge a below-market rate to the borrower and still make a profit to increase the fund.

[11] Briggs, Xavier. Course materials for "Strategic Management of Organizations." Kennedy School of Government, Spring 2001.

critical mass of units. Other organizations have found that although a large part of their energy went into property management, they did not have enough units to benefit from efficiencies of scale and therefore continued to lose money on their property-management activity. For example, Urban Edge, a Boston CDC, earned a profit on its property management operations for the first time last year — but only after expanding its operation to manage over 1,000 units.

In some cases, growth of certain activities can work hand-in-hand with collaborations. Organizations that decide to divide up provision of services by area of expertise rather than by neighborhood can potentially tap into the advantages of "scaling up" as a group. If each organization focuses on a different core competency, individual organizations can reach larger markets within the region while the group benefits by being able to provide better services at lower cost.

Foundations and other organizations are increasingly focusing on "venture philanthropy," a practice of providing funding and creating a relationship between funder and nonprofit that mimics the principles of venture capitalism. One of these organizations, New Profit, Inc., specializes in bringing nonprofit organizations with good potential "to scale." Specifically, they seek out nonprofits with a single strong core competency and an annual budget of less than $1 million, and invest in them with both financial and technical support in an effort to grow them to over $10 million annually in a period of four years.[12]

Diversification

Most nonprofit leaders would agree that is in an organization's best interest to have a diversity of funding streams. This way, they are more protected from financial loss because of changes in federal funding, failure to get a grant renewal, or failure of an earned-income activity to generate more revenue than cost. Many organizations view earned-income ventures as a way to diversify funding streams by becoming less reliant on grant funding. Strategic alliances with for-profits may be a path to diversification also if the partner or the alliance itself provides a source of funding.

Some community-development nonprofit leaders take this idea of diversification further by applying it to their activities. Kevin Smith, executive director of CVC in Kentucky, believes the key to self-sufficiency is diversification not only of finances, but also of programs and geographical focus. CVC works to provide as many services as possible in order to be highly valued in the community. Besides housing, it does business development and lending. Financially, it diversified by offering services to low-income and also higher-income markets; what Smith calls "going up-market." Income made on up-market services can then subsidize services to lower-income people. CVC also diversified geographically, gearing some services toward rural people, some toward urban. This makes CVC valuable to the entire region as well as eligible for more funding streams and attractive to more partners.

Consolidation

This may seem out of place in a list of strategies for increasing organizational effectiveness. However, given that when working in the world of nonprofits and community development, an organization's ultimate goal is maximum social impact, not infinite survival. As organizations manage their double bottom line,[13] they may reach a point where the best way to maximize

[12] Kirsch, Vanessa. From seminar at Share Our Strength's Conference of Leaders, Boston, MA, August 13, 2001.
[13] See Glossary, Appendix A, for definition.

social impact is to eliminate an activity or even to close their doors. A rule that many community organizers still hold to is that an organization or campaign should continually be trying to "organize" or "succeed" itself out of existence. Community-development nonprofits, in theory, should be watching for their success as an indicator of their relevance (or irrelevance). Although a nonprofit seldom consolidates or closes by choice, it should be considered as a viable option if the interest is truly in maximizing overall social impact.

Nonprofits, like other organizations, develop survival instincts, and decisions are usually made with the intention of keeping the organization afloat. Directors feel a responsibility as employers to keep their staff's jobs safe and guarantee the organization's future. However, examples abound where philanthropic or public dollars have more impact in one type of program than another — or perhaps no impact at all over many years. This a nearly impossible calculation to make; it requires measuring social impact, as well as opportunity cost (what else *could* have been done with that time, money, effort?), both of which are tough to measure and subjective. While acknowledging the near impossibility of making such a calculation in most cases, this option should still be considered when appropriate.

B. Methods

Referring back to Exhibit A, earned-income activities and strategic alliances are shown below the five strategies and labeled "Methods." This illustrates the idea that starting an earned-income activity, for example, is one way to tackle some larger goal. An organization could start an earned-income activity to finance **growth,** to **diversify** their streams of income, or to **tighten up** the organization by charging a higher, more accurate fee for a certain activity. Or it could propose a strategic alliance to a prospective corporate partner as a way to **diversify** its funding sources or services. Both of these methods can be entrepreneurial in the sense that they might be a new and better way to accomplish the organization's mission. They also might apply business principles and discipline since they both require a nonprofit's interaction with market forces.

It's important for organizations to consider the whole gamut of strategies they may want to pursue, and then to consider which method(s) will best carry out their strategy. Because earned-income activities and strategic alliances are widely discussed and encouraged these days, organizations may rush into them without thorough consideration of either overall strategy or risk. Organizations may also overlook some other method that may be more appropriate for their situations. Examples of other methods of pursuing a strategy of growth, for example, might be forming a CDC collaborative, approaching a venture philanthropy organization or applying for a new grant.

III. EARNED-INCOME ACTIVITIES

Increasingly, community-development organizations are striving for greater self-sufficiency. The desire for more sustainable and steady sources of revenue and more unrestricted revenue that can be used as operating capital are powerful incentives for organizations to find ways to launch earned income activities. In addition, an organization's secure, diverse and sustainable sources of funding is an indicator to potential partners and funders of a nonprofit's overall effectiveness.[14]

- 75 percent of organizations surveyed expected that their organization's ratio of earned income to total annual budget (which was, on average, 25 percent) would increase.
- 93 percent of respondents believed that the importance of an organization's ability to generate earned income would increase over the next five years.

As organizations look increasingly to earned-income activities as a way to be more self-sufficient, it's important to distinguish between income earned and revenue generated. While organizations are having increasing success with revenue-generating activities that cover all or part of their costs (usually through fees), it is still rare that an activity actually earns income (generates revenue that exceeds costs). Both types of activities can help an organization be more self-sufficient, and while few activities are good candidates for earning income, many can become revenue generators.

Key Observations Regarding Earned Income Activities

1. Earned-income activities have a history of mixed success in community development.

Current discourse makes the idea of earned-income activities for nonprofits seem like a recent trend. However, there are plenty of examples from the larger nonprofit world of organizations that rely on earned income — museums, hospitals and universities. Within the field of community development, the idea has a 30-year history and has had very mixed success.[15]

Earned-income activities vary widely, from unrelated for-profit subsidiaries to fees charged for mission-related activities. Many organizations have activities intended to earn income. But we must distinguish between revenue-generating and income-earning activities: Revenues – Cost = Income. Therefore, an activity only earns income if it generates more in revenues than it costs the organization to run. Most community-development organizations have one or more revenue-generating activities; more would like to have actual earned-income activities.

For example, many organizations currently charge fees for a variety of activities: homebuyer education, residential lending, real estate services, home rehabilitation, business and employment services, and miscellaneous services like inspections and home-delivered meals. Increasingly, community-development organizations are finding ways to generate revenues through fees, and successfully cover some of their own costs:

[14] See Appendix D.
[15] Author interview with Nancy Andrews.

- Of the organizations surveyed for this paper, 65 percent were charging fees for some of their activities. Forty-one percent responded that their organizations had, at some point in the past, started an activity that had revenue generation as one of its "top goals."

- A 1996 survey of 59 NeighborWorks® organizations showed that 86 percent of them were charging some fees; 20 percent had been since 1988. Among these organizations, fee revenue typically supported at least 15 percent of their operating costs. In most organizations, this number was steadily increasing.[16]

However, although charging fees is helping these organizations to be less reliant on grants by covering more costs, very few of these activities actually *earn income*.

Although books and articles on the subject often seem very optimistic, practitioners interviewed for this paper agree that successful earned-income activities are unusual and that community-development organizations capable of creating them are the exception, not the rule.

Approximately seven of ten small businesses fail within the first five years in the for-profit world. In the nonprofit world, an earned-income activity is up against even tougher odds because of the inefficiencies brought about by the organization's social goals. In 1988, Edward Skloot estimated that only one in twenty nonprofit earned-income ventures succeeded.[17] Several factors make it difficult to identify or discontinue a "failed" nonprofit earned-income activity:

- Organizations that are always looking to build support and find new donors do not have much incentive to talk about their failures. They may decide to highlight an activity's social impact rather than its financial shortcomings.

- Businesses started by nonprofits usually have social goals built in. Consequently, organizations may continue to run the business even though it loses money because of its social impact; for example, training or employing a target group.

- Many nonprofits do not clearly prioritize and define the goals of such a business at the outset, be they social or financial. Consequently it is difficult to recognize failure. Instead of defining a number of years after which the business must generate profit and what the return must be, many organizations just hope for the best, concentrate on the social goals, and are happy if the activity generates some revenue to recover some costs.

2. "For profit" does not necessarily mean that an activity generates income.

Another point of confusion in the discourse of social enterprise and earned-income activities is the distinction between "nonprofit" and "for-profit." When organization staff refer to their "for-profit subsidiary," the rest is often assumed: that this entity turns a profit that helps fund the nonprofit's other activities. This may not be the case.

Many revenue generators that earn income are actually fee-based services or investments that are a part of the nonprofit's operations. On the other hand, some for-profit subsidiaries of non-profits consistently lose money, but are maintained because of the service they provide or social

[16] Berringer, 1996.
[17] Skloot, 1988.

goals they accomplish. "Nonprofit" and "for-profit" are IRS distinctions and do not actually indicate whether an activity is a money-maker or a money-loser. New Community Corporation in Newark is a good illustration of this distinction.

> New Community Corporation (a nonprofit CDC) has a two-thirds equity share in the Pathmark store it developed in the Central Ward of Newark, New Jersey, from which it makes significant income. In contrast, NCC opened a Mailboxes Etc. franchise (a for-profit subsidiary) a few years ago for reasons related to its mission. The U.S. Post Office in Newark's Central Ward simply was not providing adequate service to the community; any resident who wanted to start a business, seek employment or engage in significant marketing and communication needed another resource. So NCC opened the store and has kept it open even though it has lost money since opening. It covers those losses with proceeds from the Pathmark store. In this case, the money-loser is a for-profit and the money-maker is part of the nonprofit.[18]

A "nonprofit" is actually differentiated from a "for-profit" by its 501(c)(3) tax status and its sources of capital. The most important constraint in the nonprofit tax classification is distribution of surplus. While a for-profit would try to maximize surplus to distribute it to shareholders, a nonprofit may not. There is nothing besides the culture of scarcity prohibiting a nonprofit from generating some surplus. The difference is that this surplus will be reinvested in the organization's activities. The motivation for many organizations to become "nonprofit" is to make them eligible to receive donations from individuals and other organizations, who want their donations to go to a 501(c)(3) so they will be tax-deductible for the donor.

