

be a question of setting up the solar systems, then leaving it to the community to get on with it. 'That wasn't right.' A lot of the systems stopped working, but 'it wasn't a technical problem, it was a problem of sustainability. We had to understand the social arrangements, the economy of each family, then work with social psychology and promote improvements in the model.'

### 'Not a mistake, but an adjustment'

Often so-called 'mistakes' seem to relate to the overall understanding of the situation rather than to a more specific practical issue. According to Fazle Abed (BRAC, Bangladesh), one of BRAC's cherished original tenets was that they would need to work in a community only for five to ten years, and 'after that poor people would take over and do things themselves'. This was a practical matter as well as a matter of principle: if a small organization is to have a nationwide effect, it can't spend all its time in one area. However, they found that poor people continue to need basic services if the government isn't providing them. 'So basically we have to be there.' The initial idea of withdrawing from an area he describes as 'not a mistake, but an adjustment'.

His remark could be an epigraph for this article. Social entrepreneurs aren't following books of instructions, they're making it up as they go along, and they're often attacking problems that no one has previously succeeded in solving. What's important is not that they make mistakes but that they are able to correct them and learn from them and share their experience with others. @

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# The growth capital market in the US

**Heiner Baumann** With hundreds of billions of dollars given to charities every year by individuals alone (\$180 billion in 2003), foundations with assets larger than most countries' GDP,<sup>1</sup> and a culture that places a high value on ambitious visions and entrepreneurship, one would expect it to be easy to find funding to grow social innovations to scale in the US. It isn't. One of the primary obstacles is lack of access to growth capital.<sup>2</sup> Without sufficient growth capital, social entrepreneurs are forced to continuously focus on scrambling for funds and cannot put sufficient energy into the other activities that would ultimately make their organizations more compelling to a wide variety of funders.



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Of the roughly half million US non-profits,<sup>3</sup> 92 per cent operate with a budget of less than \$1 million a year. Small can be beautiful, but for those with aspirations to reach millions in need and address large-scale social problems, small is inadequate. Over the last 30 years, an estimated 10,000 such high-aspiration social entrepreneurs have started new organizations to 'change the world'. Only 21 of these organizations have reached an annual operating budget of \$20 million or more. The result is that the 3,300 organizations (0.6%) that achieved an operating budget of \$20 million or more are dominated by outfits like the Salvation Army, Boy Scouts of America, and other non-profits that are between 50 and 100 years old.<sup>4</sup> In the battle for capital, the best social enterprises struggle to compete for resources with the household names and alumni databases of incumbents.

Some contemporary social entrepreneurs whose organizations have been growing rapidly have turned to venture philanthropy firms that specifically support the formation, establishment and growth of social enterprises. As this article will show, the US does have a developing growth capital market for social entrepreneurs, of which these venture philanthropy firms are part, but what this market provides is far from meeting the needs of social entrepreneurs in the US today.

### College Summit and its partners in growth

Take Washington DC-based College Summit as an example. Founded in 1995, College Summit prepares low-income students for college application and enrolment. Over the last three years, College Summit has grown at nearly 50 per cent per year in both revenue and number of students served. In 2004, it served

nearly 3,500 youth with a budget of close to \$6 million. With a scalable model and an increasingly diversified funding platform, College Summit is well on its way to scale.

Along the way, College Summit has worked with a number of different organizations that focus on supporting social entrepreneurs at different stages:

- ▶ In 1997, founder J B Schramm received funding from Echoing Green, a non-profit that supports promising social enterprises during their launch phase with start-up capital (typically \$60,000 over two years), some technical assistance and peer-to-peer learning for the social entrepreneur.
- ▶ In 2000, J B Schramm was named an Ashoka Fellow. Ashoka focuses on social entrepreneurs who are moving beyond the launch phase and have the aspiration and potential for national impact by changing patterns across society. Ashoka provides financial resources (typically \$90,000 to 180,000 over three years<sup>5</sup>), cross-sectoral technical assistance and opportunities for ongoing collaboration and learning among Ashoka Fellows around the world.
- ▶ In 2002, College Summit became a New Profit Inc portfolio organization. New Profit works with the whole leadership of the social enterprise (including the board), focusing as much on the model and the organization as on the individual entrepreneur. New Profit provides greater financial resources (typically \$1 million over four years); it also works very intensively on a one-to-one basis with its portfolio organizations on strategy, growth planning, leadership development and other key areas of development critical to scaling social innovations.
- ▶ In 2004, College Summit received \$300,000 over two years from the Skoll Foundation for developing and systematizing organizational operations to enable scaling.
- ▶ In December 2004, College Summit entered into an investment partnership with Venture Philanthropy Partners (VPP) to build out College Summit's regional organization in the Greater Washington DC region, with an initial target of serving 3,000 students.

