NESsT VENTURE FUND

Unique and universal adapting the model[1]

Nicole Etchart

A question that NESsT[2] staff are often asked is 'Why do you work in Chile and Hungary? They don't have anything in common.' In fact, although Chile and Hungary have very little common culture and history, they are both 'emerging market economies' and 'emerging civil societies'. But there *are* significant differences in the legal and fiscal environment in Chile, and in the way the non-profit sector has developed there. It was only by adapting to these differences that NESsT was able to successfully replicate the NESsT Venture Fund, developed in Central Europe, to the local context of Chile.

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Both regions have seen a tremendous growth of civil society organizations (CSOs) in the last decades, many of them small organizations dedicated to addressing the inequities that states are unable, or sometimes unwilling, to address. However, in both regions, external donors began to depart soon after the transition to democracy was completed: in the case of Chile, in the mid-1990s, in that of Hungary, in the late 1990s. Today, few remain and local giving, though growing, has yet to fill the void.[3]

The need thus created was the impetus behind NESsT. We began work in Central Europe in 1997 and in Chile in 1999 to develop what is now known as the NESsT Venture Fund (NVF), launched in 2000 in Central Europe[4] and in 2002 in Latin America (in Chile, and soon Peru). The NVF provides capacity-building support and financial investment to a portfolio of social enterprises – businesses owned and operated by CSOs working for systemic change – in order to generate new revenues to sustain and strengthen their impact. It has provided assistance to over 500 CSOs; it currently has an early-stage portfolio of 40 social enterprises and a later-stage portfolio of nine.[5]

Although a similar cause brought us to each region, the NVF, developed for the circumstances of Central Europe, needed to be adapted for use in Chile. Our first step was a year-long research project on the uses of social enterprise and the legal/regulatory environment that governs it in Chile, and the publishing of a guide on the subject. This took the form of a number of case studies and an in-depth look at the legal and regulatory framework. We carried out a similar exercise in Central Europe. As was the case there, we found that Chilean CSOs typically develop social enterprise in an unplanned way, and lack start-up financial and capacity-building support for these activities.

Legal and regulatory environment

The regulatory frameworks in the two areas, though, are quite different, which has a direct effect on the NVF model. Hungary limits the use of social enterprise, but the situation in Chile is even more restrictive.[6] In Hungary, for example, non-profits do not pay tax on income generated from mission-related activity, and they only pay tax on that derived from non-mission-related activity 'if the proportion of income from such activities surpasses 10 per cent of the organization's budget or 10 million forints (approximately US$5,000)'.[7] Chilean CSOs, on the other hand, must pay tax on any income earned from social enterprise.[8] As to the level of activity, the law is ambiguous, stating that CSOs must limit 'commercial activities' but not specifying a threshold amount.

This restrictive and ambiguous law has caused many CSOs to believe that they simply cannot sell products and services, or that, in order to do so, they need to create separate legal entities. This, in turn, has led many Chilean CSOs to create their social enterprises as separate for-profit corporations and to explore shared ownership of these enterprises. Options under consideration include sharing financial returns with third-party investors, and placing staff or clients of the enterprise on the board, for shared decision-making and profit-sharing.

As a result, many Chilean organizations that have approached NESsT as potential portfolio members have not been eligible. Under the selection criteria created in Central Europe, CSOs must have 99 per cent ownership of the social enterprise in order to ensure that all profits flow back into the mission of the organization, and that the main decision-makers of the enterprise are its staff and board. NESsT is currently working with a group of pro bono lawyers on the implications of these 'hybrid' organizations so that we can be in a better position to advise potential portfolio groups of the risks they are taking and, if necessary, to change our eligibility criteria. ▷

Non-profit sector infrastructure

Another difference, noted in our early research and confirmed later, is the low level of infrastructure support for CSOs in Chile compared to Central Europe. Donors that entered Central Europe in the early 1990s invested heavily in developing CSO support centres, training organizations, umbrella associations, small business centres and a host of other mechanisms. More recently, as part of their exit strategies, some of them provided sustainability grants and other forms of technical assistance or funding support to their grantees. Though the levels of funding were limited, this has meant a gradual exit process that allowed CSOs time to adjust. Today, local philanthropy is still limited, but there have been concrete attempts to fill the gap. Hungary has the 1 per cent donation law, which allows individuals to designate that amount of their taxes to local CSOs. And recently the government set up the National Civil Fund to support Hungarian CSOs, which will even provide grants for core funding. The accession of Central European countries into the European Union also brings with it new funding opportunities for CSOs.

