ONE

Creating Successful Business Models

IT IS IN THE NATURE of their work at the bleeding edge of change that social and environmental entrepreneurs are often seen to be unreasonable; the successful organizations they build, however, are anything but. Of course, people say that anyone could have predicted that a Grameen Bank or a Green Belt Movement would work, but very few people foresaw the longer-term success of Amazon, eBay, or Google. Whether entrepreneurs plan out their futures in great detail or rely on trial and error, these world-changing pioneers are learning to channel their irrepressible convictions, their boundless creativity, and their ability to amass the necessary resources into building sustainable systems and structures that address the most pressing market failures of our time.

Inevitably, many start out by responding to natural disasters (like earthquakes, hurricanes, tsunamis, famine, disease) or man-made ones (like war). The twenty-first century is likely to produce as

many—if not more of—such out-of-the-blue stimuli to action. But this isn't just about responding to existing catastrophes. Many environmental entrepreneurs, for example, are galvanized by the prospect of global climate change or other human-induced insults to the natural world. All seem driven by deeply personal, emotional responses to a disaster (or a sense of impending disaster) that threatens vast populations or ecological treasures both big and small.

Stand back, however, and it is clear that current emergency response activities and the strategies that evolve from them can rarely be called "sustainable." No matter how innovative and effective these efforts may be, they are still largely band-aid solutions. Nevertheless, a significant number of social entrepreneurs who began their work in response to specific emergencies have evolved their interventions into sustainable, transformational solutions that help prevent further disasters—or, at least, ensure coordinated and effective responses.

Some of the resulting nonprofit ventures have grown into globally respected organizations, notably Henri Dunant's Red Cross and Bernard Kouchner's Médecins Sans Frontières. Among the examples profiled in these pages, Fazle Abed's BRAC in Bangladesh and Joe Madiath's Gram Vikas in India come to mind, as do Andrea and Barry Coleman's Riders for Health in Africa, Jeroo Billimoria's Child Helpline International (which started in India and then went global), and Ibrahim Abouleish's Sekem in Egypt.

One central goal for such social enterprises—and for those who fund them—is leverage. We use this term not necessarily in the narrow accounting sense of financial leverage, although securing adequate financial resources is a critical concern for these organizations. Rather, it means leveraging all kinds of resources—from indigenous capabilities and social capital to philanthropic and governmental support, business partnerships, and income from previously untapped markets.

Increasingly, small groups of people use multiple kinds of leverage to drive change on a disproportionate scale.[1] As a result, they are able to transform their ventures and, in some cases, the entire system of which they are a part. Their efforts create new markets

and new levels of influence, often outpacing established nongovernmental organizations and mainstream business organizations.

Our best social and environmental entrepreneurs tend to excel no matter what organizational principles they adopt, but each typical structure has both advantages and drawbacks in different situations. So—like scientists racing to unlock secrets of the human genome—venture philanthropists, foundations, government agencies, and businesses are trying to uncover these entrepreneurs' secrets to success. And just as the human genome is constructed from a small number of building blocks, so too leading social enterprises seem to be built from a relatively small number of key ingredients.

The resulting structures tend to fall into three categories, or business models, which we call the "leveraged nonprofit" (model 1), the "hybrid nonprofit" (model 2), and the "social business" (model 3). All pursue social or environmental ends that the markets have largely or totally failed to address, and they use different means to do so. In the process, they may adopt unique leadership, management, and fund-raising styles, each with its own implications and lessons for people working in mainstream organizations in the public, private, or civil society sectors.

Each model offers different challenges and opportunities for would-be partners and other entrepreneurs. In this chapter we examine each one in turn, exploring several compelling examples and describing the ways they have developed. We conclude by describing one social enterprise that has morphed into a fully capitalized and profitable mainstream business without losing sight of its original goal.

Model 1: Leveraged Nonprofit Ventures

Many kinds of market failure are difficult—if not impossible—to tackle using for-profit business models. In such areas nonprofit models are likely to be the only option. The key is to leverage available resources in ways that measure up to the nature and scale of the challenges and to do so when the immediate crises that typically

drive emergency responses have faded or have yet to materialize. But nonprofits can be much harder to scale than for-profit ventures. According to the Bridgespan Group, of the 200,000 nonprofits started in the United States since 1970, only 144 have reached $50 million in annual revenue.[2]

Until recently, many people assumed that social entrepreneurs acted in the nonprofit world because their funding mainly came from the government or foundations. This has been particularly the case in the United States, where the substantial incentives for various forms of charitable giving include clear tax benefits. The paradox is that in the process, nonprofit enterprises have become uncomfortably—and often unproductively—dependent on philanthropic largesse and all the exemptions that accrue to entities operating in the public interest. This dependence generally runs counter to the possibility of expansion. In an increasingly competitive environment, the number of nonprofit organizations seeking funding has rapidly outpaced the supply of donor dollars, while the adequacy and availability of specifically targeted expansion capital has become even more problematic.

