THE ROBERTS ENTERPRISE DEVELOPMENT FUND
a philanthropic venture of THE ROBERTS FOUNDATION

A Report From the Good Ship SROI

by Cynthia Gair

The Roberts Enterprise Development Fund (REDF) is a private charitable foundation whose mission is to help people move out of poverty. The arcane world of business valuations, return on investment modeling, and public sector metrics might seem to be light years outside the realm of what would interest us. And yet, six years ago we started building a spaceship to take us into that faraway world. The spaceship was dubbed Social Return On Investment, "SROI". We've taken it out for a few test flights around the stratosphere, and now we're back to report on our findings, to plan improvements, and to chart new flights. Before we move on to improvements, however, let's look back at why we did it, how we do it, what lessons we've learned, and what questions still need to be answered.

Why SROI?

In 1996 REDF published a retrospective cost benefit analysis of the social purpose enterprises run by one nonprofit agency in the San Francisco Bay Area.[1] The study was a precursor to REDF's current approach to Social Return on Investment (SROI), published in 2001. Between 1996 and 2001, REDF brought together a group of Bay Area nonprofits and invested money, business assistance, and other resources in the 20-plus social purpose enterprises the nonprofits had started. Our common goal was to create training and job opportunities to help people move out of poverty.

As we provided a variety of resources to help REDF Portfolio organizations in this work, we simultaneously developed and implemented an approach to measuring and reporting SROI. What started out as a simple cost-benefit exercise took on more depth and difficulty as we realized the questions we were asking did not have simple answers. Developing REDF's SROI approach and making it available to the public has required a large investment of REDF staff time, REDF Portfolio agencies' time, and the generous input of numerous academic, investment, and nonprofit sector experts.

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[1] Emerson, Jed and Twersky, Fay, ed., *New Social Entrepreneurs: The Success, Challenge and Lessons of Non-Profit Enterprise Creation*, (San Francisco: The Roberts Foundation, 1996). Available for free download at http://www.redf.org/pub_nse.htm.

What (what-in-the-world?) led us to embark on this trip? What *is* Social Return on Investment, and why did we want to measure it? What did this have to do with REDF's mission - how would it help us to help people move out of poverty?

We started off on the SROI quest because we couldn't tell whether our work – and the work of our portfolio agencies – was improving the lives of the people we all intended to help. It seemed to be having good effects but we had no way of assessing our resources' impact. We wanted to answer a series of questions, including:

- How can we measure the success of our efforts?
- How do we – practitioners and philanthropist/ investors – know whether we're accomplishing what we set out to do?
- How can we – practitioners and philanthropist/ investors – make informed decisions about the ongoing use of our resources?
- How can we test and convince others of what we believe to be true: that for each dollar invested in our portfolio agencies' efforts, there are impressive, quantifiable resulting benefits to individuals and to society?

These questions and dissatisfaction with prevailing approaches (or lack of approaches) are what prompted us to start exploring and refining an SROI framework. We wanted to know if we were achieving our mission.

What is SROI?

"Social return on investment" or "SROI", is a term now used by foundations, private investors and philanthropists, government agencies, academics, private social service agencies and other nonprofits working to help their communities. As recently as 1996, the term wasn't in our collective vocabulary, but today hundreds of references in publications, conference brochures, and websites lead us to a confusing array of SROI usage.

In 1997, REDF's effort to track and analyze the impact of seven San Francisco Bay Area nonprofit organizations and their twenty-three social purpose enterprises began. Employing individuals with a range of disadvantages, the enterprises serve a dual purpose: to provide market-driven goods and services to customers, and to provide a supportive training and work environment for individuals who wish to improve their lives. We developed an SROI approach to assess the impact versus cost of these social purpose enterprises.

At a basic level, concepts of social return on investment, like their business predecessors, compare some measure of the resources invested in an activity to some measure of the benefits generated by it. In SROI, the "S" denotes some sort of social mission activity; the "ROI" denotes the use of a business investment analysis.