The position is quite different in Chile, which has very few support organizations. There was an attempt to create more informal networks, but most of these have fizzled out. Unlike in Central Europe, donors in Chile left almost overnight. Only a handful, such as NOVIB, a Dutch development agency, which announced its departure five years in advance, planned for this exit and provided funding to sustain their local CSO grantees. One of the main locally based foundations in the country has announced that it will spend out its endowment and close its doors at the end of 2005.

Again, unlike in Central Europe, advances in donations laws have been few. There are no individual tax deductions for donations to CSOs, leaving most personal giving to Catholic Church-related charities, random efforts such as the annual 'telethon', or asking people to donate their change on the street or in shops. Corporate tax benefits are limited to the more traditional fields of culture, education and social assistance, leaving others such as human rights and environmental organizations with minimal private support. Increasing attention has been given to fostering socially responsible business practice – and to encouraging more social investment by companies – but these efforts have not led to major giving.

1 This article draws from a paper called *Unique & Universal: Lessons from the Emerging Field of Social Enterprise in Emerging Market Countries*, which can be downloaded from the publications link at www.nesst.org

2 Nonprofit Enterprise and Self-sustainability Team.

3 See the June 2004 issue of *Alliance* for a series of articles looking at donors' exit strategies, including an interview with Gonzalo de la Maza on donors' exit from Chile and two articles on Central and Eastern Europe.

4 Now including Hungary, Czech Republic, Slovakia, Slovenia and Croatia.

5 At the early stage, NESsT helps organizations by providing them with the knowledge and tools to assess the feasibility of a social enterprise idea. NESsT supports later-stage portfolio members during the launch and implementation phase once the business plan is completed.

6 Both in Chile and in Hungary the law says that 'economic' or 'commercial' activities cannot be the principal purpose of the non-profit organization and that non-profits must devote all their income to not-for-profit purposes.

7 From *Legal/Regulatory Issues in Social Enterprise*, a presentation by Nilda Bullain of the European Center for Not-for-Profit Law on 25 May 2004 for the NESsT International Social Enterprise Exchange Program (ISEE), Europe 2004, in Szentendre, Hungary.

8 Though the law does make an exception for certain types of welfare organization. See Nicole Etchart et al (2002) *The Legal and Regulatory Framework for CSO Self-financing in Chile*, p 19. This is available at www.nesst.org/furthering_publication_tools.asp

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Adapting the NESsT model

These factors have also necessitated adaptation of the NVF model. Rather then require early-stage portfolio organizations to be at least three years old with diversified funding, as we do in Central Europe, the Fund is currently working with a number of start-up organizations. A six-month evaluation of our eligibility criteria led the team in Chile to modify these for such organizations. The idea is that they should be sufficiently stable to dedicate the time needed to engage in the NVF social enterprise development process. To have advised these organizations to come back to us in three years, when they had diversified funding, would have been irresponsible on our part. Diversification, in the case of Chile, means running after the very limited amount of short-term project funding provided by the government – a 'projectitis' effect that causes many of them never to fully develop or, worse still, to close down. However, though the new criteria have meant more qualified entrants, they have also meant that some CSOs have more staff time dedicated to them than others, and an internal discussion on the ideal portfolio size per portfolio manager.

Applying the model to Chile has also meant some revision of our capacity-building work. In this case, however, the lessons learned in Chile have also led to a modification of our work in Central Europe. Given the low availability of core funding in both regions, many organizations lack the staff, resources and systems needed for long-term sustainability. More and more of our early stage work now focuses on helping portfolio members to develop these areas of work, enhancing their leadership, communication, governance, human resources, financial and planning processes and systems. The increased emphasis on this kind of support was prompted by our Chilean experience, but is now being seen in our Central European operation too.

The extension of the NVF from Central Europe to Latin America was initially possible because of the common challenges facing CSO-run social enterprises in both regions. The creation of a proven methodology and appropriate tools allowed this replication to happen fairly smoothly. However, it was only by investing in entrance research, systematizing lessons learned, and adapting to the unique local circumstances that we were able to successfully replicate the model. @