Designing Your Business Model for Social Impact

CASE Business Models for Social Impact Project

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From starting-up through scaling, social entrepreneurs are constantly redesigning their business models to increase their financial stability, efficiency and ultimate impact. Building on their global study of social entrepreneurial business models, the authors offer lessons about the best ways to navigate the redesign process. Successful change is less about new funding strategies than about core operating decisions. Operations will drive the funding needs and opportunities. And these business model choices will in the end determine scalability, enhancing or limiting the potential for widespread impact.

In late 2007, Jordan Kassalow, Chairman and Co-Founder of VisionSpring, was in the midst of raising significant growth capital. With these funds, VisionSpring could expand its capacity to reduce poverty and generate opportunity in the developing world through the sale of affordable reading glasses. Jordan felt ready for this infusion of growth capital because he had significantly changed his business model in recent years and was seeing successful results.

For its first 6 years, in what Jordan calls "VisionSpring 1.0," the organization worked to develop its own on-the-ground sales force, called "Vision Entrepreneurs." The Vision Entrepreneurs were mostly women who were given a "Business in a Box" that allowed them to test vision and sell several types of reading glasses. It was a powerful social entrepreneurial idea: help low-income women in Base of the Pyramid (BoP) markets stabilize their incomes by staunching the unmet vision needs of fellow citizens. The success of this model was described in the 2008 prospectus:

> *Since 2002, when we began selling glasses as Scojo Foundation, we have grown into a social enterprise that reaches tens of thousands of customers in twelve countries throughout Asia, Latin America and Africa. As of December 31, 2007, we have sold over 90,000 pairs of VisionSpring reading glasses and provided a new source of income to more than 1,000 Vision Entrepreneurs.*[1]

With this overwhelming success, it would seem VisionSpring had perfected and proven its business model. However, as VisionSpring attempted to scale they noticed some challenges. Many of the women were effective at selling for only 18-24 months, after which they tended to exhaust their social networks. In addition, VisionSpring priced glasses at very low price points ($4 or less a pair on average compared to $15-20 in optical shops). At this price point, designed for maximum affordability for the poorest of customers, the Vision Entrepreneurs were having trouble making a sustainable living.

As a result, Jordan decided it was time for a new business model, "VisionSpring 2.0." Instead of managing its own direct sales force, Jordan decided VisionSpring should

[1] Quoted from VisionSpring's 2008 Nonprofit Finance Fund Segue Funding Prospectus, dated 6-20-08, p. 5.

test a franchise model: disseminating the Business in a Bag through partner organizations with existing sales networks. He initiated some pilots, and by 2008, partners included world-class nonprofit and for-profit organizations such as BRAC (the world's largest NGO and VisionSpring's largest Franchise Partner), Drishtee in India, Population Services International (PSI) and others. Early indicators were positive: sales volume increased (in 2010, VisionSpring sold 150,000 pairs of glasses to BRAC alone) as did income per Vision Entrepreneur, largely because they could sell glasses alongside other products, all in the same bag.

Social Entrepreneurial Business Models Are In Constant Flux

This is a powerful example of something that is actually quite common in the field of social entrepreneurship. **Social entrepreneurs are continuously refining and redesigning their business models.**

Our 2009 global survey of nonprofit and for-profit social entrepreneurs indicated[2] that many are frequently revising their business models in significant ways. 100% of respondents reported making significant changes to their business models, from products and services offered, to pricing models to marketing plans. Nearly all (94%) reported they would make more significant changes in the next 3 years. Perhaps most interestingly, those who had made the most changes were the most confident of future performance; both financial and social (***see CASE Practitioner Survey Box***).

[2] Because this survey was voluntary, it is possible that there was a response bias. Those most interested in or concerned about business models may have been more inclined to respond. So we must be cautious in generalizing from this data. However, when we tested the conclusions with organizations we know, similar patterns emerged.

CASE 2009 Practitioner Survey Reveals
Lack of Robustness and Constant Change in Business Models

In 2009, CASE conducted a global survey of practitioners to understand their past practices, future plans, and assumptions about their business models. The survey was sent to over 1,000 recognized social entrepreneurs around the world through more than 20 membership, fellowship, and grantmaking organizations. Once we applied our screening criteria (for age and strong mission orientation), the survey yielded a final sample of 138 organizations. The resulting pool was:

- 57% nonprofit, 43% for-profit.
- 59% of sample earned less than $1MM in revenue in 2008, 24% earned between 1 and 5MM, and 13% earned over $10M.
- Of the nonprofits, 60% had at least 10% of their revenue from earned income sources.
- 63% of the organizations were between 9 and 20 yrs old, and we screened out any under 2 years old.
- 84% had an office in the US; about a third had 2-10 employees and another third had 11-100 employees.