Nonprofit organizations must pay corporate-rate tax on unrelated business income. For example, admission fees at a museum would not be taxed, but income from the museum café would be. The definition of "unrelated" is open enough so that there is a wide berth for non-profits to earn income within the limitations and protection of their nonprofit, tax-exempt status.[19]

3. Earned-income and revenue-generating activities require constant balancing of "mission and money."

This challenge can best be managed by careful consideration, during implementation analysis and throughout implementation, of an activity's impact both on the organization's financial health and mission. This constant rechecking of the balance between money and mission was described by many practitioners as extremely difficult, but essential to success. Please see Appendix C for an illustration.

An earned-income activity may come into conflict with an organization's mission or core values in a least four ways:

1. It is morally inappropriate to treat certain goods and services provided by nonprofit organizations as commodities. Relief services for victims of natural disasters, for example, are not an appropriate service to sell. Fees may also be inappropriate for public goods, or goods the entire community benefits from but individuals would probably not

[18] Author interview with Bill Linder.

[19] For more information, see "What is the Unrelated Business Income Tax?" at www.allianceonline.org/FAQs/fmfaq8.html.

be willing to pay for, such as the community-organizing services provided by many CDCs.

2. It may conflict with an organization's concern for economic and business development to engage in a business that competes with local entrepreneurs. If a good or service is readily available in the community and there are local businesspeople in that sector, a nonprofit may choose not to become a competitor.

3. There are some sectors of business in which the profit margin is relatively low, even for a for-profit company. Consequently, a nonprofit may find that in order to run the business successfully it may have to make decisions which go against its values or social goals, such as charging high prices, paying low wages, or producing a poor-quality product.[20]

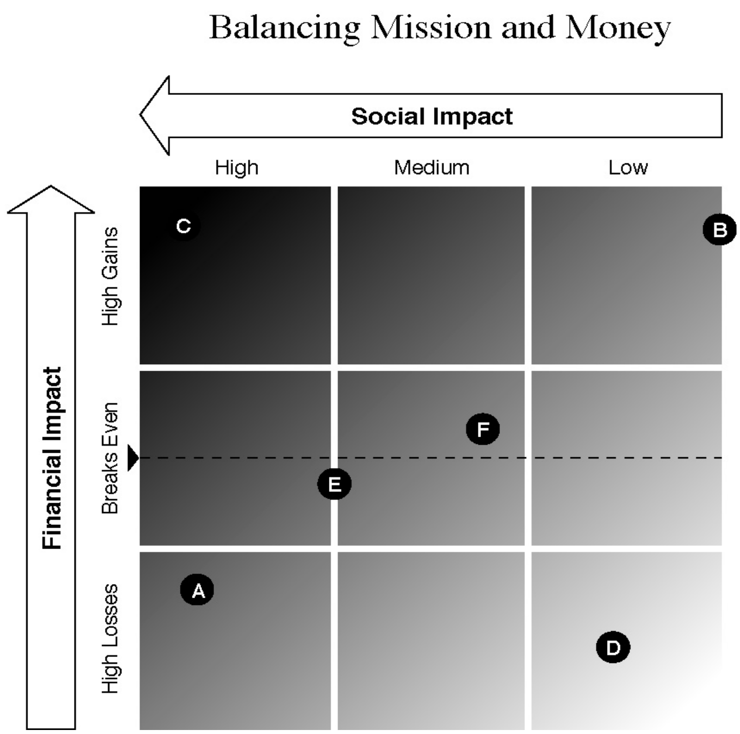
4. The line of business itself may not contribute to the organization's mission in the context of its neighborhood. For example, Fifth Avenue Committee in Brooklyn, New York, has chosen not to get into the market-rate real estate business because housing in its neighborhood is getting too expensive for many low-income people. FAC determined that by competing in market-rate real estate, it would become part of this problem.

Most activities taken on by community-development nonprofits are efforts to better integrate lower-income people into the larger economy of the community. Since they tend not to be emergency services and tend to serve people across a range of incomes, charging fees for many of these activities is appropriate. However, pricing services can often be a crossroads of the tension between money and mission. Finding a price that covers cost but is still within constituents' ability to pay can be difficult. Many organizations charge prices below cost for some activities because of this. The consequence is that the activity does not break even and must be subsidized by a grant or other income.

Exhibit B illustrates this relationship between mission and money. The upper left corner of the box is where both social impact and income are maximized. The bottom right represents activities that lose money and have little social impact. By maintaining an appropriate balance of activities above and below the break-even line, organizations can become more self-sustaining. And by weighing the true social impact of an activity against its costs, organizations can prioritize their resources. Some potential types of activities are described following Exhibit B (next page).

[20] See Enterprise Environmental case study under Observation #4.

Exhibit B



Type A: An organization may take on an activity with a high level of social impact, even if it means substantial financial losses. However, this organization must be aware of the opportunity cost of this loss of money. What must they do to subsidize the activity? What else could be accomplished with that amount of money? Community organizing may fall into this area of the chart.

Type B: Few organizations choose to operate in this sector of the chart (especially if the activity were actually *contrary* to mission). Activities with zero social impact but high gains can be tough on an organization's reputation and stakeholders. Organizations who did choose to operate here could reinvest the earned income in the organization or a type-A activity.

Type C: This represents the ideal activity for many community-development organizations. Unfortunately, few nonprofit activities have the potential for high gains and high impact. If an organization can identify one activity of type C, it can use the profits to subsidize a type-A activity.

Type D: There is no justifiable reason for a community-development nonprofit to be operating here. However, organizations that have not kept up with outcomes measurement and changes in their neighborhoods may be.

Types E and F: These represent the most common types of activities in community development. There is a way to generate some revenue from them and they have some substantial social impact. Type E activities may fall short of breaking even, but if an organization has a type-F activity, which generates revenue over cost, its earned income may be able to support E.

4. Community-development nonprofits cannot maintain values and make money in all lines of business.

There are cases where there is truth to the statement, "if there were money to be made here, someone would be making it." Some industries have very slim profit margins and some may have no profit margin in the context of a low-income community, since the profit margin will be determined by what people are actually willing to pay. Other industries have profit margins only because of practices that for-profits engage in, but nonprofits may choose not to.

> The Enterprise Foundation started a well-researched and adequately capitalized venture called Enterprise Environmental. It tried to replicate a very successful program in Baltimore where the business collected donated used appliances, repaired and resold them while employing and training a target population. It found that its costs were higher than its competitors because it did high-quality work, offered warranties with the appliances, and paid and trained employees well. Its competitors could consistently undercut it because they did not spend money on these "inefficient" measures. The service guarantee Enterprise Environmental offered didn't give it a competitive advantage because members of the community had learned not to trust such guarantees. The business folded, rather than engaging in the socially undesirable business practices necessary to compete in that market.[21]

Some industries have such a slim profit margin that for-profit companies have trouble succeeding in them. The social goals and values a nonprofit brings to the venture tend to make the business less, not more, efficient. If the margin is small for an efficient, pure-market actor, it simply may not exist for a nonprofit with a code of conduct based on mission. In a child-care business, this might mean an organization would have to charge higher prices than its community members can afford in order to cover costs. Some lines of business may be best left to companies that can do it most efficiently.

Commercial development is another line of business where profit margins may not exist for a nonprofit. For example, community-development nonprofits are likely to lose money on developing grocery stores even though many of their communities badly need them. Chain stores usually have their exact rent figure already calculated because it is a low-margin business. No one can develop a building in the inner city for an amount low enough for that rent amount to cover it.[22] This kind of development gets expensive because of acquisition, environmental cleanup, and delays due to political issues.

Finally, if an organization chooses to start an activity with the purpose of earning income (not just revenue), it will need to *limit the social goals* it tries to accomplish with that activity.[23] When operating a small business incubator, it is difficult to generate income because the organization usually has several social goals: it cares about who is employed in the activity, who gets the income, who the entrepreneurs are, mix of business sizes and types, location in a distressed area, etc. Each one of these social goals has the potential to make the business more costly or less efficient.

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[21] Author interview with Bart Harvey.
[22] Author interview with Jeff Armistead.
[23] Author interview with Nancy Andrews.

Similarly, "nonprofit enterprises"[24] that are focused on workforce development often do not generate any income. As Alvaro Lima of Initiative for a Competitive Inner City-Boston put it, it may be more accurate to say that some of these enterprises are actually "pretending at business." An organization may, for example, operate a bakery to employ a target population and provide training in baking and business. This business may not cover its costs and may be subsidized by grants. Organizations may look to these enterprises as earned-income models to replicate when in fact they are often not a way of generating income so much as an innovative way to accomplish social goals through an activity that covers *some* of its own costs through revenue-generation. This "enterprise" model is a useful tool for accomplishing certain goals and achieving partial cost recovery, but not necessarily for earning income.

5. Market-based activities involve some degree of unavoidable risk.
No matter how careful an organization is in carrying out its feasibility analysis and planning, a market-based activity may still be at risk of failure. Indeed, seventy percent of new businesses fail within their first five years. For nonprofits, the odds may be even worse because of the values-related financial inefficiencies most nonprofit businesses carry. Nonprofits may not be accustomed to working in this risk-based environment, dependent on market forces.

In addition, nonprofits may be at additional risk of failing at a new earned-income activity because it is difficult for them to answer all feasibility and implementation questions beforehand, given their often unpredictable funding situation. The following is a recent example:[25]

> The Enterprise Foundation had put everything in place to launch an Internet-based business when the dotcom decline began in 2000. It had "done everything right" — the enterprise was based on a successful one in Denver, was well capitalized, was going to accomplish social goals in workforce development and employment, and its extensive analysis showed that it would also be profitable. This is a good example of what seemed like a sure thing — except that it was based on a fast-growing market sector that was more volatile than expected.

[24] See Glossary, Appendix A.
[25] Author interview with Bart Harvey.

IV. STRATEGIC ALLIANCES

The idea of forming strategic alliances with for-profits may sound unfamiliar to some community-development nonprofits, but the basic ideas are ones most organizations already use. As the private sector searches for new ways to compete, many companies' philanthropic activities are being used to develop new markets, increase brand recognition, create community goodwill, overcome regulatory hurdles and improve employee morale and productivity. Simultaneously, nonprofits are searching for new ways to become self-sufficient and are increasingly turning to corporations as they seek to leverage their assets and create new revenue sources. Of the organizations surveyed:

- 73 percent said that their organizations had what they'd define as a "strategic alliance" with a for-profit partner.
- 60 percent of this group of organizations had initiated this alliance themselves.