Ask most model 1 entrepreneurs why they are not working on a for-profit basis, however, and they will look at you as if you are from another planet. These people aim to meet needs that are ignored by current market mechanisms and businesses. Maybe this blinds them to the occasional opportunity to operate on a for-profit basis, but generally they operate where the market air is too thin for mainstream businesses to even think of venturing.

Model 1 entrepreneurship tends to distinguish sharply between private and public goods. *Private goods* are ones people can own individually and are typically produced by for-profit businesses. In contrast, a *public good* is one where the consumption of the good by one individual does not reduce the amount available for consumption by others.[3] So if an individual eats a cake, there is no cake left for anyone else; if an individual breathes air or drinks water from a stream, there is still air or water available to others.

Although governments are often involved in producing and ensuring access to public goods, they are not always the only ones; many private firms are involved in so doing, as is the case with health, education, safe drinking water, housing, and the like. Entrepreneurs step in to fill the gap where governments are not able—or willing—to provide a public good and where the private sector cannot justify the risk in relation to the rewards.

The following characteristics are typical of most model 1 enterprises:

- A public good is being delivered to the most economically vulnerable, who do not have access to, or are unable to afford, the service rendered.
- Both the entrepreneur and the organization are change catalysts, with a central goal of enabling direct beneficiaries to assume ownership of the initiative, enhancing its longer-term sustainability.
- Multiple external partners are actively involved in supporting (or are being recruited to support) the venture financially, politically, and in kind.
- The founding entrepreneur morphs into a figurehead, in some cases for the wider movement, as others assume responsibilities and leadership.

You could argue that entrepreneurs applying leveraged nonprofit approaches are modern-day alchemists who, with minimal financing, leverage the power of communities to transform an otherwise grim daily existence. And, while they learn a good deal from their failures, the best of them are proving more successful than the alchemists, whose experiments heralded the dawn of the industrial era—laying the foundations on which "real" science would later be built. In like manner, leading social entrepreneurs signal where the coming years will head. But companies—and other potential mainstream partners—should not be fooled into thinking that these entrepreneurs' dependence on external funds and in-kind support will make them easy partners. Quite the contrary. Many carry an understandable rage born from years of watching their communities

being shortchanged, ignored, or destroyed by greed. That said, mainstream businesses that create successful partnerships with these enterprises will likely find their thinking challenged, their horizons stretched, and their own employees reinvigorated.

It is no accident that much early model 1 entrepreneurship evolved in the context of strong religious convictions, as was the case of Mother Teresa and Habitat for Humanity. Others, like Barefoot College, which we examine next, grew out of a justified sense of rage with a system that locks people into generations of poverty and exclusion.

Bunker Roy and Barefoot College

Let's start with Barefoot College, a prototypical model 1 enterprise whose founder, Bunker Roy, might seem the quintessence of unreasonableness. Roy was born to the Indian elite, was educated in India's leading public schools (i.e., nongovernmental schools, the equivalent of private schools in the United States), and even represented India in the squash world championships, for which he is still celebrated by squash aficionados. You might say he had it made, but he turned his back on it all, eschewing the trappings of privilege, and founded Barefoot College, an Indian organization that has had a huge impact in defining and driving what Roy calls the "barefoot" approach to development.

This approach rests on the idea that anyone can become anything—from an architect to a solar engineer—without formal education. So Barefoot College set out to leverage local skills and capabilities. For more than thirty years, Roy's work has made him a leading figure in the Indian civil society sector, frequently upsetting—generally to his infinite amusement—the powers that be and, in the process, inspiring many younger activists and social entrepreneurs.

Evolving out of the Social Work and Research Centre, Barefoot College was created in 1972 by a group of students from top Indian universities under Roy's leadership. Based in Tilonia, Rajasthan, it was built around the Gandhian concept of the village as

a self-reliant unit. By applying traditional but informal educational processes to manage, control, and own technologies designed to meet basic needs, the college helps illiterate or semiliterate poor people in rural areas learn to use these technologies without relying on outside paper-qualified experts. All staff at the college take a living wage, not a market wage—and the maximum living wage is $100 a month.

The central principle is simple. To improve their quality of life, Roy stresses, the rural poor must be able to satisfy their basic needs, like drinking water, health, education, and employment. Billions of dollars are spent every year to provide these services from the top. Colleges, research institutes, and funding organizations employ urban-trained, paper-qualified professionals to provide these services at tremendous cost, but the Barefoot College team argues that in such cases there will always be a vested interest in applying a top-down approach.

Poverty today is big business, Roy argues: in effect, many mainstream players want to keep the rural population poor because thousands of urban jobs are at stake. By contrast, the Barefoot College thesis is that development programs do not need urban-based professionals because paraprofessionals already exist in the villages, and their wisdom, traditional knowledge, and practical down-to-earth skills are not identified, mobilized, or applied—indeed, such people are generally penalized because they do not have a formal educational qualification.