Key findings:

- 16% highly agreed that their models were ***robust*** enough to withstand normal changes in economic conditions.
- 23% highly agreed that their business models were ***replicable***.
- 31% highly agreed that their business models were ***sustainable***.
- 36% highly agreed that their business models were ***flexible***, allowing them to be effective in making adjustments to serve their social mission.
- 39% highly agreed that their business models were ***scalable***.
- 62% highly agreed that their business models were ***highly aligned with social mission*** goals.
- ***100% of the sample reported having made changes to their business models*** over the past 3 years.
- **91% made "significant" or "very significant" changes to their business models** over the last 3 years and ***94% intended to do so over the next 3 years.***

Why is it so important for social entrepreneurs to get their business model right? Simply put, business models make all the difference in terms of an organization's survival, ability to focus on mission, and ability to scale its impact. An effective program for reducing teen pregnancy will not have much impact over time if the organization implementing it does not have a sound business model.

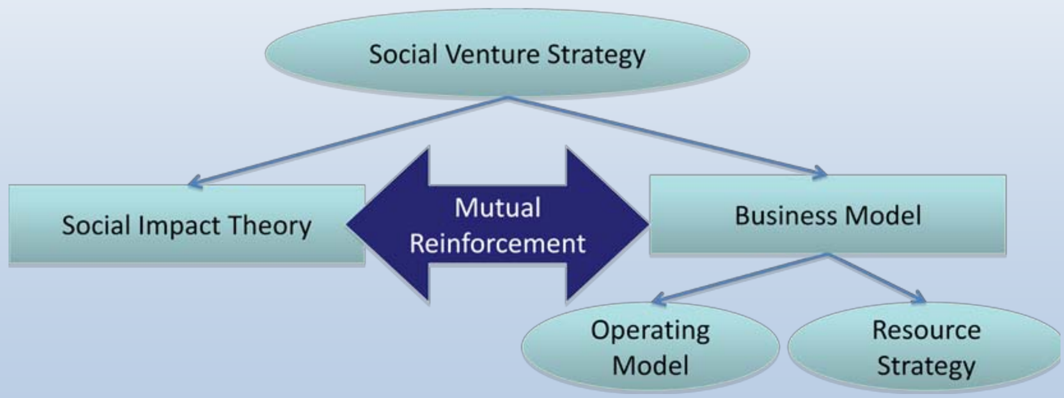
It is helpful to think of business models as having two primary components: the venture's operating model, or how it carries out its work, and its resource strategy, namely how it gets resources to execute the operating model (***see Key Definitions Box***). In the VisionSpring example, we see a venture changing its core operating model in significant ways, moving from a direct sales model to a franchise model. VisionSpring's resource strategy also changed, including looking at new funding vehicles such as the Segue syndicated grant platform.

Key Definitions

Business Model: Core decisions that determine the economics of a venture, its cost structure, revenue sources, and capital requirements

Business Model: One of the main components of a social venture's strategy

Business Model: The combination of an Operating Model and Resource Strategy



Lessons about Business Models

Building on the 2009 survey, we have interviewed social entrepreneurs from around the globe to learn more about their business model decisions. Through these interviews, we've absorbed many stories of business model change, from slight revisions to huge overhauls, and have drawn out four important lessons.

1. Innovate Your Operations

Too many people think that a business model is primarily about funding strategies. But operating decisions must come first: start your journey by mapping your core operating model and envisioning different possibilities for how you do what you do.

Your mission and intended impact do not determine the details of your operating model—the role you will play in that process does. For example, VisionSpring decided to sell eyeglasses through Vision Entrepreneurs but they could have decided to be the low cost manufacturer and let others distribute the glasses. Or they might have chosen to distribute through employers, through schools, or at major religious festivals, for instance.

Some of the iconic innovations in the social sector have been successful primarily because of core operating model innovations. For example, Grameen Bank achieved viability through several operating innovations, such as using peer groups to manage the loan process. Group members had to approve of each other and could not take additional loans unless all members had repaid. Group lending reduced the need for credit assessment (since the groups did the screening); for collections departments (the groups encouraged its members to pay); and, for loan loss reserves (since peer pressure and repayment of group members' loans assured low losses). These attributes changed the cost structure of lending and made microcredit economically viable.