By entering into partnerships with for-profit entities, nonprofits can enter a new program or endeavor without carrying the entire financial or risk burden. Bringing in private-sector partners can also increase the effectiveness of community-development activities by creating a movement that different sectors of the community contribute to in different ways. Partnering with businesses can also enhance the strategic and entrepreneurial skills of a nonprofit and make it more effective in identifying and communicating its "double bottom line." [26] By becoming leaders in structuring such partnerships, organizations can capture the latent value that is created when truly strategic alliances are made; this added value can benefit communities to an extent that nonprofits may not be able to achieve alone.

Observations Regarding Strategic Alliances

1. There is spectrum of types of strategic alliances.
Most literature and publicity of nonprofit-corporate partnerships focuses on a select few national cause-related marketing alliances. This narrow focus misses the wide variety of alliances that organizations might consider and largely ignores the strategic alliances that already exist in the community-development field. Strategic alliances in community development need not be national in scale and they are not limited to cause-related marketing arrangements.

Many corporations and nonprofits are forming "partnerships" — alliances that can range from truly integrated programs involving the sharing and exchange of human, capital and financial resources, to simpler marketing arrangements or short-term volunteer projects. One way to classify the array of partnerships is into four basic forms, each one focusing on some overlap of business and social interests.[27]

- marketing arrangements,
- human resource sharing,
- capital resource sharing, and
- joint ventures.

[26] See Glossary, Appendix A.
[27] Pearson, 2001.

Marketing arrangements are the most commonly discussed, but there are great opportunities in community development for the sharing of human resources and capital resources and for joint ventures, such as the Pathmark grocery store in Newark, New Jersey, which New Community Corporation developed and also acts as an equity partner.

In addition to the categories listed above, there are also several types of arrangements between corporations and nonprofits that focus specifically on marketing:[28]

1. In **cause-related marketing campaigns,** a corporate marketing department (or hired public relations firm) and the nonprofit work together to craft a message for the campaign that satisfies the marketing goals of both parties. Nonprofits may receive a fee or a percentage of sales from the corporate partner in exchange.

2. In **licensing agreements,** the corporation pays a fee for the use of a nonprofit's logo or name. These arrangements can be risky for nonprofits because their biggest assets are usually their name and reputation, which then become associated with the corporate partner.

3. **Sponsorship activities** are probably the most common type of arrangement. These usually involve either a single event or series of events and can be local, regional national or international. Usually the company commits financial support and in return the associated nonprofit ensures publicity for the company's sponsorship.

When considering the various types of alliances, organizations should consider the variety of resources that can be gained from a strategic alliance, other than money. Seventy-two percent of the organizations that reported having strategic alliances said they gained some nonmonetary resources from the alliance. Maria Garciaz of Salt Lake Neighborhood Housing Services, a NeighborWorks® organization, tries to identify at the beginning of each new endeavor all the resources needed to make it possible — everything from paint to good interest rates; then she tries to think of partners who both have some of those resources to offer and would stand to gain something from an alliance.

Within community development, there are currently many examples of sponsorships. There is also a wide variety of other marketing relationships that are not licensing agreements but are also not traditional cause-related marketing alliances. Many involve nonprofits helping companies to access their communities better as markets, while having a say in the products and services that will be offered. Many organizations have relationships with lenders that get them better access to capital. Finally, there are many informal alliances in which the for-profit partner is providing money as well as volunteers and technical assistance. These are marketing relationships, but also involve human capital and expertise sharing.

2. There is great potential for community-development organizations to build their existing relationships with the private sector into more strategic alliances.

Most practitioners from organizations interviewed reported having some type of "pure philanthropic relationship" with a for-profit organization. Many corporations have grant programs or support nonprofits with employee volunteer days or workplace giving campaigns. These relationships may have great potential for blossoming into strategic alliances (see Exhibit

[28] Ibid.

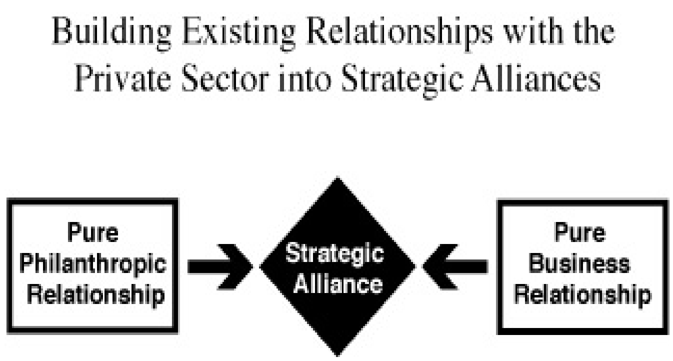
D). It is up to the entrepreneurial community-development nonprofit to think of ways the relationship could benefit its partner and begin to propose ways of working together that create value for both organizations. Exhibit C shows how a relationship might develop:[29]

Exhibit C

Phases of a Strategic Alliance

Virtually all community-development nonprofit organizations have at least one pure business relationship with a for-profit. Examples might be the bank where the organization's accounts are kept, a contractor who frequently works on the organization's development projects, or a vendor who regularly supplies the organization with office supplies, construction materials, etc. In all of these cases, the nonprofit is likely a valued customer in a business relationship. These relationships, like pure philanthropic or "grantor-grantee" relationships, may also have the potential to be arranged in a way that becomes as beneficial to the nonprofit as it is to the business. See Exhibit D for an illustration.

Exhibit D



Virtually all community-development nonprofit organizations have at least one pure business relationship with a for-profit partner, usually a vendor. In addition, many organizations already have a purely philanthropic relationship with a for-profit. Both types of relationships have the potential to be arranged into strategic alliances that create value for both partners.

Strategic alliances are nothing more than an extension of excellent relationship-building and donor development, skills which nonprofits have been honing for years. The widely known examples like SOS–American Express are different from more common examples only in their scale and complexity, which were carefully developed over time. The basic best practices in donor development — such as finding new ways for donors to be involved, finding projects which will benefit both the donor and the nonprofit, increasing levels of commitment from both sides as the relationship progresses and wins are accumulated — are already being used by some community-development organizations. Next steps might be to turn these relationships into contractual agreements, examine whether the nonprofit's assets are being appropriately valued and see if more value can be extracted from the relationship. For example, if the opportunity to supply goods or services for a certain project or event is valuable enough to for-profit entities

[29] Adapted from phases of a collaboration, Austin, 2001.

because of the visibility or marketing potential, nonprofits may be able to bid the opportunity out. Share Our Strength bids out the privilege of supplying bottled water for some of their events. Companies pay them for this opportunity — and not just in free water! CDCs can offer valuable opportunities like this to prospective for-profit partners.

> One alliance that began as good donor development on the part of the CDC has emerged into something unique and has the potential to grow. Maria Garciaz, executive director of Salt Lake City Neighborhood Housing Services (SLNHS), called GE Capital Financial several years ago to request an in-kind donation of a refrigerator and microwave for the SLNHS office. The relationship that began there evolved, building on each successful interaction. Today, GE Capital Financial supplies top-of-the-line appliances for all affordable housing units built by SLNHS. The NeighborWorks® organization is able to save about $5,000 on each unit and the company gets its product into more households and the chance to build consumer brand loyalty. Executives from GE have sat on SLNHS's board. Company employees participate as volunteers in community-service events, helping to paint newly built housing. Again, this satisfies a need of both organizations, improving employee satisfaction for GE and increasing community involvement and free labor for SLNHS. As yet, this arrangement is not in writing — it is just an example of how practitioners are fashioning their own strategic alliances by being creative. When it comes to any potential partner from the private sector, Garciaz says she just tries to think in terms of "how can we work together in a way that will build both our businesses?"[30]

3. Community-development nonprofits have assets that are valuable to a variety of for-profit companies.

Community-development professionals surveyed named the following assets that they bring to their alliances with for-profit partners:

> Community development knowledge and experience; increased profit; credibility in the neighborhood; eligibility for city funding; access to second mortgages; credit- and homebuyer-counseling services; eligibility for tax credits; housing-development experience; management expertise; good reputation; political ties; expertise in preparing buyers; loan and savings account customers for banks; intake and education services of prospective homebuyers; neutral advice; qualified staff; good publicity and press opportunities; access to low-moderate income markets; knowledge of how to get people mortgage-ready; 501(c)(3) status.[31]

According to Bill Linder of New Community Corporation, another important asset of inner-city community-development organizations is access to large numbers of people during a time when companies are growing and employees are scarce. This trend has changed because of the current market situation, but as demographic shifts in the workforce in coming years make employees scarce again, there may be opportunities. Linder sees an opportunity for alliances with companies that need large numbers of employees and community-development organizations that do workforce development and job creation work. For example, a call center in Kansas City, created as a partnership between the Black Economic Union and Sprint, was highlighted recently by Inititative for a Competitive Inner City as an innovative solution to a tight labor market.

[30] Author interview with Maria Garciaz.
[31] From survey, Appendix B.

Community-development organizations have special access to and knowledge of their constituents. These might include minorities, new homeowners, citizens of specific geographic areas, people who need loans, renters and people who need insurance. These are all groups that various sectors of business would value access to. However, there is a tough ethical dilemma when an organization offers a company access to their community; in some cases it would be inappropriate for a nonprofit to "steer" customers to a company because of the trust relationship between the nonprofit and its community members. But some organizations, like Kansas City's El Centro, are successfully forging strategic alliances based on their access to a certain population in ways that benefit that population.

> El Centro is teaming up with the area's largest community lender to form the first Latino bank in greater Kansas City. Both partners will invest capital as well as local investors. The Hispanic population in the city is growing at 130 percent of the nationwide growth rate. No other lender was reaching out to provide banking services to this growing population. El Centro will take care of marketing and public relations and help to come up with line of products, while the bank will provide the backroom operations. The bank's commitment goes far beyond Community Reinvestment Act (CRA) requirements, with an initial investment of almost $1 million. They are interested because they stand to gain so many new customers and will be able to provide more services for people as their families get established in the area. El Centro is able to greatly increase social impact by being a full partner in the deal and having a great deal of influence over the products and services offered to this population. They are also likely to make a profit, which can grow their loan funds or finance some of their unprofitable activities.[32]

Intermediaries

Community-development intermediaries share some of the same assets as their network organizations. They have an unique role to play in the formation of strategic alliances on two fronts: first, there are some types of alliances more suited to an intermediary than an individual organization, so intermediaries can partner with companies in order to better serve their networks. Second, intermediaries can play a role in educating their networks about strategic alliances, finding opportunities for alliances and offering technical assistance as they develop. The best asset they have to offer a potential partner is access to their network of organizations.