On a deeper level, SROI may posit real, sometimes radical departures from traditional concepts of financial return by broadening the "who" a return may accrue to, and by expanding the "what" that can be considered part of an activity's return. REDF has pioneered this broadening of concepts of return. In our approach to SROI, we recognize and attempt to quantify the "return" that accrues to a whole community, rather than just those returns that accrue to a specific set of investors. We believe that "return" may take the form of a wide range of changes, including those that can be monetized, such as community tax savings, decreased social service costs, and individuals' increased income; as well as changes that have distinct effects on individuals and communities but are hard to translate into dollars, such as individuals' increased housing stability or self esteem.

For many years nonprofits have attempted to document the non-monetizable benefits they have generated. REDF's SROI expands this traditional view where possible, translating results into dollar impacts. We incorporate estimated dollars worth of return and the estimated investment required to generate them into a numeric gauge of return on investment, our Index of Return. We incorporate the "returns" that cannot be monetized into a broader assessment of a social purpose enterprise's value. [2]

How does REDF measure SROI?

Concepts of Value

Underlying REDF's analyses of our portfolio social purpose enterprises' SROI is our view of value. Social purpose enterprise value creation occurs simultaneously in three ways along a continuum, ranging from purely economic, to socio-economic, to social:

Economic __________________ Socio-Economic __________________ Social

[2] Much in this article is excerpted from, and can be explored in greater depth within papers published and available from our website, www.redf.org.

Economic Value

Economic value is created when there is a financial return on an investment. Examples of measurement of economic value can be seen in the reports on activities of for-profit corporations. Measures of economic value creation have been refined over centuries, resulting in a host of econometrics, including return on investment, debt/equity ratios, price/earnings ratios and numerous others. These measures form the basis for analyzing much of modern economic activity.

Social Value

Social value is created when resources, inputs, processes or policies are combined to generate improvements in the lives of individuals or society as a whole. Most nonprofits focus their resources in this arena, but unfortunately it is here that they have the most difficulty measuring the value generated. Social value can be found in a wide variety of activities from anti-racism efforts, community organizing, environmental protection, and the creation of art, to a family moving from welfare to work. These activities may generate results with high intrinsic value, but it can be difficult to agree upon or quantify the actual value created. For example, the psychological impact on an individual whose family has moved from welfare to work may be significant but hard to translate into dollars of value.

Socio-Economic Value

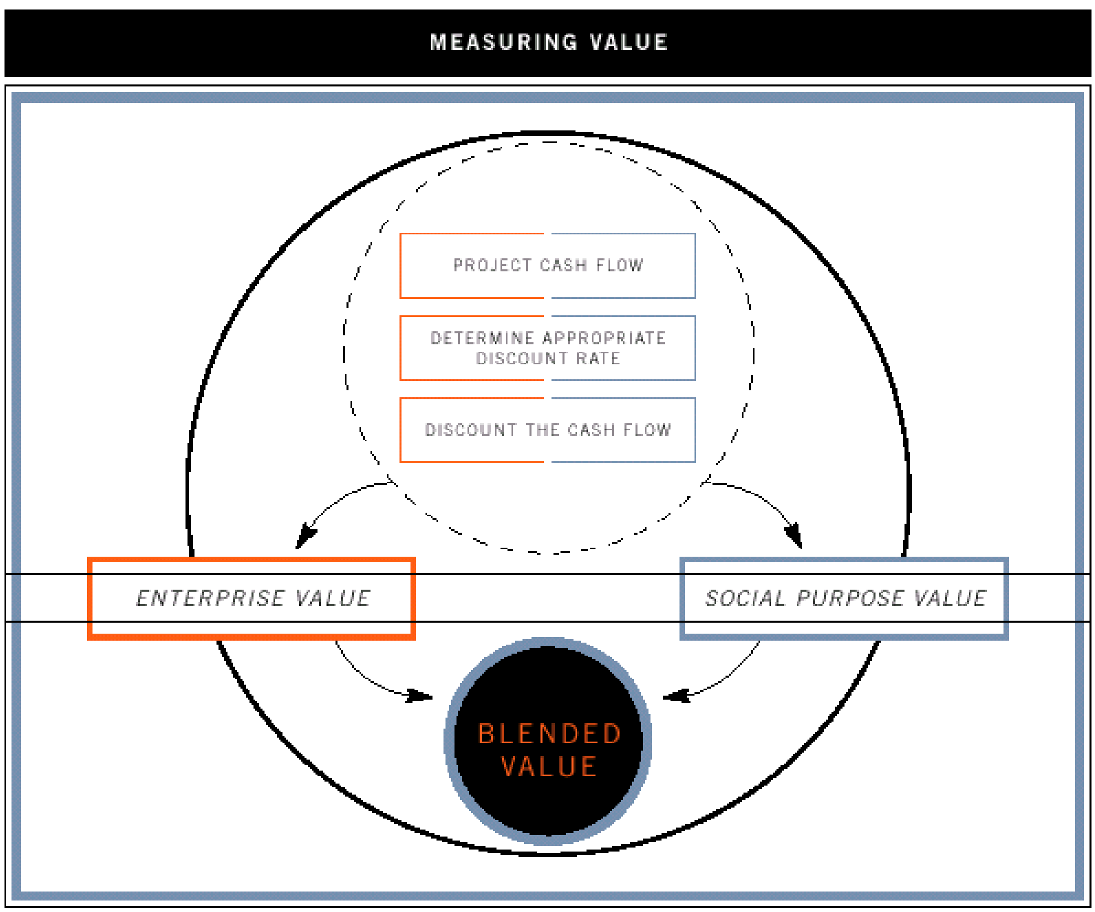
Measures of economic value are standardized and support the basis for most financial activity in the world. Many results of social mission-driven activities are beyond measurement, yet clearly *are* of value and worth affirming. In between these two poles of value creation, economic value and social value, lies socio-economic value. We measure socio-economic value using economic value measurement tools: we quantify and monetize the elements of an activity's social value that lend themselves to such analysis. A nonprofit organization or program creates socio-economic value by making use of resources, inputs, or processes; by increasing the value of these inputs; and then by generating cost savings and/or revenues for the public sector – its community. These cost savings and revenues may be realized in decreased public dollar expenditures and in increased revenues to the public sector through additional taxes collected.