Other growth-oriented, highly successful social entrepreneurs have followed a similar path.

Interestingly, five of the eight social entrepreneurs leading New Profit portfolio organizations have been Echoing Green Fellows.

## The growth capital providers

At the Venture Philanthropy Summit last November, more than 200 representatives from several dozen US philanthropic organizations that focus on supporting social entrepreneurs and their organizations at different stages of their development met to share their experiences and reflect on joint opportunities and challenges. The table opposite provides an overview of some of the organizations represented. What these capital providers have in common is that they all work in long-term (three to seven year), mutually accountable, high-engagement relationships with a focus on results and capacity building. All provide non-financial as well as financial support. Not all of the organizations are purely growth funders, and they don't necessarily use the term 'venture philanthropy', but they all focus on social enterprises and growing the social impact of the organizations they support.

## What is missing?

While this group of capital providers has been an enrichment to the philanthropic landscape in the US, the less than \$100 million in their collective annual payout is only a drop in the bucket – and not all of that is directly for social entrepreneurs, or intended to serve as growth capital. Individual donors, companies and government do sometimes play a growth-funder role, but this is not their specific focus. More often they prefer working with well-established organizations or restrict their giving to programmatic support. Nor are they geared to providing the non-financial input that dedicated growth funders provide.

There are also capital providers like the Non Profit Finance Fund (NPF) and Calvert, which provide zero interest or reduced-rate loans and other financial non-grant arrangements. These organizations tend to provide working capital rather than unrestricted growth capital. Bell, for example, one of New Profit's portfolio organizations, received a \$1.5 million bridge loan from NPF to make up for a temporary shortfall of cash and working capital. Earned revenue strategies can yield unrestricted income that can be used for growth purposes, but for many social change organizations such opportunities are limited. More, and larger, venture philanthropy funds, and other growth capital providers who understand social entrepreneurs, are therefore needed to satisfy the demands of rapidly growing, high-impact social enterprises.

Dollars aside, the other piece that's missing is the next step up from New Profit. While New Profit typically helps social enterprises grow to approximately \$10

1 The total assets of the Bill and Melinda Gates Foundation, for example (\$26 billion), are larger than the gross domestic product of 103 countries.

2 Another major barrier is lack of access to top talent. Yet another is the difficulty for relatively small organizations in carrying out satisfactory performance measurement – something that is vital if they are to raise the money they need.

3 This figure excludes religious organizations, church and school organizations and organizations not required to file with the IRS. Altogether, there are currently 1.4 million non-profits in the US and that number currently grows by 40,000 a year.

4 This is in stark contrast to the for-profit sector where the largest company (Wal Mart) is 40 years old and many Fortune 500 giants such as Microsoft, Dell and Home Depot have been founded in the last 30 years.

5 These figures are valid for the US only; in general, Ashoka provides a stipend that is equivalent to the remuneration of an executive director of a start-up non-profit.

million over four or five years, no issue-agnostic, nationally oriented, next-stage funder exists that can support these organizations' expansion from \$10 million in revenue to \$20 million or \$30 million.

**What is growth capital?**

It's important to differentiate between programmatic revenue and growth capital. New Profit defines growth capital as the deficit incurred en route to a sustainable new level of enhanced performance. Enhancement could mean several things. Enhanced quality of impact, enhanced scale of impact or enhanced financial health. Programmatic revenue doesn't pay for any of this. It pays for delivering a certain service without really augmenting the quality or financial health of the organization. Social entrepreneurs need to know how much of each category they need – internal accounting as well as interactions with funders should be different in each case. Funders also need to understand how much of each they give and what exactly they are 'buying'. Are they 'buying' a stronger, more capable organization, or the services and 'output' of

6 My thinking in this paragraph was very much influenced by George Overholser, who is an expert on the topic of non-profit growth capital and the difference between 'building' versus 'buying'.

an organization within its current strengths and capabilities?<sup>6</sup>

Where is the income of a 'sustainable' organization going to come from? New Profit encourages its portfolio organizations to develop diversified funding – with an appropriate combination of government contracts, corporate sponsorship, individual donations, foundation grants, and fees for service. In most cases, however, where the clients are young or poor or otherwise marginalized people, fees are never likely to make up a significant proportion of income. What the growth funder wants to help build, therefore, is the capacity to raise these diversified funds.