Barefoot College provides abundant evidence of the capacity of ordinary people to identify, analyze, and solve their own problems. Over the years, it has trained barefoot doctors, teachers, engineers, architects, designers, metal workers, IT specialists, and communicators. And the results speak for themselves. This is the only college based in a rural area that is built by the poor and managed by them. Barefoot engineers have solar-electrified the college: indeed, it is still the only fully solar-electrified college in India. Barefoot solar engineers, many of them illiterate women, have solar-electrified thousands of houses in eight Indian states. Barefoot water engineers installed the first hand pumps ever in Ladakh, fourteen thousand

feet up in the Himalayas, something that urban experts had said was technically impossible.

One of the most unusual aspects of the informal education the college provides is the night schools for children whose various responsibilities keep them from attending school in the morning. Over three thousand boys and girls attend 150 night schools. One unique aspect of their education is the emphasis on governance: the management, supervision, and administration of these schools are in the hands of a children's parliament. Every three years, the children elect a prime minister and a cabinet of ministers, who are between six and fourteen years old. (All three of the prime ministers elected to date have been girls.) The present prime minister looks after twenty goats in the morning but is prime minister in the evening. In the same spirit of democracy and transparency, Barefoot College was the first—and remains one of the few—community-based organizations in India to have conducted a social audit, opening all its accounts to public scrutiny and answering questions from the community in a public hearing.

Meanwhile, traditional barefoot communicators using puppets have changed the attitudes of many communities on issues such as child marriage, the rights of women, equal wages for women, and legal literacy. And Roy loses few opportunities when speaking overseas to tell audiences that the puppets were made from papier-mâché produced by recycling World Bank reports. True or not, the story sticks in the audience's memory and, with it, the fundamental principle of people taking their destinies into their own hands.

A visit to Barefoot College redefines the concept of simple living, as one young Australian engineer put it. While the college is life transforming for all those involved, without Roy's enormous capacity to raise external resources, it would be difficult to keep pace with some of Barefoot's current projects, including hosting solar engineers in training from other countries. This is particularly important because the college's efforts have catalyzed generation upon generation of trainees who return to their rural communities in developing countries with the knowledge and skills needed to construct rain-

water-harvesting tanks from local materials or to solar-electrify their villages and others. Comparing typical costs to the expenditures made through international aid and international consultants, Barefoot College's solutions look like an amazing bargain.

When we asked Bunker Roy what governments and mainstream business can learn from the Barefoot College experience, he replied, "First unlearn and then relearn from the simple examples of the rural poor and their amazing capacity and competence to think of simple barefoot solutions. They said of Mahatma Gandhi how expensive it was to make him look simple! Today, regrettably, this is what could be said of governments and mainstream business."[4] If there is one lesson that emerges from the Barefoot College story, it is an age-old one: visionary, energetic, and inclusive leaders can release extraordinary human potential.

Model 2: Hybrid Nonprofit Ventures

Innovation happens in each of the three models, but the most experimentation happens with hybrid nonprofit business models. Many of the new philanthropists strongly favor model 2 enterprises and are eager to work with them. One key reason: these people hope (even expect) that such organizations' imaginative blending of nonprofit and revenue-generating for-profit strategies will produce unexpected forms of hybrid vigor. Also, the more businesslike aspects of a hybrid venture can make it seem more normal than a model 1 venture, where there is no realistic prospect of profit, either now or—in some cases—ever.

As in biological hybridization, the process of creating entrepreneurial hybrids can be time consuming, the results uncertain, and the opportunity costs fairly high. Whereas biology's so-called F1 hybrids can display significantly improved growth and yield, model 2 ventures have the potential to reach new levels of social or environmental value creation.[5]

Hybrid enterprises model some of the novel forms of social and environmental value creation that will be central to business success and sustainability in the coming decades. Their main characteristics include the following:

- As with model 1 ventures, goods and/or services are delivered to populations that have been excluded or underserved by mainstream markets, but the notion of making (and reinvesting) a profit is not totally out of the question.
- Sooner or later, the founding entrepreneur—or his or her team—typically develops a marketing plan to ensure that the poor or otherwise disadvantaged can access the product or service being provided.
- The enterprise is able to recover a portion of its costs through the sale of goods and services, in the process often identifying new markets.
- To sustain activities and address the unmet needs of poor or otherwise marginalized clients, the entrepreneur mobilizes funds from public, private, and/or philanthropic organizations in the form of grants, loans, or, in rarer cases, quasi-equity investments.
- As mainstream investors and businesses enter the picture, even when they are not seeking mainstream financial returns, they tend to push hybrid nonprofit ventures to become model 3 social businesses, to ensure access to new sources of funding, particularly capital markets. This may be warranted in some cases, but it risks refocusing activities to the point where the poorest will no longer be served.

Let's take as our examples here a pair of hybrid ventures: Rubicon in the United States, which creates jobs for the disadvantaged, and Aravind in India, which restores eyesight to those unable to pay for the necessary operations.

Rick Aubry and Rubicon Programs

The first of our model 2 hybrids was founded as a nonprofit organization in 1973, but it was not until 1986, when entrepreneur Rick Aubry took over, that Rubicon Programs became a recognized leader in the social enterprise world. Rubicon was the first multiservice agency in the United States to link a real job with decent housing and a support system to sustain homeless or otherwise disadvantaged people who are trying to make positive changes in their lives.