Of the three forms of value - economic, socio-economic, and social - REDF 's SROI approach focuses on the measurement of economic and socio-economic value. Economic value is monetized via our *Enterprise Value*; socio-economic value is monetized via our *Social Purpose Value*. We then combine the two, to get the enterprise's *Blended Value*. In addition, within each social purpose enterprise's SROI Report, we include the description of a typical enterprise employee, challenges he or she has faced, and ways in which the enterprise's supportive employment has helped in meeting these challenges. These employee profiles, together with information about the risk characteristics of employees, provide a sense of the enterprise's non-monetizable contributions.

The REDF Approach: Step-by-Step

REDF's efforts to calculate our portfolio social purpose enterprises' SROI is an attempt to capture and track the impact these enterprises have on the lives of individuals and their communities. REDF's SROI measures value and return, and is performed in six stages which are briefly described below. It uses standard investment analysis tools, adapted to encompass our expanded concept of value. For more detailed descriptions of each stage, see our SROI Methodology Paper, available at http://redf.org/pub_sroi.htm#methodology. For an Excel model that takes the user through each of these stages, see http://redf.org/pub_sroi.htm#excel.

The first three stages of our approach focus on measuring value: what value a social purpose enterprise creates and "returns" to its community.



Stage 1: Calculate Enterprise Value
Using a discounted cash flow analysis of the business performance of social purpose enterprises in the REDF Portfolio, we calculate each enterprise's economic value.

Stage 2: Calculate Social Purpose Value
Using a discounted cash flow analysis of each enterprise's socio-economic results, we calculate its Social Purpose Value. We identify socio-economic factors: direct, demonstrable cost savings and revenue contributions that are associated with individuals' employment in a social purpose enterprise. Such factors include increased employee income taxes and tax dollars saved when REDF Portfolio enterprise employees reduce their dependence on public assistance, homeless shelters, and other government-supported services.

Example Savings and Revenues per Individual Employee: Enterprise ABC Social Purpose Results

SOCIAL PURPOSE RESULTS (PER TARGET EMPLOYEE)	1999
PUBLIC SAVINGS	$15,644
NEW TAXES	$1,815
WAGE IMPROVEMENT	$12,097
FINANCIAL IMPROVEMENT	$9,849

The community savings and revenues generated by a social purpose enterprise are offset by the additional costs involved in pursuing a social mission. Within REDF Portfolio job creation businesses, these "social costs" can include above-market levels of training and supervision, as well as counseling or other support programs.