A. Forging their own strategic alliances

A corporate partner might be attracted to the structure of a community-development intermediary. Many are national but have local offices, much like the structure of many companies. Because of this, intermediaries may be able to attract the type of large, cause-related marketing alliances that individual organizations otherwise probably could not. These work best in situations where large numbers of consumers are coming into a store or making a certain kind of transaction. This setup might be most easily found in a retail company. For example, Enterprise Foundation has set up partnerships with both Home Depot and Kohler. While private developers would seem like a more natural partner for community-development organizations, they simply don't have the kind of volume that a retail operation would.

The National Congress for Community and Economic Development (NCCED) has also forged a strategic alliance to benefit its network.

[32] Author interview with Richard Ruiz.

The National Congress for Community and Economic Development, NCCED, forged a strategic alliance in November 2000 with UrbanAmerica, L.P. NCCED brings 30 years of experience in community development and a network of 3700 CDCs with extensive knowledge of inner-city markets. UrbanAmerica, a commercial real estate company, will help NCCED's member organizations develop new revenue streams from property management and commercial and retail development by making equity investments and using "Wall Street savvy." The alliance is intended to attract national retailers to inner cities, develop inner city economies and create jobs for community residents.[33]

Through their networks, intermediaries can provide access to emerging markets in revitalized communities, as well as an opportunity to serve first-time homebuyers and other valuable customers. In a paper assessing Neighborhood Reinvestment's attractiveness as a partner, a consultant explained, "because the customers of NeighborWorks® organizations consume such a broad range of goods and services (from real estate services, mortgages, and insurance, to construction materials, home-repair supplies, and home appliances), there is a large range of potential partners and marketing arrangements."[34]

B. Helping their network organizations to forge strategic alliances
NCCED is actively involved in seeking out alliance opportunities for its network organizations. It has launched a Corporate Partnership Program, which seeks to identify financial and technical resources necessary for the formation of strategic alliances between CDCs and companies. Its focus is on companies in the health-care, telecommunications, and franchising industries, the areas where it sees the greatest opportunity. NCCED has partnerships with the International Franchise Association, Business for Social Responsibility, the National Grocer's Association and the National Cooperative Bank to develop franchises and food stores with CDCs.

The Local Initiatives Support Corporation (LISC) works on behalf of its network with TRI, The Retail Initiative. TRI is a real estate company that invests equity in neighborhood retail centers, which can help CDCs bring in successful businesses and reap some of the profits as equity partners. CDCs are then able to enter deals they otherwise would not be able to afford. It is unlikely that CDCs could make money on these shopping-center deals if they only have a development role, so LISC is trying to create opportunities for them to be true partners and to reap some benefits from the relationships.

4. Marketing and personal relationships are crucial to success.

Marketing
Corporate giving is very strategic. Companies tend to pick a giving focus and structure nearly all their philanthropy and community work around that theme. Having a corporate giving focus on housing is fairly common among lending institutions, because of its close ties with their business. However, housing is difficult to build support around. Examples of causes that tug easily at the heartstrings of the public are literacy, hunger and children's health. Housing and community development take a bit more explaining. People tend to like the idea of helping homeless families, but do not immediately connect with needs like housing for low- and moderate-income people, transitional housing and economic development. Small-business

[33] NCCED, 2001.
[34] Pearson, 2001.

development does not imply urgency. Workforce development and the needs sparked by welfare reform carry some controversy; not everyone feels like they need to help pay for them. The rhetoric of "neighborhood revitalization" has the best hope of gaining wide public support.[35]

Washington Mutual focuses its giving on housing and education. It formed an alliance with Neighborhood Reinvestment Corporation because of its network of NeighborWorks® organizations. Washington Mutual has been trying in this initial phase to educate its network of people that affordable housing matters not just to the very poor, but to many employees and customers. One thing that makes marketing NRC's work difficult is that each NeighborWorks® organization has a different name, so it is not always easy to explain how they are all connected. Park says that Washington Mutual's marketing around education issues is "110 percent easier" than their marketing around housing.

An important marketing component for any community-development nonprofit will be its local connection. Rather than seeing small-scale and local focus as a disadvantage, community-based organizations can prove the value of their local focus through outcomes measurement and effective marketing. For-profit companies have an interest in doing good things for the communities in which their headquarters, back offices or branches are located. Their customers will also connect more readily with an initiative that has impact locally, rather than a less tangible national or global campaign.

Personal relationships

John Nelson of NCCED's Corporate Partnership Program feels that forging personal relationships with people in the private sector is one of the keys for successful strategic alliances for community-development organizations. In fact, he spends much of his time interacting with private-sector companies and trade associations to find opportunities for organizations in NCCED's network to work with them.

According to Chris Park, a Washington Mutual executive who helped to forge its alliance with Neighborhood Reinvestment Corporation, a deciding factor from a prospective corporate partner's viewpoint is the "feeling" they get from meetings with the nonprofit. This has to do not only with the competence the organization's representatives, but also with interpersonal dynamics. An organization that does not pay attention to this interpersonal part of relationship building will have a hard time building partnerships that bring it maximum benefits.

Part of this ties in with staffing. As with an earned-income activity, a strategic alliance should have a "champion" within the nonprofit.[36] This makes working with the for-profit partner smoother, since it will almost certainly assign responsibility for managing the relationship to a specific person. Frequent contact between the two point people helps increase chances of them developing a good relationship. Further, these point people can work together on the problem of how to best get others in their organizations connected to the alliance and to each other.

Of the practitioners interviewed who had built strategic alliances, each referred to the importance of some personal relationship. Usually either the director or a board member had a good relationship with someone at the partner organization. Sometimes that relationship was the start of the alliance, other times the personal relationship just helped the alliance to grow. Interest-

[35] Author interview with Chris Park.
[36] Author interview with Alfred Wise.

ingly, many of these alliances were quite informal, relying heavily on trust and on these personal relationships. Partnerships with banks, in contrast, which usually did not go beyond Community Reinvestment Act requirements, were usually formalized by some type of contract and relied less on personal relationships.

5. Not every alliance with a for-profit is strategic.
As the overlapping or even "blurring," as some call it, between the nonprofit, private and public sectors grows, and the scarcity of resources continues to increase, the ability to identify beneficial alliances becomes a requisite characteristic of an effective nonprofit. Of practitioners surveyed, 85 percent believe the importance of an organization's ability to build creative alliances with for-profits will increase over the next five years.

However, this idea, too, has the potential to become a bandwagon. Rather than trying to simply increase the number of for-profit partners an organization has, an organization should think very critically about the pros and cons of a strategic alliance before committing its name and resources. According to Jim Austin of the Harvard Business School, there are seven essential characteristics for a successful collaboration: connection with purpose and people; clarity of purpose; congruency of mission, strategy and values; creation of value; communication between partners; continual learning; and commitment to the partnership.[37]

Spotting a bad fit
A proposed alliance may be a bad fit for a variety of reasons. The scale of the organizations may not match up well. For example, a small CDC may be better off in an alliance with a neighborhood gas station or with a small franchise deal, rather than a large partnership with a company. Fifth Avenue Committee in Brooklyn, New York, came to this conclusion and decided to pursue a franchise relationship with Valvoline that is limited to one store within its service area.

In some proposed alliances, the for-profit partner may simply not bring very much value to the alliance. Nonprofits can be critical in choosing their alliances and must try to "price" the value they bring accurately. Nonprofits should always be looking for new value-adding opportunities, from both sides of the partnership. Could the company's board become volunteers of the nonprofit? Could the nonprofit be profiled in the company's annual report? Should our partner be paying us for the opportunity to supply goods or services to our constituent population? What nonmonetary resources could the company bring our organization — technology, training, etc.?

Included in this "pricing" analysis should be some thought about the risks a nonprofit takes when entering an alliance with a for-profit. Potential risks for a community-development nonprofit include drain on staff and other resources away from other activities, jeopardy of governmental and foundation funding because of perceptions of wealth or distaste for corporate partnerships or the specific partner.

Another reason for a bad fit may be ethics. The obvious examples that come to mind are companies whose very business is ethically questionable. Many nonprofits won't work with cigarette or alcohol companies. But community-development organizations are likely to encounter more subtle examples. For example, a nonprofit may find a licensing deal or endorse-

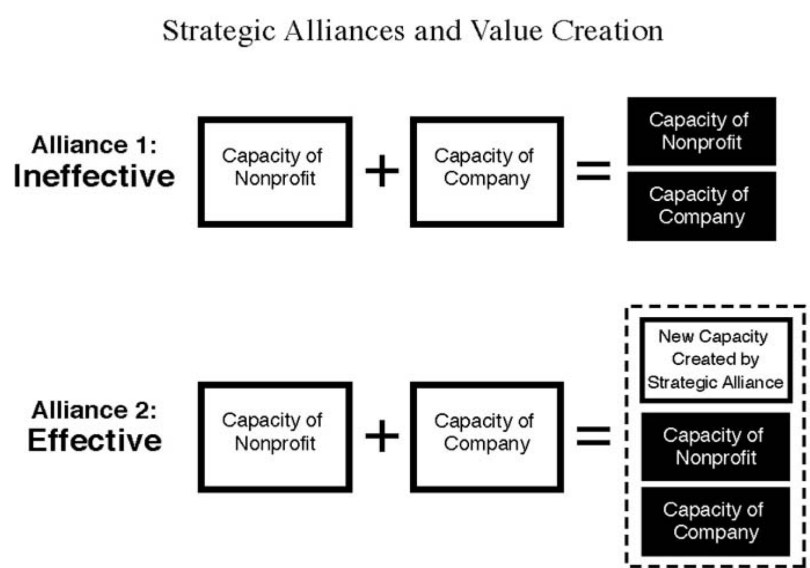
[37] Austin, 2001.

ment of a certain company unethical. Some CDCs are facing the dilemma of whether it is ethical for them to do mortgage brokering and pass customers on to the bank they have partnered with rather than simply educating people about their choices but remaining neutral.

Although it may be tough to spot, a prospective alliance may be a bad fit if it requires an organization to play a role or engage in activity in which it does not have a strong competency. Community-development nonprofits have important roles as communication, awareness and change agents in their communities and close ties to their communities. They should rely on these valuable established roles and on their core activities to bring value to their corporate partners. Entering alliances which require something else is likely to steer the organization off course.

Finally, some alliances may not seem like obviously bad fits, but may not be worth the trouble. The exciting thing about an alliance or collaboration is the idea of value creation. Any good strategic alliance should be greater than the sum of its parts. If it is not, then both organizations may be simply wasting resources by maintaining their relationship — both may in fact be better off without the alliance. Exhibit E illustrates the idea of value creation.

Exhibit E



V. IMPLEMENTATION: THE REAL TEST

Community-development practitioners interviewed described the most important keys to success and the most common pitfalls for organizations venturing into earned-income activities or alliances with for-profits. The issues raised, which ranged from small mistakes they made to general requirements for success, consistently revolved around *implementation*. That is, the reason for failure or key to success did not lie in the strategy itself, but rather in the organization's implementation of that strategy.