In another example, Aravind Eye Care System[3] created a self-sustaining business model that allows it to serve the poorest people in need of eye care, for free. Key operating model innovations include a highly efficient production process (performing high quality cataract surgeries much faster than traditional models); its own manufacturing facility for producing intraocular lenses at much lower cost; and, a dual hospital set-up (a somewhat higher quality facility for paying patients and a lower cost facility for the poor). These operating decisions allow for a pricing structure in which revenues from the full paying patients create profits which subsidize those who cannot pay.

It was these operating model innovations that allowed both organizations to become more financially sound and help millions of people. So, instead of simply looking for new sources of funding, keep your mind open to new possibilities of how you do your work. Look at peers in your area, and those with similar business models in other areas.[4] You may find that some alternative approaches allow you to achieve greater impact with fewer resources.

2. Be "Resource-Smart"

As you try to re-envision how you might operate, you will want to look for alternatives that are "resource-smart" without compromising your intended impact. Resource-smart decisions are ones that reduce inefficiencies, and reduce your burden for attracting scarce resources: human, technological, financial, real estate, or whatever form the scarce resource takes. An operating model dependent on scarce resources is hard to sustain and scale. Look for resource-smart alternatives in three areas:

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[3] See http://www.aravind.org/aboutus/index.asp, last accessed March 17, 2011.

[4] We have been experimenting with a *business model typology* to allow social entrepreneurs to identify and compare themselves to peers with similar business models. For more information, see http://www.socialedge.org/discussions/business-building/legal-form-strategies/?searchterm=clark%20typology

- **<u>CONSIDER YOUR BUILD VS BUY OPTIONS, decide what you will do and what you will let others do.</u>**
  VisionSpring 2.0 is an example of "buying" vs. "building" - using BRAC's community health workers instead of hiring and managing its own Vision Entrepreneurs. In another example, KickStart, an organization working to increase income and productivity of farmers in Africa, sells a line of treadle irrigation pumps. Originally, KickStart planned to build the pumps in the African countries where the pumps would be sold, but this turned out to be an expensive proposition. Instead, the founders decided to source the pumps in China so that KickStart would not have to attract the skilled human resources or the capital to build and operate production facilities.

  A key principle here is <u>concentrating on those functions where you truly add value</u>, where <u>your role is essential to social impact</u>, or <u>you have greater expertise or capacity</u> than a partner. One caveat is important here. Relying on partnerships that are hard to duplicate in other locations may limit the scalability of your model. Nevertheless, finding a way to use existing capability instead of building it yourself can be very resource-smart for your organization and the world.

- **<u>Use PRODUCTIVITY AND EFFICIENCY TOOLS to increase impact</u>.**
  Many social entrepreneurs are finding ways to leverage technology or other productivity tools to increase their impact and lower their costs. For instance, Sisterhood Agenda was originally a direct service provider designed to promote self-esteem in women and girls, particularly those of African descent. Sisterhood Agenda increased its productivity by becoming a web-based service providing materials to a network of existing organizations already reaching its intended audience. Through this network, Sisterhood Agenda now "serves over 5 million women and girls each year in more than 32 countries."[5]

  Of course, the productivity drivers do not have to be high technology. In the Grameen example mentioned earlier, the peer groups played this role, at Aravind, it was the highly efficient operating procedures.

- **<u>Consider your TERMS OF ENGAGEMENT WITH RESOURCE PROVIDERS, including suppliers, partners, and workers.</u>**
  Ideally you want tangible resource providers who will accept value propositions that do not place significant burdens (high prices, or other onerous demands) on you. But you also want relationships that will endure, be scalable, and provide incentives aligned with your impact goals.

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[5] See http://www.sisterhoodagenda.com/index.php?option=com_content&task=blogcategory&id=46&Itemid=90 last accessed on March 16, 2011.

Think carefully about the terms on which you will acquire the human and other resources needed to execute your social impact theory. For example, low compensation may not provide the right incentives to your workforce. Free goods and volunteer labor may be tempting, but it also may not be the right choice. Should VisionSpring rely on donated glasses as some groups do instead of the newly manufactured glasses from China? What are the risks?