Tracking the socio-economic changes that take place over time in an individual's life can be very complex and fraught with possible inaccuracies. As we developed our approach to valuing each enterprise's contribution to its community, we realized that portfolio agencies also needed expanded ability to measure changes in the lives of the individuals their social purpose enterprises employ. REDF 's comprehensive data gathering and tracking system, OASIS[3], enables portfolio nonprofits to track the services provided to individuals and to assess, over time, the impact of these services on individuals' lives. Enterprise employees are interviewed at the beginning of their employment, and thereafter every six months for two years, whether or not they are still working in a portfolio

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[3] More detail about OASIS, the Ongoing Assessment of Social ImpactS, can be found in *An Information Oasis*, May 2002, at www.redf.org.

enterprise. The implementation of OASIS has systematized and simplified our calculation of Social Purpose Value. However, finding and interviewing former employees continues to be a very complex and time-consuming portion of SROI analysis.

We believe that measuring an enterprise's Social Purpose Value and its Enterprise Value separately gives a clear understanding of how it generates value. However, it is also important not to look at either value in isolation. For this reason, a Blended Value, showing the full monetizable value of the social purpose enterprise is generated.

Stage 3: Calculate Blended Value
Having calculated the Enterprise Value and the Social Purpose Value, we add the two together and subtract any accrued long-term debt, to derive the enterprise's Blended Value.

Stages 4, 5, and 6 focus on social purpose enterprise returns. Enterprise and Social Purpose Values are compared to the investment required for each. Our "return" is articulated in the Index of Return. This index tells us whether the investment lost, maintained, or created value.

Stage 4: Calculate Enterprise Index of Return
The Enterprise Index of Return summarizes a social purpose enterprise's financial performance – its Enterprise Value - compared to the investment made in it. Enterprise Value is divided by the investment to date to derive this index.

Stage 5: Calculate Social Purpose Index of Return
The Social Purpose Index of Return summarizes a social purpose enterprise's monetizable social impact – its Social Purpose Value, compared to the investment required for this portion of the enterprise. Social Purpose Value is divided by the investment required to date.

Stage 6: Calculate Blended Index of Return
The Blended Index of Return compares the Blended Value of the social purpose enterprise to the total investment to date. It shows the return on both business and social mission activities.

The Index: What Does It Mean?

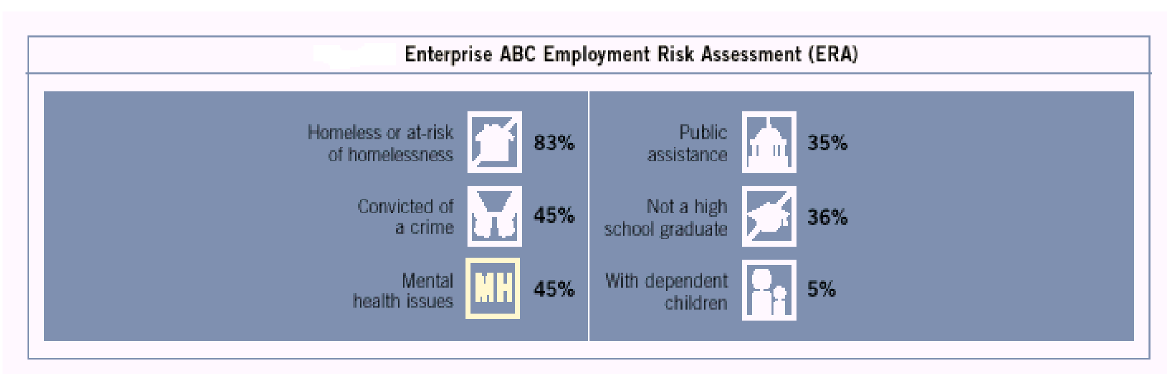
A Blended Index of at least one means that the social purpose enterprise generates enough value to satisfy all investors' expectations. An Index greater than one shows that excess value is generated. However, a low or negative Blended Index of Return doesn't necessarily equate to a poor investment. For some of the most disadvantaged populations, such as homeless people or individuals with psychiatric disabilities, an increase in use of public services, at least for some period of time, may be desirable, resulting in lower public cost savings. Some enterprises may provide crucial training for living wage jobs, but are not designed to be large enough to realize economies of scale. Combinations of these and other factors can lead to the low Blended Index of Return on a vital, valid investment.