Rubicon's business ventures were originally conceived to provide training opportunities for poor clients. But the businesses were approaching a scale where their own needs and the needs of the training programs were no longer aligned. So in 1986, when Aubry took over, he and his colleagues asked themselves a question: was the primary strategy to offer training opportunities, or was it to run successful businesses that could create jobs and sustain a training component? If the answer was the former, Rubicon would always be 100 percent donor dependent—a pure model 1 nonprofit. If the answer was the latter, Rubicon could offer training *and* earn an income from the services provided (and thereby empower people by allowing them to be part of a successful enterprise in the mainstream market). As a result of these deliberations, Rubicon took the second approach, deciding that each of its businesses would have to succeed in the competitive market in which it operated, a model that others now emulate.

Under Aubry's leadership, Rubicon has incorporated mainstream business principles into its practice and built two highly successful social enterprises: Rubicon Landscape Services, which generates annual revenues of more than $4 million, and Rubicon Bakery, one of the San Francisco Bay Area's leading bakeries, with annual sales of $2 million. Employees are primarily people with little or no work history who are trying to overcome the challenges of poverty, homelessness, and/or mental health disabilities. By contrast, the customers of Rubicon's high-end baked goods and its

high-quality landscaping services are well to do. A fundamental lesson that Rubicon has learned is that while people may like its social mission, they tend to base their buying decisions on the quality and value of Rubicon's products and services.

If you ask Rick Aubry what governments and mainstream businesses can learn from the Rubicon experience, he replies, "We focus on the outcomes that people want. The people we serve want a decent job, a place to live, and to be part of the community. By focusing on creating jobs in our businesses and with our partners and building a comprehensive range of services to make sure that people succeed in their own lives, we have created a model that governments can emulate—and that businesses can support."[6]

Dr. Venkataswamy and the Aravind Eye Care System

The Aravind Eye Care System offers one of the most intriguing hybrid models. Founded over thirty years ago by the late Dr. Venkataswamy (or "Dr. V.") and based in India, it has potentially huge implications for the health-care business worldwide, with the model even proving viable in the United States. Dr. V. and his team turned an eleven-bed eye clinic into one of the largest and most productive eye-care facilities in the world. The Aravind community has been unreasonable in exactly the same way Gandhi was—refusing to accept that the future would be a straight-line extension of current reality.

Taking its services to the doorstep of rural India, the Aravind Eye Care System has become self-sustaining—treating over 2 million patients a year (two-thirds of them for free or with a steep subsidy) and still managing to make a profit that it reinvests in growing the enterprise and continuously upgrading its services. It is an international resource and training center that is revolutionizing hundreds of eye care programs in developing countries. Amazingly, with less than 1 percent of the country's ophthalmic workforce, Aravind performs about 5 percent of all cataract surgeries in India. Since its inception, Aravind has performed more than 2.8 million surgeries and handled over 22 million outpatients.

Aravind has pioneered a sustainable model that follows the principle that large-volume, high-quality, and community-centric services can result in low-cost and long-term viability. By charging wealthier patients more and poorer patients less, it has developed a sustainable business model. This success has been achieved without diluting poor patients' quality of care. As a result of the unique fee system and effective management, Aravind is able to provide free eye care to the majority of its patients.

To give some sense of the potential of this approach, there are an estimated 37 million people worldwide who are blind and an additional 124 million who are visually impaired. The global economic burden of blindness is estimated to be around $25 billion per year. Almost 90 percent of the blind live in developing countries that face the challenges of a growing population, inadequate infrastructure, low per capita income, illiteracy, and diseases in epidemic proportions. In India alone, an estimated 12 million are blind, yet 60 percent of blindness there is a result of cataracts, which are almost always curable.

A key part of the challenge has been getting health care to those in need. So, for example, 70 percent of India's 1 billion people live in rural areas. By contrast, 80 percent of the ten thousand ophthalmic surgeons in the country live in urban areas. Given the magnitude of the blindness problem, the government alone cannot meet the needs of all at risk. Realizing this, in what looks like a modern miracle even at close quarters, Dr. V. established an alternate health-care model that would both supplement the efforts of the government and be self-supporting.

Ask Thulsi Ravilla, Dr. V.'s successor as executive director, what others can learn from the Aravind experience, and he advises:

> When trying to reach economically poor sections of the population or engaging in development work, you have to transcend the stage where you are simply reacting to market demands, shifting instead to "market driving." In most such situations, while the need or potential may exist, the market doesn't. The market-driving approach potentially gives invaluable insight

> into the design and development of products or services, their pricing, and [their] delivery mechanisms. This approach essentially defines the design parameters for success. When you look back at developmental initiatives that have failed or succeeded, you see this common thread, and this applies equally to government programs and business activities.[7]

The motivation for exploring so-called base-of-the-pyramid markets may be to address government or market failures and bring much-needed benefits to poor people or, in the case of the more commercially minded, to make money in unlikely circumstances. Just as important as the immediate questions about who will benefit and who will profit from such ventures is what they tell us about the nature and scale of the nascent markets they serve. Because they operate in emerging markets, model 1 and 2 initiatives may provide early indications of where business could head in the future. The potential for services, products, and technologies created at this level to leapfrog back into developed world markets can only grow.