Appendix C shows how the pressures discussed in section I might lead to a discussion of strategy (1), then a choice of method for putting that strategy into practice (2), then a thorough implementation analysis (3), and finally implementation itself. The problem that emerged from interviews was that an inexperienced organization or one feeling intense pressure might jump straight to step 2, choose to create an earned-income activity or a strategic alliance and immediately begin implementing it. This may be dangerous for two reasons:

- the organization has not determined the overall strategy or goal for which it is investing in this new venture or partnership, and
- it has not done a careful *implementation analysis* to see how well its prospective method would actually meet its needs.

The issues practitioners felt impacted an organization's likelihood of success with an earned-income activity largely overlapped with those issues they felt would impact their success with a strategic alliance. The following are key issues practitioners recommend for consideration in a careful implementation analysis.

1. Maturity of the Organization

According to Jeff Armistead of LISC, there are a few CDCs that have been around since their start in the 1980s who have much more capacity and are at much less risk going into both earned-income activities and alliances with the private sector. He suggests that there are actually two to four tiers of community-development organizations, with descending levels of maturity. Usually, but not always, the more mature a CDC is, the more capable it is in terms of financial discipline, marketing and managing a double bottom line. Often, too, a mature CDC will have grown larger and consequently have more access to capital, more operating reserves, fewer cash-flow problems, more political clout and more community support than a smaller or newer organization might. All of these are factors which can affect an organization's general vulnerability.

However, while this group of more mature CDCs tends to be more entrepreneurial, collaborative and financially savvy than less mature organizations, they generally do not have sufficient equity to support their continued growth and development. In order to maintain their effectiveness, these organizations will need the help of policymakers to gain access to corporate capital so they can compete more successfully in larger markets, where their business competitors have access to traditional sources of equity investment.[38]

[38] Taken from The Housing Partnership Network's response to the *Questionnaire on Housing Policy Issues*, distributed by the Millennial Housing Commission. Response written by Tom Bledsoe, 2001.

2. Policy and Regulatory Requirements

The policy and regulatory environment cause market irregularities. For example, strategic alliances between banks and community-based organizations are largely an anomaly caused by the Community Reinvestment Act (CRA). This does not mean the partnerships do not have value, but it is important for organizations to evaluate whether the alliances they build are conditional upon something beyond their control. In some cases, organizations may be able to build the alliances to such a degree that they will no longer rely on the policy.

Another example of the effects of policy lies in the disparity between policies supporting affordable housing development and the relative lack of similar policies to support economic development. Without these policies acting as insulation, many economic development projects may be too risky for community-based organizations to successfully take on.

Incentives such as the CRA or tax-credit eligibility sometimes draw for-profits to relationships or projects with nonprofits. Relationships that rely on those incentives alone differ from true strategic alliances. In effect, society and funders are asking nonprofits to generate their own resources rather than relying on the breaks they are given. Entrepreneurial use of these existing incentives by nonprofits to create relationships is certainly something to strive for. But something more sustainable to strive for is building recognition of the valuable assets of community-development nonprofits to an extent that those incentives are less necessary. Many community-development nonprofits have relationships with banks but are not so sure those relationships would be there if CRA disappeared. An appropriate goal, then, might be to manage those relationships strategically and develop them to an extent that if CRA disappeared, the partnerships would be secure. This discussion is built on an interest in not being entirely dependent on those funds. Hence, the ideal strategic alliance would be one that was not entirely or primarily dependent on regulatory obligations or tax incentives.

3. Operating Reserves and Capital

There are several reasons why an organization might be more likely to succeed in an earned-income venture if it already has some capital or operating reserves. First, few foundations will grant money for capital expenses. Some progressive funders are beginning to change their practices, but they are still the minority. Many are putting "venture philanthropy" into practice[39] and beginning to fund operating expenses on a limited basis. Second, new earned-income ventures need time to prove themselves, and small organizations may run out of cash before that time has passed. If an organization is not prepared for several years of losing money on an operation, it may be putting itself at risk. Third, traditional capital lenders are often not willing to lend to nonprofits for earned-income activities.[40]

In a strategic alliance, being able to bring some of an organization's own money to the table may attract partners that otherwise wouldn't be interested, may make it possible for the nonprofit to reap more revenues if it is a joint venture, and may give the nonprofit more clout in the partnership.

A frequently cited partnership that generates revenue for the CDC is the partnership between New Community Corporation and Pathmark in Newark, New Jersey's, Central Ward. NCC was the developer and is the landlord of the space, which is a fairly traditional role for a CDC. The

[39] See Glossary, Appendix A.
[40] Skloot, ed., 1988, Ch. 9.

highly unusual part is that NCC has a two-thirds equity share in the business itself. NCC was able to help decide what products the store would carry and makes enough profit to fund many of its other activities. El Centro's partnership with the Kansas City lender echoes this lesson: because it invested a significant amount of its own capital in the partnership, it stands to make a profit and also have an influence over the lending products that are offered.

4. Human Resources

The interviewees universally agreed that if an organization decides to go into a line of business fairly unrelated to its core competency, it is important to bring in new talent with expertise in that line of business. As Julius Walls, president of Greyston Bakery, put it, "don't try to turn social workers into business people or vice versa." He is a good example — he was brought in to head up the organization because of his years of experience in the culinary business.

Another human-resource issue that arose was the cultural clash that will probably happen, at least to some degree, when a corporate partner is first introduced into a community-development nonprofit due to an earned-income activity. Practitioners suggested that it is a mistake to ignore or deny the tension and the obvious differences between a purely bottom-line focus and a purely social focus. It is better to expect and to manage this tension. This means supporting new staff brought in to run a business activity, or finding ways to make personal connections between the organization's staff and the corporate partner's staff.

According to Alfred Wise of Community Wealth Ventures (the consulting arm of Share Our Strength), the staffing situation of a nonprofit is critical to its success in running an activity to generate what it terms "community wealth." Two indicators that an organization is capable of success are:

A. The presence of a champion, someone who is committed to the idea and can focus his or her energy to see it through. It also is helpful inside and outside of the organization to have a specific person identified with an activity.

B. Managerial savvy or willingness to bring that in: if there are not people with business and management expertise within the organization who can be pulled together for the project, then expertise must be hired. The employees must be able to handle the extra challenge of running a profit center, so it cannot just be added on to a program staff member's job.

5. Objective Analysis

Brad Lander, the executive director of Fifth Avenue Committee in Brooklyn, gave this advice: "Don't write your business plan and feasibility analysis like you'd write a grant proposal." His point was that organizations, when trying to plan an earned-income venture or structure a corporate partnership, often get so invested in the process that they stop actually analyzing whether to do it or not. Other practitioners also referred to that feeling of getting pulled into the process and just trying to figure out how to implement something with no further regard for "why" or "if."

Business literature reminds us that "getting to no" during a feasibility or implementation analysis is just as important as deciding to pursue a venture. Although it may feel anticlimactic, the ability to do an objective analysis and be honest about what it finds will benefit any organization.

This analysis doesn't stop once implementation begins. Program activities and business ventures grow, strategic alliances mature — they will need to be reevaluated continually to see if they are still on track and are meeting their benchmarks. Although it requires some good negotiation and damage control skills, a strong entrepreneur must be able to discontinue an activity or alliance that is not working, or make the changes necessary to get it back on course.

6. Leadership and Board

Leadership

Sometimes, an outstanding organization's effectiveness is attributed to the vision or charisma of its leader. These leaders are usually people who either founded the organization or have been with it for many years. They are people who have earned the respect of community, staff and board and often people whose identity is strongly tied to their organization.

But what can other organizations learn from these outstanding organizations and their leaders? Since we clearly cannot replicate these leaders themselves, one possible lesson is simply that leadership development is important for organizations to pay attention to. Any organization can work to attract and retain talent. Fran Justa, executive director of Neighborhood Housing Services of New York City, was recently awarded a fellowship by Fannie Mae that she will use to work on the issue of succession planning in community-development organizations, which she believes to be of central importance to the future of community development.

A secondary lesson for funders and policy-makers is that great nonprofits, just like great businesses, need to invest time and resources in leadership and staff development. Incentives and funding that support this organizational development are sorely lacking.

Board

Corporate partners sometimes complain that one of the difficulties of partnering with nonprofits is in working with their boards — their decision-making process is too messy or too slow. From a corporation's perspective, strength and capability of an organization's board is one of the most important characteristics of a prospective partner.[41]

Several directors of organizations stressed the importance of the board and executive director's ability to work well together and the board's willingness to give leaders room for significant decision-making without board approval. According to Rosa Rios Valdez of Cen-Tex CED in Texas, it is important for her board to give her room to make decisions and trust that she will keep them involved and steer the organization well.

Other directors mentioned that it is helpful to have some board members with a background in business. They can help illuminate the perspective of a corporate partner in a strategic alliance and can educate the rest of the board on some of the practices necessary for successful earned-income activities.

7. Understanding of Market Forces

Many nonprofit leaders do not have a good grasp of market forces. To be successful working with a partner who operates completely within the market economy, a basic understanding is

[41] Author interview with Chris Park.

essential. This allows a nonprofit leader to better anticipate his or her partner's interest and therefore both to negotiate more successfully and to build the alliance in such a way that it will be strengthened rather than threatened when the market challenges the for-profit company.

Whether charging fees for a current activity or starting a business enterprise, an organization must understand how prices are constructed as well as how to assess demand, evaluate competitors and find a market niche. One challenge for community-development organizations is to understand the limitations of their geographic focus. Most consumer markets are not confined to a certain region the way community-development work is. Understanding this will help organizations decide whether only serving their target areas with business is feasible, or if this activity must be more geographically broad in order to generate revenue.

8. Project-Based Cost Accounting

This is purely a practical matter, but of enormous importance. Although this financial practice is captured under "tightening up" in Section II, project-based accounting is worth mentioning here because of the emphasis put on it by practitioners interviewed. Every interviewee and collaborating staff member listed the lack of cost- and project-based accounting as obstacles for community-development nonprofits who want to use social entrepreneurship strategies to be more self-sufficient. Every case of a successful earned-income activity or strategic alliance involved an organization that practiced project-based cost accounting.

Cost accounting

One of the biggest weaknesses of nonprofit sector in the eyes of funders and potential private-sector partners is the inability to account for the complete costs of activities or document the use of resources. Most community-development nonprofits are not keeping track of the amount of resources going into each activity, including overhead, staff time and supplies. Consequently, they have a hard time setting prices and fees or even figuring out which activities lose money and why. Knowing an activity loses money does not mean an organization will cut that activity — it just allows the organization to make the conscious choice to lose money on something and to think about why. The mission-money balance will be different in every organization, but every organization can benefit from knowing all the facts and from struggling with that balance.