REDF's SROI Reports

Similar to for-profit stock reports, REDF's SROI Reports provide an array of factors that should be considered in assessing a social purpose enterprise's value and potential. We invite you to look through an example report at http://www.redf.org/pub_sroi.htm#reports. In the same way that for-profit investors look to more than one indicator when assessing the performance of a corporation, philanthropic investors may now make funding decisions based on an intelligent mix of business, social impact, and socio-economic return measures.

The Blended Index of Return, with its component Enterprise and Social Purpose metrics, makes up just one part of REDF's SROI Report. Other types of information in the report include highlights of one of the enterprise's employees, information about the enterprise's employment risk profile, summaries of the enterprise's past and planned business and social initiatives, an assessment of its strengths and challenges, and accounts of some of the hard-to-quantify changes individuals undergo such as increases in an individual's self-esteem and social support systems, or decreases in an individual's drug use.

Example of an enterprise's employment risk profile



Lessons, Questions, and The Future

We present our approach to analyzing social return on investment as a balanced and effective way to understand the connection between the funds provided to investee nonprofit organizations and the results those organizations achieve. It is only a start, it is not definitive or complete, but it is a significant effort to raise the bar of practice to a new level. During the development of our SROI, we have learned some important lessons and have uncovered more questions. We hope these lessons and questions will help all of us do a better job of assessing – and then doing – our work.

Big Lessons

- **The SROI Analysis Process is Resource Intensive**
  Practitioners need significant financial and human resources to conduct an SROI analysis. For over a year REDF had a full-time, dedicated staff member who designed and implemented our SROI approach. We provided funding and consultants at all stages of building the infrastructure needed to capture the relevant social impact data. Practitioners will likely need time and resources to tailor our approach to their specific enterprises or fields, although REDF's SROI Excel Model (http://redf.org/pub_sroi.htm#excel) should help simplify the process. Foundations need to plan on making a significant financial commitment to enable investees to build such systems.

- **Engaging the Practitioner is Essential**
  This is not a top-down process, it is a bottom-up process. The approach is based upon detailed information provided by agency staff members and employees. Many evaluations are conducted by outside "experts" who enter an organization with the charge of assessing whether or not a particular program has attained its goals and fulfilled the mission for which it was funded. In our approach, the social goals, against which practitioners' work is assessed, are set by the practitioners themselves. This assures more whole-hearted and high quality staff involvement.

- **SROI Analysis Can Give Clarity to Our Work**
  Discussing issues such as investment timeframes, capital requirements and projected returns forces us to be extremely clear about expectations for and the appropriateness of any given investment. It encourages us to think about future funding opportunities and the types of enterprises and stages of business development in which we should invest. Practitioners, too, can use SROI results from past strategies to fine-tune future strategies.

- **Metrics are Important, but Metrics Aren't Everything**
  The SROI Reports feature SROI metrics along with business data, social impact data, qualitative information about the social purpose enterprise, and analyses of each of these areas. We maintain that without this broader context of social return on investment, the SROI metrics have limited application.

- **SROI is a Good Tool, But SROI Isn't Everything**
  REDF's approach to SROI is an evolving approach to valuation of social purpose enterprises. We want to be careful to not oversell the product of our work. While we believe SROI analysis can be a useful tool and look forward to refining it, it is just one tool. And it is important to remember that a tool is only useful if applied appropriately toward building something greater than itself. At REDF, the core of our attention remains focused on the work of helping disadvantaged members of our community improve their lives.

Big Questions

Our work has resulted in an approach to analyzing SROI that helps practitioners and investors understand more about the cost and impact of their work. Community cost savings data and revenue generation data, in combination with other social impact findings, can be a powerful tool for social sector managers to use in advocating for financial support of their work. This data is also central to analyzing a community's return on its investment.