However, sometimes, donations can be used in creative way to develop breakthrough models. Wikipedia represents a radical variation on the terms of agreement for writers and editors of encyclopedia entries. Get people to volunteer their "cognitive surplus" as Clay Shirky has called it[6], and you change the economics of creating a go-to online information resource. What terms give you the greatest value per dollar of resources expended? And, what terms are most likely to be sustainable and replicable? Special deals may be resource–smart in the short-term, but not viable or scalable as a longer-term strategy.

3. Align Your Money and Impact

Now that your operating model is efficient, it is important to align your revenue model and capital strategy with your impact goals. Your earned income or revenues need to be aligned with the kind of impact you wish to achieve; your pricing needs to reflect your view of what your target beneficiary or customer can pay, and your capital needs to align with your ultimate objectives around ownership, growth and governance.

- **Determine POTENTIAL SOURCES OF EARNED INCOME - who could, would, and should pay.**
  Who are the primary beneficiaries of your products and services and can they pay? Charging beneficiaries, especially if they are poor, can seem counter intuitive, but it can serve as a screening or commitment device, helping to assure they will use your product or services. It also creates a relationship in which the beneficiaries are customers with the dignity of paying and the right to complain, offering direct feedback for your products or services.

  In some cases, however, it is not wise —or moral, think of a rape crisis center—to charge intended beneficiaries because it would deter participation by those you want or need to reach to fulfill your mission. In other cases, beneficiaries can pay something, but not enough to cover full costs. If intended beneficiaries are not likely to be an adequate source of

[6] Clay Shirky, Cognitive Surplus: Creativity and Generosity in a Connected Age, New York: The Penguin Press, 2010.

earned income, is there another potential paying customer? What is the value proposition to this new customer and will it pull you away from your mission? One could imagine an employer who wanted to maintain productivity by paying for eye exams and glasses for workers. This source of earned income would create value by keeping workers employed but may direct attention away from the unemployed poor if that group is an important target for your organization.[7]

- **Determine your PRICING STRATEGY - how much to charge and different ways to structure your prices.**
  Assuming that you have a target customer who is willing to pay, you need to set prices that allow you to optimize social impact while maintaining financial strength. It is interesting to note that lower prices, even when selling to the BoP, do not always result in better outcomes. If VisionSpring glasses are priced too low, the community health worker will not have an incentive to sell them but may focus on selling other items with higher margins.

  In some cases, the best pricing for optimizing social impact may not be promising from a business model point of view. In those instances, can you tier your prices or have a sliding scale based on ability to pay? Do you have segments of customers who should be subsidized internally—by other customers, as in the Aravind case mentioned earlier?

- **Determine the LEGAL FORM[8] that best fits your business model, philosophy, and subsidy/profit expectations.**
  Consider how long it will take you to prove your social impact theory and determine how much subsidy you need to get through that period. How far are you from a profit-generating business model? Will it ever be possible to cover all operating costs and generate a profit through your paying customer base? If not, a for-profit legal form is probably not the right model for you. If you think you can get your business model to profitability in a reasonable time frame, you can explore different legal forms based on the amount and potential availability of subsidy/investment capital to get you to a point of profitability.

  VisionSpring choose a nonprofit form that allows it more time to achieve profitability and does not require it to repay investors. It can also use philanthropy to subsidize its operations until it is able to cover costs or even generate a surplus through earned income. Then it could consider a for-profit

[7] See, for example, the varying customer value propositions and resulting business models for eyeglass distribution in "Better Vision for the Poor", SSIR Spring 2011.
[8] Jim Fruchterman's article "For Love or Luchre" does a wonderful job of laying out the current legal options in the U.S., SSIR, Spring 2011.

arm or subsidiary to access growth capital, as several other organizations we studied are doing.

- **Determine what kind of CAPITAL ALIGNS best with your venture.**
In addition to temporary or even permanent operating subsidies, social ventures need to raise capital to invest in capacity building and infrastructure development. This capital can come in different forms, primarily grants, debt, and equity.[9] It can also come from different sources, including individuals, foundations, corporations, and investment funds with different goals and requirements.

  Your business model will determine how mission-oriented and patient your capital providers need to be. Without deviating from your mission, does your business model provide enough free cash flow for repaying particular capital providers at a rate and on a timetable they will find acceptable? Or can you envision alternative methods by which they can be repaid, such as a public offering of stock or a later round of financing that will buy out earlier investors? In order to assure mission focus, you also have to ask: what kinds of relationships will investors or funders have with your governance structure?