Model 3: Social Business Ventures

Model 3 ventures, many of which first appeared outside the United States, may have evolved as an interesting but unintended by-product of the smaller philanthropic funds available to social entrepreneurs in other countries. Such limited resources forced entrepreneurs to set up their enterprises as social businesses—that is, for-profit entities focused on social missions. A survey of the 98 ventures formed by 115 social entrepreneurs from the Schwab Foundation's network of accomplished practitioners showed that just under one-third (30) headed model 3 social businesses. Only 2 of those enterprises, however, are based in the United States, despite the fact that the total number of U.S.-based entrepreneurs in the network is 20. The remaining 18 are model 1 leveraged nonprofit enterprises or model 2 nonprofit-based hybrids.

On the other hand, particularly in the United States, the for-profit social business is the model of choice for most environmental entrepreneurs—perhaps because there are already more obvious market opportunities for ecofriendly products and services.

Model 3 ventures are distinct from their model 1 and 2 counterparts. They are set up as for-profit businesses from the outset, though they tend to think about the question of what to do with any profits very differently than mainstream businesses. The main characteristics of people and enterprises operating in this zone include the following:

- The entrepreneur sets up the venture as a business with the specific mission to drive transformational social and/or environmental change.
- Profits are generated, but the main aim is not to maximize financial returns for shareholders but instead to financially benefit low-income groups and to grow the social venture by reinvestment, enabling it to reach and serve more people.
- The entrepreneur seeks out investors interested in combining financial and social returns.
- The enterprise's financing—and scaling—opportunities can be significantly greater because social businesses can more easily take on debt and equity.

Balancing such a venture's social mission and its financial sustainability can, however, create internal tensions. The founding entrepreneur must exercise a strong leadership role, which may make succession more challenging than it is with leveraged or hybrid organizations. On the plus side, social businesses are significantly easier for mainstream businesspeople to understand—and to develop partnerships with. This, in turn, facilitates (at least in principle) these organizations' access to capital markets, a window that's closed for philanthropy-dependent entrepreneurs.

To date, the best-known social businesses tend to be found in the area of microfinance, including the Grameen Bank and BRAC

in Bangladesh, SKS Microfinance and Basix in India, and Acción and Finca in the United States. But the number of these organizations is growing, and—particularly in the area of cleantech—they are gaining traction. Let's look at two social businesses that are quite different from those described in the sections on model 1 and model 2 organizations, as well as from the microfinance institutions just mentioned.

Ibrahim Abouleish and Sekem

Our first example was founded by Dr. Ibrahim Abouleish. Sekem, headquartered outside Cairo, takes its name from the hieroglyphic transcription meaning "vitality of the sun" and was the first entity to develop biodynamic farming methods in Egypt. Similar in many ways to organic farming, this approach also utilizes astronomical principles for planting. The approach is built around the notion that profit making can go hand in hand with an integrated socioeconomic business model, providing employees and farming communities throughout the country with the opportunity to improve their education, health, and quality of life.

Sekem's six businesses generate revenue and are grouped into a holding company that provides centralized services, including financial, quality assurance, information technology, and human resources. The first company, Isis, is a household brand in Egypt. It produces and packs bread, dairy products, oils, spices, teas, honey, jams, cereals, and many other food products that are sold in grocery stores and other shops throughout Egypt and abroad. The second, Atos Pharma, established in 1986 as a joint venture company with German companies, focuses on developing the Egyptian phytopharmaceuticals market (phytopharmaceuticals are drugs created from plant compounds—a higher-quality form of herbal medicines). This, according to Sekem's CFO, is Sekem's biggest income generator. A group of physicians and pharmacists work together in the research and development of new products for different conditions. One early indicator of quality: in 1992, Atos secured a license agreement with Weleda, a leading manufacturer of

phytopharmaceuticals in Germany, to manufacture and market natural cosmetics in Egypt.

The third company, Libra, was set up by Sekem in 1988. It is a farming company that supplies raw materials to the other Sekem companies for further processing and production. It arranges long-term agreements with farmers, ensuring them favorable conditions independent of price fluctuations in domestic and global markets. We spoke to a number of farmers about why they stick with Sekem when the market price for their produce can sometimes be higher than Sekem's price, and their consistent response was security in the long term. Sekem has a participatory approach to setting product prices. Each year, farmers talk with wholesalers, retailers, and consumers to set an optimum price for their products. That price considers incurred costs and a margin that will allow the farmer to develop further. This transparent system based on information and feedback creates trust between Sekem and the farmers and frees farmers from the anxiety of finding a buyer that will give them a fraction more per unit. Farmers also note that the organic method provides them with consistently better yields per acre year after year than the chemical method.