Should growth capital be repayable? For many social enterprises, unless there is a third party payer, this is not a realistic option if they want to keep the service at a price that is affordable by their clients. In effect, this would mean charging poor and vulnerable clients premium fees in order to pay back loans – something that is unacceptable to all parties involved. @

**Profiles of selected US nonprofit capital providers\***

	Cash paid out to non-profits annually	Estimated value of pro-bono services contributed annually	Overarching goal of the organization	Does the organization focus on a specific field or issue	Geographic scope	Does the organization actively try to grow the non-profits it supports
Ashoka (US)	\$1.1m	Not tracked	Support the development of an entrepreneurial, productive and globally integrated citizen sector	No	National/International	Yes
Common Good Ventures	\$50-100k	Approximately \$1m	Improve the performance of non-profits, leading to greater social returns and greater sustainability	No	Local/regional	Growth in impact and sustainability, not necessarily size
Echoing Green	\$1m +	Not tracked	Provide first-stage funding and support to visionary leaders with bold ideas for social change	No	National/international	Yes
Edna McConnell Clark Foundation	\$25-27m	Not tracked	Improve life prospects of low-income youth (9-24)	Youth development	National	Yes – after ensuring effectiveness and strong internal operations
New Profit Inc	\$1.7-2m	\$3-4m	Support social entrepreneurs with financial and strategic resources necessary to grow high-impact social innovation	No	National	Yes
New Schools Venture Fund	\$2-8m \$19m+ projected in FY05	Not tracked	Transform public education by empowering education entrepreneurs and by building a network of thought leaders	Public education for underserved communities	National	Yes
Peninsula Community Foundation/Center for Venture Philanthropy	\$60m total/ \$2-3m to VP grantees	No figure but 'central to what we do'	Powerful community impact, connecting donors to causes they care about, catalysing partnerships	No	Mostly local/regional but also some national/international	Strengthen, build, then grow
REDF	\$500k-\$1.5m	\$1-1.5m	Create opportunities for homeless and low-income individuals to move out of poverty while sharing our lessons with the fields of social enterprise and philanthropy	Supported employment for formerly homeless and low-income individuals	Local/regional	Yes – growth in capacity, impact and sustainability
Robin Hood	\$50m+	\$2.5m	Fight poverty in New York City	Education, early childhood, jobs/economic security, housing, after school, hunger, government benefits	Local/regional	Yes
Silicon Valley Social Ventures	\$0.5m	Not tracked	Provide organizational capacity-building and capital and strategic assistance to non-profits	No	Local	Growth in infrastructure, service provision and, ultimately, impact
Skoll Foundation	\$12m in FY 2003-2004 out of \$25m new commitments	N/A	Advance systemic change in communities around the world by investing in, connecting and celebrating social entrepreneurs	Focuses on global social entrepreneurs at a point of inflection rather than on specific issue areas	Global	Actively tries to expand impact, which may not require a growth strategy for the organizations themselves
Social Venture Partners (US)	\$13m	\$39m	Catalyse significant, long-term positive social change by educating individual philanthropists and supporting innovative non-profits	Affiliates choose their own focus including kids, education, environment and workforce development	Local/regional	Yes – but not in most cases. Program/organizational quality usually predominates
Venture Philanthropy Partners	\$1.1-\$4.4m, with \$7m projected in FY06	Not tracked	Provide growth capital and strategic assistance to high-potential community-based organizations	Children of low-income families	Local/regional	Works to grow its investment partners to increase their impact

\* The organizations profiled, with the exception of Ashoka, Echoing Green and Skoll Foundation, all participated in a roundtable at the 2004 Venture Philanthropy Summit at Stanford University.