  VisionSpring, as we have said, decided to grow with philanthropic capital. As a nonprofit, it could also have taken on debt, but this would have probably required repayment at a time when any positive cash flow was needed to subsidize operations. By contrast, Compartamos started as a nonprofit micro-finance affiliate of Accion International in Mexico, but converted to a non-bank financial institution and then to a commercial bank. Along the way it raised debt and equity capital. Accion and early funders of the nonprofit were also given shares. Eventually the initial equity providers were able to get their returns through an initial public offering of stock that brought in $450 million for 30% of their stock, providing a very hefty return. The Compartamos case has been controversial with critics alleging that this kind of profit-seeking ownership structure will pull the bank away from its mission to serve the poor. The bank's defenders argue that this structure has allowed the bank to serve more people and that its culture, values, and governance structure will assure that it remains focused on its mission.

4. Fit Your Business Model to Your Scaling Strategy (and Vice Versa)

[9] Technically, nonprofits may not issue equity as entities "owned" by and for the public good in the country in which they are incorporated. Some organizations, however, like NFF, are using the word "equity capital" for nonprofits to distinguish capital needed to grow the organization from capital needed to run the daily operations of the organization. They see equity capital as the former, and believe it deserves different fundraising attention and approaches. See http://nonprofitfinancefund.org/files/docs/2010/ssir_summer_2008_equity_capital_gap.pdf, accessed March 20, 2011.

Scale has been a major challenge for social entrepreneurs, and a major aspect of that challenge is creating a scalable business model. While there is no single formula for creating the right scalable business model for every organization, it is wise to assess your model and the intersection between it and your preferred scaling strategy. For example, here are three common scaling strategies and some implications for business models:[10]

- **Local Branches or Affiliates:** If your primary scaling strategy is to create wholly-owned branches or to establish new affiliates in other locations (in essences as franchises), then you need a business model that can work in multiple locations. It is also helpful if that model has some opportunities built in for economies of scale in centralizing certain functions, such as national fundraising, HR, training, and evaluation. Key questions to ask include: To what extent does our current operating model depend on local partnerships or resource providers that will be difficult to duplicate in other locations? If it does, then, either these resources and partnerships have to be managed centrally or the business model needs to be revised for replication purposes.

  This scaling strategy requires a transferrable, locally adaptable business model. It can be a very costly way to go. That was one of the reasons that Angela Coleman, Founder of Sisterhood Agenda, switched scaling strategies. After building a successful program in North Carolina, and experimenting with new locations elsewhere, she saw costs increasing dramatically. She knew there were existing organizations already working with the girls and women she wanted to reach. She had the curriculum, the ideas, and materials. What if she turned Sisterhood Agenda into a web-based resource for other providers? That brings us to a second scaling strategy option.

- **Smart Networking/ Partnerships:** This strategy is often considered, in our opinion, too late in the organization's development. Most social entrepreneurs start out wanting to establish their uniqueness and do not consider building relationships with existing organizations that may have networks or platforms that can be leveraged.

  Consider the extraordinary growth of Net Impact, the nonprofit membership organization for students interested in social innovation. In early days, they were struggling with how to reach the new generation of emerging leaders of socially responsible business. Instead of creating an individual membership model, they focused on a chapter model, allowing them to leverage the power of an existing institutional network, namely graduate MBA programs worldwide. Now with more than 260 chapters on six continents, Net Impact boasts over 20,000 members.

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[10] For more detail on branching, affiliation and dissemination as scaling strategies, see: J. Gregory Dees, Beth Battle Anderson, and Jane Wei Skillern "Scaling Social Impact: Strategies for Spreading Social Innovations," *Stanford Social Innovation Review*, vol. 1 no. 4, spring 2004

When you're thinking about partnering, you want to consider what it might cost to build your own network and what economies of scale an existing network can bring to you. Of course, if you use an existing network to scale, your business model must be structured to deliver value to that partner and may force difficult decisions about mission. A key customer can be considered a network partner if they bring your product to scale. A good example of this is Greyston Bakery, a for-profit social venture with a mission of hiring hard-to-employ workers in entry-level bakery jobs. They are also the sole supplier of brownies to Ben & Jerry's ice cream. The relationship between Greyston and Ben & Jerry's originated from mission-fit between the two companies, but as the needs for brownies grew, Greyston had to greatly increase their brownie production or risk losing exclusivity with their most important customer. They built a new state-of-the-art facility, increasing automation to assure quality which reduced their entry-level job positions and greatly increased their resource needs. It is a bet that has paid off – they are now a thriving B Corporation, recognized for their exemplary employee policies, and have retained the relationship with Ben and Jerry's to stabilize their operations. But the fact remains that significant partnerships can be risky and resource-intensive decisions.