Project-based accounting

It is helpful to keep each activity's expenses and income distinct from those of other activities, at least on paper. This information will probably remain completely internal, but it allows the organization to know which activities make or lose what amount of money. With this information, organizations can make sure their resources are being spent in a way that is compatible with their mission priorities. For example, if economic development were an organization's most expensive activity but its fourth most socially impactful activity, perhaps a reallocation of resources is necessary.

9. Sticking Close to Core Competencies

A recent study of several nonprofits with earned-income activities found that the successful fee-chargers were organizations that sold services to corporations without major changes to mission.[42] Practitioners caution against "thinking you can open a restaurant just because you like to cook." With an earned-income activity, an organization may already be going outside of its

[42] Skloot, ed., Ch. 9, 1988.

core competency by operating with a goal of generating income. If, on top of that, the line of business it chooses is new to it, it will be learning that business, as well as business principles in general, as it goes. This steep learning curve will make success less likely.

It is usually a mistake, for example, for an organization to think a core competency in affordable housing development equals a competency in commercial or industrial development. Housing projects are usually fairly simple and there is virtually unlimited demand for the product. With commercial and industrial development, the process is usually much more complex and the magnitude of financial risk larger. A smaller group of organizations than most people assume is actually capable of this kind of work.[43] One of the success stories in industrial development is Greenpoint Manufacturing and Design Center in Brooklyn, New York. Its success can be partially explained by its tight focus on core competency. It does not build housing; it acquires and rehabilitates warehouse spaces to rent to local small businesses. GMDC has the staff and skills to do this specific activity effectively and has figured out the financial parameters for doing so sustainably.

Core competency is important for being a good strategic alliance partner, too. Organizations can benefit by assessing what they are "best in class" at and how that will be of value to a for-profit partner. Entering an alliance that requires something the organization does not have means risking disappointing a partner or steering the organization off course.

10. "Being Ahead of the Curve"

The ability of an organization to not only understand but to *anticipate* changes in its community's needs and in the market environment is essential for succeeding with any entrepreneurial approach.

Bill Linder of New Community Corporation in Newark, New Jersey, especially stressed this point. NCC has succeeded in rising to meet enormous community needs by being ahead of the curve. For example, it started a planning and discussion process on how to handle the need for services brought about by welfare-to-work long before those changes happened in Newark. Consequently, it was able to get services up and running quickly, and is currently providing job and employment training to large numbers of people, as well as child care and other services. It is the largest provider of welfare-to-work services in its county, which makes it eligible for many funding streams and also able to steer the development of state services in ways that benefit the community. Linder's advice is to "always be scanning the environment."

The following table lists the ten issues presented above along with some sample questions regarding each issue that an organization might ask during implementation analysis.

[43] Author interview with Jeff Armistead.

Exhibit F: Ten Implementation Issues and Questions for Implementation Analysis

Issues That Impact Success	Sample Implementation Analysis Questions	
	Earned-Income Activity	**Strategic Alliance**
1. Maturity of the Organization	■ Do we have the reputation and political support to survive a period of money and confidence loss at the beginning of this venture? ■ Do we have enough experience with our mission and with money management to add another dimension? ■ Where is a logical place to start, based on our size and scope?	■ Have we earned enough trust and confidence of stakeholders to rely on their support in this alliance? ■ Do we have enough experience with our mission and with money management to add another dimension? ■ Where is a logical place to start, based on our size and scope?
2. Policy and Regulatory Requirements	■ What policy or regulatory measures help to make this activity profitable or unprofitable? ■ What would happen if those policies changed and how have we prepared? ■ Does a lack of policy "cushions" make this activity too risky for us?	■ Does our partner have any policy or regulatory incentives for entering this alliance? ■ If so, how can we build the alliance so their commitment goes well beyond such incentives? ■ What if those incentives disappear?
3. Operating Reserves and Capital	■ Do we have enough access to money to survive a period of loss from this activity? ■ If the activity succeeds, can we fund its growth? ■ What are the up-front costs of this venture? Can we afford to lose that money?	■ Do we/should we have a financial stake in the alliance? ■ Would a commitment of capital endanger other activities or operations? ■ If we do not commit financial resources, will we give up any control of the relationship?
4. Human Resources	■ Do we have staff with skills in both business and the specific line of business for which we want to earn income? If not, can we afford to hire them? ■ Do we have the capacity to give this activity appropriate staff attention? ■ How will we make sure the income center doesn't detract from other work?	■ Do we have staff with the skills to manage this relationship or can we hire them? ■ Do we have the capacity to give this relationship appropriate staff attention? ■ Will the alliance take us away from other work or pull us off course?
5. Objective Analysis	■ What have we learned from market and feasibility analyses? Is there any profit margin in this business? ■ Is there enough of a margin for us to break even or make a profit, given the inefficiencies caused by our social goals?	■ In what measurable ways will we increase our social impact by entering this alliance? ■ What if we do not reach benchmarks or if the alliance begins to steer us off course? ■ Has our emotional investment in the alliance colored our analysis?
6. Leadership and Board	■ Do some board members have an understanding of the business world and willingness to help build support for this venture internally and help advise us? ■ Does the board either give leadership enough room to make decisions, or make decisions at a pace appropriate for a business?	■ To what degree is our partner's commitment due to the reputation, competence or connection of the current leader(s) or board members? What if they leave the organization? ■ What role should the board and leaders play in the alliance? ■ Is the decision-making and mindset of our leadership and board compatible with our partner?
7. Project-Based Cost Accounting	■ Which of our activities make/lose money? Where will this new one fit in? ■ Can our current systems measure the true costs of this activity to determine whether it makes or loses money?	■ How much this alliance will cost us in resources, overhead, staffing, etc. and how much we have available to support it? ■ Do the financial and/or social benefits exceed costs?
8. Understanding of Market Forces	■ Who is the market for our good or service? What are they willing to pay? ■ Who are our competitors? What are their prices?	■ What are the factors that affect our partner's business? Why are they in this alliance? ■ Are we getting a fair "price" for what we bring to the alliance?
9. Sticking Close to Core Competencies	■ Are we good at this activity? Are there obvious competitors or peers who are better at it? ■ Is this activity a stretch for us? Will we actually be learning it as we go? How will that impact our financial success?	■ Can we show our partner that we are experts at whatever knowledge we bring to the alliance? ■ Are we trying to become what our partner is looking for? Is it worth it and how successful can we really be?
10. "Being Ahead of the Curve"	■ What potential changes in the market economy will affect this line of business? ■ How steady is the demand for this good or service? Will it be short-lived? ■ How can we position ourselves with regard to competitors?	■ What changes in our community's need might be well served by this alliance? ■ What changes in the market will affect our partner's business, and how might this endanger the alliance? How can we safeguard against this?

VI. CONCLUDING REFLECTIONS

The following are general recommendations for increasing the impact of community-development organizations through the application of business discipline and entrepreneurial thinking:

1. Improving the Dialogue

Overcoming False Separations

Currently there is a frustrating lack of communication between those organizations which are "in the know" about social entrepreneurship and those which are not. This strengthens the perception of funders and academics that some organizations are simply ahead of the curve, some behind. These labels are oversimplifications at best. They create a false paradigm that there exist two kinds of community-based organizations when in fact there is a broad spectrum and many shades of gray. Some could be called entrepreneurial but do not employ the discipline of business, while some are very disciplined but may have little social impact because they lack the creativity and flexibility to address community need.

Going Beyond the Jargon

This field of discussion has an abundance of jargon. Besides being less than obvious to the lay person, much of this jargon is used differently by nonprofit professionals and business professionals. Words like "enterprise," "entrepreneurship" and "venture" are being adapted from the business world to the nonprofit world, but are often buzzwords rather than actual descriptors. Even the word "efficiency" has become misunderstood. Economists know it as a way to describe the solution with the least possible monetary waste. But when a funder seeks efficiency in its grantees, the word is much more value-laden and does not always allow for the market inefficiencies inherent in an organization whose mission is to correct for the market's negative externalities. We could greatly improve the quality of our dialogue if we make an effort to speak and write on this topic in the most plain and precise language.

Distinguishing Business Discipline From Entrepreneurship

As this paper has discussed, ideas of "tightening up" or increasing business discipline are distinct from entrepreneurialism. Tools for business discipline are relatively simple, concrete ideas meant to help organizations waste less and be more effective. Ample resources and teaching materials are available to organizations seeking them. "Entrepreneurial" is this less tangible realm — it is certainly desirable, usually means creative, does not always mean efficient and can apply to a person or organization in any sector. This paper mainly uses "entrepreneurial" to refer those organizations which find the best ways to accomplish their goals by considering the full spectrum of strategies and methods. It will be important, going forward, for funders, policymakers, practitioners and academics to work together to develop these concepts as distinct ideas with meanings we all understand in a uniform way.

2. Sharing the Responsibility

The pressure on the nonprofit sector to incorporate both business discipline and entrepreneurial savvy is strong, but it is unfair and unrealistic to put the burden on the organizations alone. Both funders and policymakers can work to enable these changes in the nonprofit sector. Support from both of these groups can greatly affect the ease with which community-development nonprofits continue to find creative ways to meet the needs of their communities while integrating new tools from the business world to help their resources go farther.

Many foundations reward organizations with business discipline and entrepreneurial spirit. Some are now realizing the need for them to become partners in the process of developing those traits in organizations.[44] Foundation leaders can help the nonprofit sector by understanding what really works in practice and how organizations come to possess certain desirable characteristics. Some grant processes still provide perverse incentives: the more effort an organization makes toward greater self-sufficiency, the fewer funds they are granted. Some funding organizations are showing leadership by designing more realistic funding systems. Bankers Trust, which primarily funds community-development corporations (CDCs) for housing and economic development projects, provides two-year loans after an initial three-year grant with the intention that the organization will be self-sustaining after that point.

The growth of venture philanthropy[45] can help nonprofits fund startup or expansion of entrepreneurial activities. Venture philanthropists are looking for those organizations that have the potential to "go to scale." They are interested in significantly investing in organizations and working side-by-side with them to manage their growth. While this type of funding will not work for every organization, and may allow the funder more control than some nonprofits are comfortable with, venture philanthropy funds may be a viable option for a few community-development organizations.