Fourth is Hator, established in 1996, which produces and packs fresh fruit and vegetables for local and export markets. Internationally, the products are sold through Organic Farm Food in the United Kingdom and through Eosta in the Netherlands. Hator is the fastest-growing Sekem business, and it consistently meets the demand of European and local customers. Fifth are the Sekem shops, set up in 1996, which offer a complete range of Sekem products. Finally, there is Conytex, which processes cotton without any synthetic chemical additives, producing beautiful, high-quality children's and babies' wear. Partner companies export the clothes to buyers in the United States, Germany, Switzerland, and Austria. The clothing is marketed locally under the name Cotton People Organic. In Europe it is called Alnatura, and in the United States it is sold as Under the Nile.

Sekem's growth has been meteoric. It now employs two thousand people and has become a nationally renowned enterprise and

a market leader in organic food products and phytopharmaceuticals. It has established links with European and American customers in the export trade, which account for 45 percent of its overall sales. Its commitment to innovative development led to the nationwide application of organic methods to control pests and improve crop yields. In collaboration with Egypt's ministry of agriculture, for example, Sekem deployed a new system of plant protection for cotton, reducing a farm's total pesticide intake by more than 90 percent, which led to a ban on crop dusting all over Egypt.

Egypt's many social and environmental problems are interrelated and include overpopulation, environmental degradation, inadequate education, and health care. Agriculture involves around 40 percent of the workforce and remains the least developed sector of the economy. The cost of agricultural production has increased as the land and natural resource base has shrunk. As a result, Egypt has become one of the world's largest importers of food. Because of the interconnectedness of the country's problems, Sekem has integrated into its operations a thriving social and cultural dimension to help address Egypt's crumbling health, educational, and cultural-preservation capacities.

As Abouleish explains:

> The Sekem initiative was founded to realize the vision of sustainable human development. It aims to contribute to the comprehensive development of the individual, society, and the environment. A holistic concept encompassing integrated economic, social, and cultural development forms the key to the Sekem vision. The initiative is formed of three independent, but closely interrelated, entities. First, Sekem Holding, a group of companies, producing a wide range of goods for national and international markets, based on products from Sekem's own biodynamic [i.e., organic] agriculture. Second, the Cooperative of Sekem Employees, which seeks to develop work models that ensure respect for human dignity, safeguard human rights, and guarantee the equality of everybody in the community. And, third, the Sekem Development Foundation, which is supported by the group companies and provides education, training, and health care for the local population, as well as [conducts] social and scientific research.[8]

When we asked Abouleish what governments and mainstream business can learn from Sekem, he suggested, "Governments and mainstream business can recognize and respect the three independent domains: culture, economy, and legal—and foster cooperation and interaction to foster human development."[9]

Cristóbal Colón and La Fageda

The second of our social businesses was founded by Christopher Columbus. No, not *that* one—but, yes, his name is really Cristóbal Colón ("the good one," as he likes to emphasize). A Spaniard, he started his career at age fourteen working for his uncle, a tailor, but possessed by a desire to work with the mentally ill, he studied psychiatry and later found himself working in a hospital for the insane. Work therapy was the treatment of choice at the time—this was the late 1970s—and Colón was put in charge of the relevant program. This entailed assigning useless tasks to the patients to keep them occupied, including making ceramic ashtrays, book marks, and other little trinkets like those a five-year-old brings home from art class or summer camp. There is no market for such items, and really only a mother could cherish them. Whereas most reasonable people would have accepted this approach as the way mentally ill people were treated, Colón grew frustrated with the patients' meaningless activity. They might be crazy, he thought, but they are not stupid; they need to feel worthwhile. Like Rick Aubry at Rubicon Programs, Colón realized that one thing that would provide a sense of purpose was a real job in a real company that produced something other people genuinely wanted to buy.

It was 1982 at the time, and living in Cataluña, Colón decided to set up a dairy business. But he needed capital, so he visited a

bank to ask for a loan. Imagine being the loan officer in a bank where a psychiatrist shows up asking to borrow money. He says that his name is Christopher Columbus and that he wants to set up a dairy company that will employ mostly mentally ill workers. Now there is an unreasonable person, you might conclude, perhaps someone who is even verging on insanity himself.

Undeterred, Colón got his way. Today, La Fageda, his dairy farm, is a thriving business and has the third-largest market share for yogurt in Cataluña—outdone only by Danone and Nestlé. It still employs the mentally ill. Its annual revenue is over $10 million, and it is now fully self-sustaining. It pays its workers well, and they may choose to live on site, which many opt to do. La Fageda works closely with the public sector, which refers psychiatric patients to the company for training, employment at La Fageda, and eventual reincorporation into society, where possible. It has a fully staffed mental health facility on site, providing ongoing support for workers. It is certified by Spain's ministry of agriculture as a dairy farm, and most of its customers are completely unaware that the mentally ill are responsible for producing the products they enjoy. (Typically, people buy La Fageda's products because they taste great, not out of charity.) Meanwhile, the mentally ill are no longer viewed as "patients," which is a disempowering term; they earn their living by contributing to one of their country's leading dairy companies and are proud of that fact.

La Fageda—like Sekem—is a for-profit business, but not a profit-maximizing business. Its business is social transformation, and its profits are used as a means to that end. Working with the mentally ill is La Fageda's core business, not a public relations afterthought or part of the company's social responsibility activities. Although it provides a public health service by supporting the mentally ill—a task usually left to the government—it is not a government organization, and it is most certainly not a charity, which would make it dependent on donor funding and philanthropy.