- **Open Source Scaling:** When we think of scaling we often think of scaling organizations. However, ultimately moving the needle on a social issue like public health often requires adoption of an idea, a program, or a model by many different players in an ecosystem. Many organizations are open to having their programs and ideas replicated and would encourage others to try, but effective open source scaling (often called dissemination) is not easy to pull off. It may take some proselytizing, the birth of a movement, or the emergence of a new source of funding—as it did with the hospice movement.

  Obviously a business model that is financially attractive will be more likely to spread than one that is dependent on hard to find resources or large amounts of subsidy. However, even cost-effective models can be ignored without marketing and other forms of assistance to the open source process. Being open and economical is rarely enough. This is referred to as the "better mouse trap fallacy" in the entrepreneurship literature. The world will not beat a path to your door. Aravind Eye Care's partnership with the Lion's Club to train other eye hospitals in India is a great example of this. Aravind realized they didn't need to build a new network of hospitals but could, at much lower cost, help the ones that already existed to perform better. Aravind moved from being primarily a human service provider to also functioning as an intellectual capital distributor. [11]

[11] Aravind has actually experimented with nearly every kind of scaling. See "To Control or Not Control: A Coordination Perspective to Scaling" Funda Sezgi and Johanna Mair Pgs. 29-44 in *Scaling Social Impact: New Thinking*, Paul N. Bloom and Edward Skloot, eds, 2010.

Licensing or giving away ideas and models in smart ways can propel not just scaling, but social movements. Consider TED, the conference for "ideas worth spreading." For years, TED's business model was to charge high event fees for a live annual event whose appeal was based in no small part on its exclusivity. In recent years, TED went open source and decided to allow anyone to license its brand using a set of ground rules to produce TEDx conferences wherever they wanted. There have been well over 1,000 TEDx conferences since 2009 when it started. Now that TED is also providing all its talks free through YouTube, this strategy has allowed this intellectual and social capital distributor to spread ideas on a much larger scale as well as build up an asset base than can be monetized in many more diverse ways.

Conclusions

So where is VisionSpring today? They are busy piloting a new business model in El Salvador, which Jordan calls VisionSpring 3.0. The new model involves the addition of a different kind of human capital: professional optometrists; a different physical product: prescription glasses; and, a different strategy: using the Vision Entrepreneurs as the spokes who refer patients to the optometrist hubs. Jordan says he borrowed this "hub and spoke" operating model from Aravind Eye Care, which sets up low-cost temporary eye camps to test vision and refer patients back to its brick and mortar eye hospitals. We see it as a way to be resource-smart by leveraging high quality labor (the optometrists at the hub) through broad distribution of lower cost labor (the Vision Entrepreneurs as the spokes).

In VisionSpring 3.0, Jordan has expanded VisionSpring's product offerings and enlarged its mission. In previous models, Vision Entrepreneurs could only sell reading glasses; now in El Salvador they can refer anyone who needs prescription glasses to the VisionSpring office. This allows the organization to serve a much larger population in need of vision correction and earn more margin per sale. As a result of this new model, four months after VisionSpring started selling prescription glasses it covered all of its operating costs in El Salvador.

Jordan feels this might be the model that allows them to achieve long-term financial sustainability. It remains to be seen whether this is a model that could be distributed through franchise partners such as BRAC. It may not be suitable for that kind of scaling strategy, but that is the way social entrepreneurship works. Business models are in constant flux. New innovations may lead social entrepreneurs, such as Jordan, down new paths.

Clearly, business model design is one of the most important tasks a social entrepreneur can engage in. It is a task that starts at the core of the venture

with the operating model. What are we going to do? What will we leave to others? Of the things we are going to do, how will we do them so as to minimize our need for scarce resources, remain true to our mission, and increases our chances of having something that is scalable?

Smart business model design and redesign can make all the difference in determining the scale, scope, replicability, and ultimate impact of the entrepreneur's innovation. No matter how brilliant the social impact theory is, unless it is supported by a strong business model, it will fail to achieve success for society. The world of social entrepreneurship is one of on-going experimentation, refinement, and innovation. Because the balance of social impact and economics is often complex, business model design is an essential art. It is hard to know in advance what will work, the assumptions need to be tested as you go and adjustments made accordingly.

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