Supports in place for housing development show how policy can be used to help nonprofits do the work most needed in their communities. The Low Income Housing Tax Credit and other policy supports have shaped affordable housing development and the development of organizations around the provision of affordable housing. As times change and those same organizations rise to the new challenges in their communities, such as economic development, welfare-to-work transitions and, increasingly, other human service work, policy-makers can help by finding new ways to support the new work of nonprofits. The New Markets Initiative was an attempt to address the current lack of support for economic development efforts, but probably will not have much effect during this administration. Currently, there is little safety for nonprofits and little incentive for the private sector provided by policies to support economic development in distressed communities.

Finally, a critical shortage of operating capital still exists for many community-development nonprofits. This remains both an obstacle to, and an incentive for, organizations to integrate business discipline. But no amount of entrepreneurialism or discipline is likely to cure this shortage of operating capital. In fact, earned-income activities often require significant start-up capital, increasing nonprofits' capital shortage. It may be unrealistic to expect organizations to address this shortage alone. If an earned-income activity succeeds, its income may be used as operating capital. However, since we know that few such activities succeed at earning income and more likely generate some revenue, covering some of their own costs, organizations may still end up short on operating capital. The Robin Hood Foundation and other funders are beginning to provide funding at some level as long as an activity is performing well, demonstrating an understanding that just because a nonprofit starts an earned-income activity does not mean its capital problems are solved.[46] Funders, lending institutions and policy-makers can all play a role in addressing this chronic shortage of operating capital.

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[44] See Appendix D for a list of characteristics and indicators from the Kauffman Foundation.
[45] See Glossary, Appendix A.
[46] Collins, et al., 1997.

3. Customizing Social Entrepreneurship to Fit the Organizations

There is no silver bullet for making nonprofits effective and self-sufficient. Rather than making community-development organizations try to fit into a new mold or new culture of business, ideas of social entrepreneurship must be customized to individual organizations. While every organization can benefit from some amount of tightening up — improving accounting systems, improving staff training, measuring outcomes — that amount may be different depending on the organization's size, culture and goals. It will help any organization to do cost accounting and know where all resources are gained and lost, but what is done with that information must depend on that organization. For example, a small organization whose roots and competency lie in community organizing probably should not cut that out of its activities because it loses money.

Beyond general improvement of business discipline, there is a spectrum of potential entrepreneurial activities for community-development organizations. For some, the best solution may be forming a CDC collaborative to reach efficiencies of scale. For others, it might be forming a strategic alliance with a developer or bank to expand services. For some, it might be charging below-market fees for job training. For a few, it might mean starting a manufacturing or loan business and funding 90 percent of the organization's budget with the revenues.

4. Realizing the Limits of Nonprofit Self-Sufficiency

The goal of 100 percent self-sufficiency is probably unfeasible and possibly inappropriate for most community-development nonprofits. As Richard Ruiz of El Centro put it, "if you rely 100 percent on self-generated income, you will inevitably begin to make all decisions based on how to ensure and increase that income. That's when you lose sight of your mission."

Social enterprises often create social value through both their end product and their processes. This is true of many CBOs that focus on community participation and democratic methods of decision-making. The "process-related value" created through business operations may not adequately replace the civic participation facilitated by nonprofits. Process-related value is tough to measure and easy to overlook, but should be weighed in the decision to convert operations or activities to more businesslike or efficient models.[47]

Simply put, nonprofits exist for a reason. The negative connotations sometimes attached to business rhetoric developed because of the undesirable social outcomes that can arise from a pure market system. The field of community development emerged to combat some of these outcomes; to make decisions, provide services and serve people the market otherwise would not. Therefore, strategies for applying the principles discussed in this paper are useful only insofar as they are able to *enhance* the social impacts of organizations. Somewhere, as organizations are beginning to discover, there exists a fine line for each organization between employing these strategies in ways that enhance mission and in ways that detract from mission. Finding an organization's formula for maximizing this overlap of market forces and nonprofit ethics by staying close to that line — without crossing it — will be the challenge for community development leaders in the coming years.

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[47] Dees, 1994.

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Harvard Business Review on Nonprofits. Harvard Business School Press, Boston, 1999.

Letts, Christine, William Ryan and Allen Grossman. *High Performance Nonprofit Organizations: Managing Upstream for Greater Impact.* John Wiley & Sons, New York, 1999.

Sealey, Kelvin Shawn, Jerr Boschee, Jed Emerson and Wendy A. Sealey, editors. *A Reader in Social Enterprise.* Pearson Custom Publishing, Boston, 2000.

Also see the list of recommended readings on the Roberts Enterprise Development Fund Web site at www.redf.org/download/other/readlist/doc.

Web Sites

Aspen Institute, www.aspeninst.org.

The Conference Board, www.conference-board.org.

Community Development Research Center at New School University's Milano School of Management and Urban Policy, www.newschool.edu/milano/publications.html.

The Financial Innovations Roundtable, www.finir.org.

National Congress for Community and Economic Development, www.ncced.org.

The National Economic Development & Law Center, www.nedlc.org.

Paving Pathways to Sustainability (a project of Fannie Mae, Community Wealth Ventures and the Meyer Foundation), www.pavingpathways.org.

The Roberts Enterprise Development Fund, www.redf.org.

APPENDIX A: GLOSSARY

Cause-related marketing
In cause-related marketing campaigns, a corporate marketing department (or hired public relations firm) and the nonprofit may work together to craft a message for the campaign that satisfies the marketing goals of both parties. Nonprofits may receive a fee or a percentage of sales from the corporate partner in exchange.[48]

Double bottom line
Adapted from the phrase "bottom line," this is used to describe the balance that effective nonprofits must maintain as they monitor their two measures of success: social impact and financial health. For a nonprofit manager, mission is the primary bottom line. Many socially conscious, for-profit businesses are said to have a double bottom line as well, but generally hold social goals as secondary to financial ones.

Nonprofit enterprise
A revenue-generating venture founded to create jobs or training opportunities for very low-income individuals while simultaneously operating with reference to the financial bottom line; also known as social-purpose businesses, community-based businesses, community-wealth enterprises.[49]
Also: Income-producing enterprises developed by nonprofits primarily for their income streams.[50]

Program-Related Investment (PRI)

An alternative to grants that involves below-market-rate investments in social enterprises, both nonprofit and for-profit.[51]

Social enterprise
A private organization dedicated to solving social problems, serving the disadvantaged and providing socially important goods that were not judged to be adequately provided by public agencies or private markets. This does not include all nonprofits, specifically those that are primarily member-serving.[52]

Social entrepreneur
According to a tentative definition constructed in 1998 by J. Gregory Dees of the Harvard Business School, a social entrepreneur is one who:

1. plays the role of change agent in the social sector;
2. relentlessly pursues opportunities to create and sustain social value;
3. applies innovative approaches in his or her work and funding;
4. acts boldly without being constrained by the resources currently in hand; and
5. exhibits a heightened sense of accountability to the various constituencies served (communities and investors) for the outcomes he or she creates.

[48] Pearson, 2001.
[49] Emerson and Twersky, 1996.
[50] Dees, 1994.
[51] Ibid.
[52] Ibid.

Social-purpose business venture
For-profit organizations that also qualify as social enterprises; their investors or funders are willing to cap their financial returns in order to further the organization's social objectives. Also: Synonym for nonprofit enterprise, community-based business, community-wealth enterprise.[53]

Social Return on Investment (SROI)
Popularly used to mean the social value created by nonprofits; a more specific meaning has been given to this term by the Roberts Enterprise Development Fund. Its SROI Methodology measures SROI quantitatively using six metrics.[54]

Venture capital
Builds an investment model for innovative ideas and capable organizations to get them to market.[55]

Venture philanthropy
Approach that emphasizes funding social entrepreneurs in organizations with scale-up potential. Support by the funder tends to be long-term and hands-on. Funders invest significantly in a few organizations rather than minimally in many. Support may also include sharing of expertise, board participation and team-building between the organizations.[56] Uses some principles from venture capital firms.[57]

[53] Emerson and Twersky, 1996.
[54] More information available at www.redf.org.
[55] Reis and Clohesy, 1999.
[56] Letts, et al., 1997.
[57] See above definition of venture capital.

APPENDIX B

EARNED-INCOME ACTIVITIES AND STRATEGIC ALLIANCES: A SURVEY OF COMMUNITY-DEVELOPMENT NONPROFITS[1]

Attention NRTI participants: Your Help is Needed!

Please take a moment to fill out this brief survey ONLY IF you work at a community-development nonprofit organization:

1) The organization I work for is called: ***59 different organizations are represented in the results***

2) My position there is: (circle one)

executive or senior manager: **28** ***middle manager:*** **15** ***program/other staff:*** **16**

3) Do you charge fees to customers for any of your activities?

No, we do not charge any fees: 21

Counseling/Training: 18 Loan Pkging/Origination: 16 Inspections: 10 Other: 12

If "other" please state activities:

Credit reports, energy audits, rent technical assistance to CDCs, grant writing, real estate, sale of training publications, Individual Development Account coordination, appraisals, immigration services, mortgage application processing

4) Please estimate what % of your annual operating budget currently comes from:
Don't know/left blank: 9

- **"earned income" (i.e. fees, interest/rental income):_____%** ***Range: 0-100%, Average: 24.8%, 41<50%, 9>or=50%***
- **Private grants: _____%** ***Range: 0-100%, Average: 30.9%, 37<50%, 13>or=50%***
- **Public subsidies/grants: _____%** ***Range: 0-90%, Average: 42.5%, 26<50%, 24>or=50%***
- **Other: ______%** ***Range: 0-50%, Average: 2.59%, 42=0%, 8>0%***

Please specify "other" sources:
housing development project surplus, membership dues

5) In the next five years, do you expect the ratio of earned income to total annual budget to:

Increase: **44** ***Remain about the same:*** **5** ***Decrease:*** **1** ***Don't Know:*** **9**

6) Have you ever started a new activity or subsidiary with generating revenue over costs (that is, turning a profit from that particular activity) as one of its top goals? ***Yes: 24 No: 32 Don't Know: 3***

7) Do you have any "strategic alliances" with for-profit partners? ***Yes: 43 No: 13 Don't Know: 3***
If you answered "yes", please continue answer the following:

-If with a bank, does their commitment go beyond CRA requirements?
Yes: 29 No: 10 Don't Know: 4

-What assets does your organization bring to the alliance?

Community development knowledge/experience, good PR, increased profit, credibility in the neighborhood, eligibility for city funding, access to 2nd mortgages, credit and homebuyer counseling services, eligibility for tax credits, housing development experience, management expertise, good reputation, political ties, expertise in preparing buyers, loan and savings account customers for banks, intake and education services of prospective homebuyers, neutral advice, qualified staff, good publicity opportunities, access to low-moderate income markets, knowledge of how to get people mortgage ready, 501(c)(3) status.