Cristóbal Colón says this about what other sectors can learn from his experience: "La Fageda is a company that was constructed in reverse. Its first asset was the workers, a group that needed to

be employed—ex-interns in the psychiatric hospital in Girona. Subsequently, the company was created. La Fageda demonstrates that a company that starts with people, putting people before profits, can grow to be a strong organization. That strength and that culture act as levers in addressing the multiple and seemingly insurmountable challenges that come along."[10]

What are some of the downsides to model 3 approaches? One has been replication. A few social businesses, including Muhammad Yunus's Grameen, have managed both to replicate and to inspire much larger organizations (among them, Citibank) to follow their lead, but most have so far proved harder to replicate than mainstream businesses. While they are certainly scalable, as their track records clearly show, and are scaling, replicating Sekem and La Fageda in other contexts is tough. In fact, it has yet to be done.

A number of reasons make replication challenging. For one, the problems Sekem and La Fageda are addressing are complicated. Furthermore, these businesses have to be profitable, or they can't survive. It would be much easier for Abouleish and Colón to be regular entrepreneurs; then, the only driver would be the financial bottom line. No wonder the conventional business world views people like them as unreasonable. But perhaps replication is not the real issue here. How about inspiration? In Egypt and in Spain, Abouleish and Colón have achieved almost Yunus-like status. They have demonstrated that there is another alternative (indeed, Abouleish was the 2005 recipient of the Right Livelihood Award, sometimes described as the "alternative Nobel Prize").

For these organizations to achieve wider replication, market conditions must change, funding sources must evolve, and the financial markets (from investors and lenders through risk takers and insurers) must adapt to the needs of these new actors. We examine the question of how such entrepreneurs raise funding and other resources for their ventures in the next chapter. Before we do, however, let's take a quick look at one business with a social mission that has grown and replicated at a tremendous rate and is now a publicly traded company.

Achieving Scale as a Social Business: Whole Foods

With some thirty-nine thousand employees, Whole Foods Market is on an altogether different scale than enterprises like Sekem. Founded in 1980 as a single small store in Austin, Texas, it is now the world's leading retailer of natural and organic foods, with nearly two hundred stores in North America and the United Kingdom. Its success is monitored by tracking customer satisfaction, team excellence and happiness, return on capital investment, improvement in the state of the environment, and local and larger community support. Operating at the interface between model 3 organizations and the business mainstream, Whole Foods indicates the potential for some social business models to scale and replicate.

Given that Whole Foods' founder John Mackey says that many of his former colleagues thought that he had gone to the "dark side" when he began to scale his business, it is worth asking why Whole Foods is a social business. One part of the answer is that it has done a great deal to drive whole food and organic food concepts into the commercial mainstream. Mackey would probably be the first to accept that there is big chasm between model 3 ventures and fully fledged, publicly listed enterprises with a social purpose, but his story suggests that the ripples of unreasonableness are spreading. As we shall see, it also shows that even those who claim to fight for social or environmental issues may still have their dark sides.

Mackey erupted into the spotlight in 2007 when reports emerged that he had been using anonymous postings on an investors' online message board to attack Wild Oats Markets, a firm that Whole Foods hoped to acquire. The Federal Trade Commission had blocked the proposed $565 million takeover on competitive grounds, and Mackey then faced a U.S. Securities and Exchange Commission inquiry into the postings. Mackey's initial belligerent response soon morphed into a public apology—coupled with a plea for stakeholders' forgiveness. (This was not new behavior: Mackey admitted that he had been posting anonymously over nine years.) People

who knew Mackey might have been surprised that he had so egregiously infringed on Whole Foods' core value of integrity—something he had touted often in public—but no doubt they would also have concluded that his behavior reflected the forthright personality that had done so much to push the company forward.

Before the scandal, Mackey had made much of the fact that he had come full circle from the antibusiness zealotry that fuels social activists, and he stressed that he considered Whole Foods the better for it. Whichever way you look at him, Mackey has always been a very different kettle of fish from the social entrepreneurs we've profiled to this point, some of whom might think *him* unreasonable.

Like other social entrepreneurs, however, Mackey has been the mainspring of the business, which made the scandal even more damaging.[11] Earlier in his career, he had noted that before founding Whole Foods, he attended two different universities but "ended up with no degree." He explained:

> I never took a single business class. I actually think that has worked to my advantage in business. I spent my late teens and early twenties trying to discover the meaning and purpose of my own life. My search for meaning and purpose led me into the counter-culture movement of the late 1960s and 1970s. I studied eastern philosophy and religion at the time, and still practice both yoga and meditation. I studied ecology. I became a vegetarian (I am currently a vegan), I lived in a commune, and I grew my hair and beard long. I'm one of those crunchy-granola types. Politically, I drifted to the Left and embraced the ideology that business and corporations were essentially evil because they selfishly sought profits. I believed that government was "good" (if the "right" people had control of it) because it altruistically worked for the public interest.[12]

Mackey's first steps included launching his own business in 1978, a natural foods market called Safer Way, a small store that he opened with his girlfriend, with an initial $45,000 in capital.