At the same time, our exploration has generated many questions that we haven't been able to answer. Six major questions are summarized below in the hope that upcoming explorers will help us find answers. They are:

1. How can we minimize the disadvantages of using public sector savings as a measure of success?
2. How can we better address the attribution and causality challenges that are prevalent in SROI analysis?
3. How can we capture the costs and benefits that are not reflected in our analysis?
4. How can we improve the ways we offset our lack of industry comparables?
5. How can the complexity and cost of SROI analysis be further reduced?
6. How is REDF's SROI approach applicable to other fields of practice?

1. How can we minimize the disadvantages of using public sector savings as a measure of success?

   REDF's SROI approach uses public sector savings as a measure of positive change. Such savings come from reduced use of publicly funded programs such as food banks and clinics, as well as reduced use of prisons. We compare individuals' use of these programs before they are hired to their usage after they have worked at portfolio social purpose enterprises. Disadvantages of this approach include:

   - None of the REDF Portfolio nonprofit organizations have the mission of saving taxpayer dollars spent on public services. By using public sector dollars saved as a measure of success, SROI measures an area in which few nonprofits would consider a primary area of achievement.

   - An enterprise's Social Purpose Value is based on measures of cost savings for society, not on the benefits accrued to individuals. However, our mission and the mission of REDF Portfolio agencies focus on helping *individuals* improve their lives. In many cases, reduction in the use of these services is one aspect of the increased stability in individuals' lives, so there can be strong correlation between public cost savings and individuals' progress. But, though the SROI Index of Return incorporates this measure of how individuals' lives are improving, it does not provide a full picture of improvements. This is why REDF has also supported a full social impact analysis that identifies the benefits of employment that accrue to the individuals hired, including benefits that are difficult to monetize. This social impact assessment is ongoing and is meant to complement the portions of our SROI analysis that focus primarily on cost savings to society.

     Another problem with the cost-savings-to-society approach is that a decrease in use of public services is not always an appropriate social goal. For populations such as homeless youth, agreeing to access public assistance may be viewed as a benefit, since it involves youth taking the initiative to access services available to them, and can be a step on the path to other life improvements. In such cases, an increase in use of public services is considered positive, but it would continue to be reflected as a lower value in our SROI Index of Return.

   - In attempting to take a "conservative" tack to our analysis, we are probably undervaluing the social benefit of the enterprises under study. We decided to use directly identifiable and quantifiable cash flows that affected the public. We acknowledge that there are additional socio-economic value and multiplier effects that are not captured in REDF's SROI Framework, some of which are listed below:

- Increased future earnings for the individual
- Increased assets of individuals and their communities
- Unemployment insurance savings
- Sales tax from businesses
- Change in real estate value in enterprise's or individuals' neighborhood
- Change in earnings and social service consumption by later generations of family members

- Emphasis on public savings in our SROI approach could have an unintended long-term effect: it could encourage social purpose enterprises to focus hiring on individuals currently receiving public assistance, and away from those who are not, and who may have greater needs.

2. How can we better address the attribution and causality challenges that are prevalent in SROI analysis?

   In our SROI framework, we have attributed 100% of the public cost savings to the associated social purpose enterprises. The reality is that there are other influences and factors that contribute to the change in an individual's life — including other social programs provided by the parent agency and other social service providers. The challenge is to derive a way of finding what percentage of change in an individual 's life is a result of their employment in one of these enterprises.

3. How can we capture the costs and benefits that are not reflected in our analysis?

   There can be benefits and costs that accrue to a social purpose enterprise as a result of its nonprofit status that are not accounted for in our SROI analysis. For example:

- Social purpose enterprises that are nonprofit corporations (or part of nonprofit corporations) do not pay corporate taxes. Comparisons to for-profit enterprises might be made more precise by adding in a proxy for these taxes.

- Social purpose enterprises sometimes receive below-market interest rates on debt, donated goods, or access to government contracts without typical private sector marketing costs; and *on the other hand*

- Market perceptions of nonprofit organizations may result in longer ramp up periods before a social purpose enterprise can establish business credibility.