-Does your organization gain nonmonetary resources from the alliance?

Yes: 31 No: 6 Don't Know: 6

-Was this relationship initiated:

by your organization: 26 by the for-profit: 5 with the help of an intermediary: 5 don't know: 7

8) In the next 5 years, do you think the importance of creative alliances with for-profits for your organization will:

Increase: 50 Remain about the same: 2 Decrease: 0 Don't Know: 7

9) In the next 5 years, do you think the importance of a community-development nonprofit organization's ability to generate earned income will:

Increase: 55 Remain about the same: 2 Decrease: 0 Don't Know: 2

10) What is your level of confidence in your current accounting system to accurately calculate the total costs for each of your activities, including staff time, overhead, etc.?

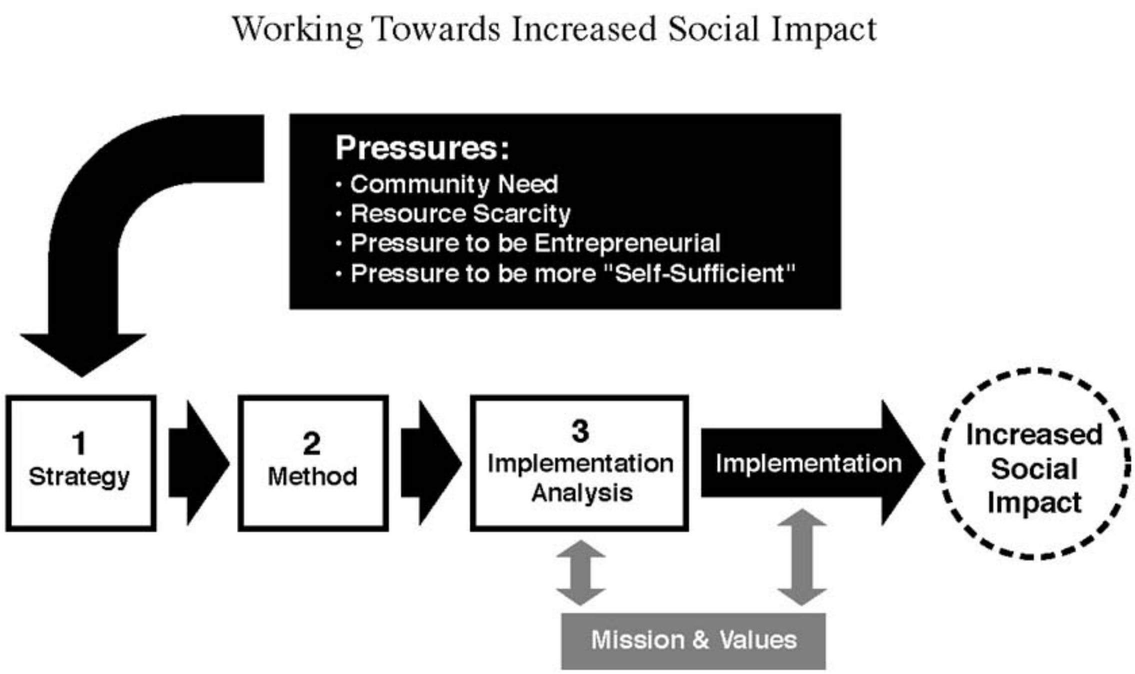
Not at all confident: 4 Not Very Confident: 8 Modestly Confident: 28 Very Confident: 19

11) Does your organization have a multi year business plan? ***Yes: 43 No: 13 Don't Know: 3***

--If yes, does it contain financial goals? ***Yes: 36 No: 7***

THANK YOU FOR YOUR TIME!!
YOUR INPUT IS ESSENTIAL FOR A CURRENT RESEARCH PROJECT.

APPENDIX C: ILLUSTRATION OF WORKING TOWARDS INCREASED SOCIAL IMPACT



- Organizations feel pressure to be more entrepreneurial and less reliant on grants.
- The ultimate desired end to making improvements to entrepreneurialism and self-sufficiency for a community-development organization is increased social impact.
- Many organizations feel pressured to use earned-income strategies or strategic alliances as methods (2) for achieving those ends
- It is helpful to go to step 1 first and decide what overall strategy an organization is trying to achieve with that method. Diversification? Growth? (See section II of paper.)
- Many organizations then jump from choosing a method straight into implementation. It is helpful instead to spend some time on step 3 and do a thorough an implementation analysis.
- Most earned-income activities and strategic alliances that fail do so because of some problem with implementation.
- Any method of increasing social impact must be checked and rechecked not only during implementation analysis but also throughout implementation, since the environment or situation may change.
- These methods are only useful in the event that an organization can balance them with mission and values to achieve increased social impact.

APPENDIX D: CHARACTERISTICS OF EFFECTIVE NONPROFITS[58]

Characteristic	*Indicators of That Characteristic*
Sustainable	■ Organization has diverse funding sources so it is not overly dependent on a single funding source. ■ Mutual respect, knowledge and integrity between the organization and funders. The organization communicates with its major funders on an ongoing basis to address fiscal issues or challenges. ■ Organization attracts, creates and sustains sufficient new resources by continuously seeking funding sources. ■ Appropriate financial controls are established and followed within the organization. ■ Independent auditors conduct financial audits and reviews at regular intervals. ■ Financial crises (unpredictable events beyond the control of the organization) are managed. ■ Organization's leadership has, as a matter of written policy, established a reserve fund sufficient to cover operating expenses for a planned period of time.
Customer-Focused	■ Everyone connected to the organization treats customers with respect and courtesy. ■ Facilities provided for customers are safe, attractive and well maintained. ■ Customers may express opinions and concerns via well established and publicized channels. ■ Feedback from all customers is solicited and responded to on an ongoing basis. ■ Customer satisfaction is a primary concern. ■ Organization understands the needs of stakeholders and constituencies.
Entrepre-neurial	■ Organization continually pursues opportunities that are aligned with its mission. ■ Organization has taken the lead in identifying unmet community needs and developing innovative solutions to address those needs. ■ Organization continually pursues new resources to apply to fulfill its mission. ■ Organization takes responsible risks to develop or promote new programs without needed resources at hand. ■ Organization uses due diligence when approaching new challenges or opportunities. ■ Organization understands the importance of crossing boundaries, as appropriate, between the public, private and nonprofit sectors. ■ Organization is trusted by community it serves; communicates openly with staff, customers and community. ■ The community, organization staff and customers hold leaders in high esteem. ■ Organization invests resources in professional development for management, staff and volunteers. ■ Leaders are active and hold leadership positions in other community or professional organizations at the local, state or national levels.
Outcomes-Oriented	■ Organization recognizes the importance of incremental achievement. ■ Procedures are in place to measure program and organizational outcomes. ■ Organization reviews the quality of services to generate improvements that will benefit clients. ■ A strategic plan guides the organization. ■ Organization monitors organizational changes. ■ Organization evaluates outcomes in ways that are innovative and useful to guide decision-making by program leadership and funders. ■ Organization documents the connections between the mission and outcomes.
Adaptable	■ Organization can identify major changes it has made within the past several years to meet changing community needs. ■ Organization analyzes whether and how the changing environment can work to its advantage. ■ Continuous innovation and learning prevail throughout the organization. ■ Technology is current and appropriate to services provided. ■ Programs are reviewed on a regular basis to ensure that the current needs of customers are met. ■ Organization uses partnerships, strategic alliances and collaborations to leverage opportunities. ■ Organization plans for the future for its competitive advantage. ■ Organization acknowledges its links to the past, its responsibility to look toward the future and changes it has make in response to community needs.
Mission-Directed	■ Organization uses the mission statement as a guidepost by which success is determined. ■ Mission and vision statements are communicated throughout the organization and prominently displayed. ■ Actions and programs of the organization reflect the mission and vision statements. ■ Procedures are in place for the review of the mission statements at appropriate intervals. Organization can demonstrate that it reviews its mission and vision statements at regular intervals and makes necessary adaptations that support its strategic plan. ■ Organization can document how the strategic and/or business plans are aligned with the mission. ■ Organization is able to cite examples of cases in which decisions at all levels of the organization were guided by the mission and values of the organization. ■ A dynamic and engaged board clearly understands governance and carries out its responsibilities.

[58] Adapted from "Profiles in Organizational Effectiveness for Nonprofits." Report by the Ewing Marion Kauffman Foundation, 2001.

ACKNOWLEDGEMENTS

Interviews
Nancy Andrews, Low Income Housing Fund
Roland Anglin, SEEDCO
Jefferson Armistead, LISC
Michael Barr, Brookings Institution
Peter Beard, Fannie Mae
Don Chatfield, Primavera Builders
Lisa Davis, Codman Square CDC
Annie Donovan, National Cooperative Bank Development Corporation
Evelyn Friedman, Nuestra Communidad Development Corporation
Maria Garciaz, Salt Lake Neighborhood Housing Services
Mossik Hacobian, Urban Edge
Bart Harvey, Enterprise Foundation
Daniel Helfman, Greyston Bakery
Dick Jones, Boston Community Capital
Brad Lander, Fifth Avenue Committee
Alvaro Lima, Initiative for a Competitive Inner City-Boston
Monsignor William Linder, New Community Corporation
George McCarthy, Ford Foundation
Brenda McDaniel, Kentucky Highlands Investment Corporation
John Nelson, NCCED
Jeremy Nowack, Reinvestment Fund
Chris Park, Washington Mutual
Richard Ruiz, El Centro, Inc.
Mike Savage, NCCED
Michael Swack, Southern NH University
David Sweeny, Greenpoint Manufacturing and Design Center
Rosa Rios Valdez, Cen-Tex Certified Development Corporation
Marc Weiss, Economic Development Assistance Consortium
Alfred Wise, Community Wealth Ventures

Additional Thanks
Sharon Anderson, Neighborhood Reinvestment Corporation
Xavier Briggs, Hauser Center for Nonprofit Organizations, Harvard University
Robert Burns, Neighborhood Reinvestment Corporation
Conrad Egan, Millenial Housing Commission
Greg Gonyea, g2 studios
Bruce Gottschall, Chicago Neighborhood Housing Services
Cornelia Kent, Neighborhood Reinvestment Corporation
Kathryn Lawler, Kennedy School of Government, Harvard University
Donna Hubbard Mobley, Sacramento Neighborhood Housing Services
Meredith Pearson, Consultant

Ron Phillips, Coastal Enterprises, Inc.
Bill Ryan, Hauser Center for Nonprofit Organizations, Harvard University
Richard Stallings, Pocatello Neighborhood Housing Services

Collaborating Staff at The Joint Center for Housing Studies of Harvard University and Neighborhood Reinvestment Corporation
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