"We were very idealistic, and we started the business because we thought it would be fun," he recalls. Idealistic he may be, but Mackey is no friend of left-wing politics these days. "At the time I started my business," he says, "the Left had taught me that business and capitalism were based on exploitation: exploitation of consumers, workers, society and the environment. I believed that 'profit' was a necessary evil at best, and certainly not a desirable goal for society as a whole."

Mackey's experience with Safer Way completely changed his life:

> Everything I believed about business was proven to be wrong. The most important thing I learned about business in my first year was that business wasn't based on exploitation or coercion at all. Instead, I realized that business is based on voluntary cooperation. No one is forced to trade with a business; customers have competitive alternatives in the market place; employees have competitive alternatives for their labor; investors have different alternatives and places to invest their capital. Investors, labor, management, suppliers—they all need to cooperate to create value for their customers. If they do, then any realized profit can be divided amongst the creators of the value through competitive market dynamics. In other words, business is not a zero sum game with a winner and loser. It is a win, win, win, win game.

That, at least was the theory. Mackey says:

> However, I discovered despite my idealism that our customers thought our prices were too high, our employees thought they were underpaid, the vendors would not give us large discounts, the community was forever clamoring for donations, and the government was slapping us with endless fees, licenses, fines and taxes. Were we profitable? Not at first. Safer Way managed to lose half of its capital in the first year—$23,000. Despite the loss, we were still accused of exploiting our customers with high prices and our employees with lower wages. The investors weren't making a profit and we had no money to donate. Plus, with our losses, we paid no taxes. I had somehow joined the "dark side." According to the perspective of the Left, I had become a greedy and selfish businessman.

At this point, Mackey chose to abandon the leftist philosophy of his youth because it no longer adequately explained how he thought the world really worked. So does he still agree, as he did when he was young, with Milton Friedman's view that "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud"?[13] No, Mackey insists:

> That's the orthodox view among free market economists: that the only social responsibility a law-abiding business has is to maximize profits for the shareholders. I strongly disagree. I'm a businessman and a free market libertarian, but I believe that the enlightened corporation should try to create value for *all* of its constituencies. From an investor's perspective, the purpose of the business is to maximize profits. But that's not the purpose for other stakeholders—for customers, employees, suppliers, and the community. Each of those groups will define the purpose of the business in terms of its own needs and desires, and each perspective is valid and legitimate.[14]

Whether or not you subscribe to his politics, Mackey has certainly built a substantial model 3 business and has moved it into the business mainstream. "In 2005, [Whole Foods Market] did $4.7 billion in sales and realized $136 million in net profits," he noted a couple of years ago. "With our current growth rates by 2010 we should do over $12 billion in sales. On a percentage basis, Whole Foods Market is the most profitable public food retailing business in the United States, with the highest net profit percentage, sales

growth, and sales per square foot." But, he stresses, that isn't the end of the story. "I believe that business has a much greater purpose," he explains. "Business, working through free markets, is possibly the greatest force for good on the planet today. When executed well, business increases prosperity, ends poverty, improves the quality of life, and promotes the health and longevity of the world population at an unprecedented rate."[15]

Whether his postings about Wild Oats over those nine years were simply a case of a high-octane entrepreneur blowing off steam or a conscious effort to drive down the price of a takeover target, Mackey's story remains something of an exception among model 3 ventures, but it hints at the approach's potential. Given that the very nature of capitalism makes many such experiments fail and that all experience wobbles along the way, it remains to be seen how Whole Foods and other social businesses fare in the long run. But as publicly traded companies focus more on social and environmental objectives alongside their financial requirements, social businesses could gain greater prominence in serving the expanding markets of social and environmental needs.

Each of the three models described can be used to address any of the great social and environmental divides we explore in chapter 3—and the market opportunities they reveal. Remember, too, that individual entrepreneurs may move between models—and, over time, a given enterprise may morph from one business model to another, as several of our examples have done. In every model and for every market need these models seek to address, however, entrepreneurs must raise funding and gather other resources, a subject to which we now turn.

TWO

Tapping Financial Resources

WHATEVER MODEL THEY USE, and whether they set up their ventures as for-profits or nonprofits, even the most successful entrepreneurs can soon find themselves on a nonstop treadmill where they spend every waking moment chasing money. Often, this can be at the expense of using their talents to strengthen the impact of their ventures. As Richard Jefferson, founder of the open source biotechnology organization Cambia, remarked, "I can no longer be the playwright, the director and the principal actor."[1] But so it goes. As organizations scale, the role of the entrepreneur changes—as does the nature, scale, and availability of the needed funding.

The very definition of an entrepreneur is someone who "shifts economic resources out of an area of lower production into an area of higher yield and production," according to Jean-Baptiste Say, who is credited with coining the term *entrepreneurship*.[2] Social entrepreneurs who aim to transform communities almost inevitably operate under significant financial constraints, yet this might actually