4. How can we improve the ways we offset our lack of industry comparables?

   In many ways, REDF Portfolio social purpose enterprises and others like them are not directly comparable with other, for-profit enterprises. We attempted to adjust for the major differences in our analysis. However, our adjustments have not necessarily fully addressed these differences. To the extent that they haven't, enterprise valuations are affected. The differences, and our adjustments, include:

   - Most REDF Portfolio social purpose enterprises incur labor costs that are higher than the labor costs in similar private sector enterprises, due to mission-related aspects of the business. They purposely employ more inexperienced workers with more barriers to successful employment. The additional cost of employing these workers is identified as a social cost, and is separated out from the enterprise's cost of goods sold and operating expenses. While this concept is straightforward, implementing it can be complex.[4] To date, REDF Portfolio enterprises quantify these social costs with various estimation techniques.

   - Some nonprofits have been able to partially finance their enterprises' start up phases with below market rate debt and grants. Grants received do not appear as "equity" on their enterprises' financial records since nonprofits do not have an ownership metric comparable to "equity". Thus, standard assumptions about the cost of debt and the required level of equity in a small business must be adapted.

   - Industry ratios and analyses are a significant piece of typical for-profit stock report analyses. These industry ratios and analyses are not included in the SROI Reports. Ratios only provide useful information when examined in the proper context - when comparing them to similar businesses' performance. The challenge for the social purpose enterprise is finding appropriate comparable businesses and industry metrics. Comparing a social purpose enterprise to a for-profit company can be inappropriate since for-profit companies generally try to avoid actions that add to their costs and do not add to their profits (such as purposely hiring people who may be difficult to employ).

[4] An in-depth discussion of the challenges of determining social costs can be found in REDF's publication: Heather Gowdy et al, "True Cost Accounting: The Allocation of Social Costs in Social Purpose Enterprises," found in *Social Purpose Enterprises and Venture Philanthropy in the New Millennium*, 2000. Available for download at http://www.redf.org/pub_boxset.htm#boxset_vol2.

- Social purpose enterprises are also difficult to compare to each other. Target populations and needs may differ and the requirements of nonprofit accounting, while very stringent, are not geared to reflect differences in business enterprise activity. Thus the differences between social purpose enterprises may be very significant but difficult to identify clearly.

5. How can the complexity and cost of SROI analysis be further reduced?

   For SROI analysis to be used, the information that feeds it must be available and reliable.

   At present, the complexity and cost of collecting managing this information may be prohibitive for many social purpose enterprises.

6. How is REDF's SROI approach applicable to other fields of practice?

   REDF's approach to SROI has been designed for and its research is based upon our experience with social purpose enterprises run by nonprofit organizations to provide employment and training to disadvantaged individuals. REDF's mission and the mission of our portfolio agencies have shaped our approach to SROI analysis. We believe that variations on this SROI framework may also be applied to other areas of interest such as environmental and educational entities, and we hope to see creative adaptations.

Future Journeys – Join Us!

REDF's SROI framework builds upon historic approaches to cost-benefit analysis. We invite you to deconstruct our model, re-configure it and re-introduce the model in ways that better meet your own needs. The good ship SROI was built with ideas and feedback from many of you. Elements from the "faraway world" of business analysis are now part of our world. We look forward to strengthening its structure and taking it even further out into the beyond!

The following REDF publications were drawn on heavily for this article:

Emerson, Jed and Twersky, Fay, ed., *New Social Entrepreneurs: The Success, Challenge and Lessons of Non-Profit Enterprise Creation*, (San Francisco: The Roberts Foundation, 1996).

Emerson, Jed et al, "Social return on Investment: Exploring Aspects of Value Creation in the Nonprofit Sector", in *Social Purpose Enterprises and Venture Philanthropy in the New Millennium, Volume 2,* (San Francisco: The Roberts Foundation, 2000), pp. 131-173.

Chun, Suzi et al, "Social Return on Investment Methodology: Analyzing the Value of Social Purpose Enterprise Within a Social return on Investment Framework" (San Francisco: The Roberts Foundation, 2001).

Jones, Julia and Tuan, Melinda "Social return on Investment Reports: Overview and Guide" (San Francisco: The Roberts Foundation, 2000).

Cynthia Gair is the Portfolio Director of The Roberts Enterprise Development Fund. The ideas presented in this piece are explored in more detail in REDF's recently released paper, *SROI Methodology*, available for free download at www.redf.org