

## BUILDING SUSTAINABILITY BY INCREASING EARNED REVENUE

### The How and Why of Sustainability

This *FIELD forum* is the third in a series of case studies illuminating strategies used by microenterprise programs to increase the sustainability of their organizations and the services they provide. Each case profiles an organization, describes its strategy and how it contributes to sustainability, and identifies key success factors and lessons learned. The first two cases profiled organizations pursuing sustainability through social enterprise and new capitalization strategies, respectively. This issue explores the experience of an organization actively seeking to grow multiple earned-revenue streams in order to reduce reliance on grants to support operations.

As is true throughout the nonprofit sector, the issue of sustainability has long been of concern to the microenterprise field. Although some microfinance organizations operating overseas have achieved high levels of self-sufficiency,<sup>1</sup> in the U.S. the existence of a widely dispersed and highly diverse customer base that demands higher levels of business development services, combined with higher costs of doing business and lower interest rates has made it harder for domestic programs to find a successful formula for self-sufficiency. For example, data for 2006 from FIELD's MicroTest program found that on a median basis, credit-led microenterprise programs generated revenues equal to 30 percent of their total

operating costs; this figure dropped to 7 percent for training programs. As a result, most program managers must routinely pursue a variety of avenues for securing the funds required to operate and achieve their mission over the long term.

### Focus of this Case Study

One obvious, but not easy, means to achieving greater sustainability is by increasing an organization's level of earned – or nongrant – revenues. This *forum* profiles one organization's experience pursuing a range of earned-income strategies as a means to increase sustainability. Interestingly, unlike most of the microenterprise organizations that have achieved higher levels of earned income and self-sufficiency, the organization profiled here – the Appalachian Center for Economic Networks, or ACEnet – has as its primary line of business the provision of business development services. Its success – and its struggles – growing these revenue sources illustrate why the path to sustainability is in fact “a long and winding road.”

ACEnet is a community development corporation based in Athens, Ohio that has worked since 1985 to support the development of a healthy and vibrant economy in the counties of Appalachian Ohio. Early in its development, ACEnet worked with worker-owned cooperatives, and in 1991 launched its first business incubator. Soon afterward, ACEnet launched the sectoral or industry-focused network and service approach that remains its focus today, and for which it has become nationally recognized.

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<sup>1</sup> Data published in the Spring 2008 issue of the MicroBanking Bulletin, indicate that financial self-sufficiency has been largely achieved across the peer groups of international microfinance organizations on which it collects data. Among the 340 organizations on which it has trend data for three years, median self-sufficiency was 112 percent. See [http://www.mixmbb.org/Publications/001-IND/01-IND.ANLS/01-IND.ANLS.MBB/MIX\\_MBB16\\_Spring%202008%20Issue.pdf](http://www.mixmbb.org/Publications/001-IND/01-IND.ANLS/01-IND.ANLS.MBB/MIX_MBB16_Spring%202008%20Issue.pdf).



## Access to Markets Services

At the core of ACEnet's work is a focus on industry cluster-based access to markets services. According to ACEnet, an industry cluster comprises businesses in related and complementary markets and activities. Thus, for example, its initial cluster work focused on the specialty foods and agricultural cluster, and included food manufacturers, locally owned restaurants and farmers interested in specialty crops. It also included businesses that provided services (graphic designers, accountants), markets (grocery stores and other retailers) and distribution to these businesses, as well as nonprofits (Small Business Development Centers, agricultural extension and educational institutions) that could provide assistance.<sup>2</sup> ACEnet's role is to provide technical assistance, expertise and market information to the firms – in areas such as marketing, product placement, production and kitchen incubation – as well as to help all parties within the cluster develop and strengthen relationships in mutually beneficial ways.

One of the key “products” of ACEnet's work in the specialty foods and agricultural cluster has been the development of its Food We Love regional brand. Food We Love is, as ACEnet notes, a marketing campaign “that allows producers to bundle products under a brand umbrella that encourages retailers to buy from small local firms.”<sup>3</sup> Firms that become part of the brand receive technical assistance from ACEnet in areas such as modifying recipes for large-scale production, labeling, marketing and pricing. In addition, ACEnet works collaboratively with others in the cluster to promote the brand throughout the region, and

in some cases participation in the brand provides a direct entrée to area retailers. For example, all food producers who are part of the brand automatically receive an initial placement in the Athens Kroger supermarket. As of July 2008, 49 specialty food producers and farmers were participating in the Food We Love brand.

In recent years, ACEnet has launched two other major initiatives. In 2006, it acquired a second incubator campus in the community of Nelsonville, Ohio. And in 2007, it launched a second regional brand, Art of Ohio, which supports area artisan, food and wood entrepreneurs through an e-commerce initiative. In addition, the Athens Kroger has an Art of Ohio display that features functional art, such as pottery, ceramics, wooden bowls and cutting boards, art cards and other artisan gifts. Kroger is partnering with ACEnet free of charge for the sales transactions as a promotion collaborative. As the broker, ACEnet receives 20 percent of all sales.

These initiatives, along with ACEnet's existing work in the specialty-foods cluster, combine to support a strategy called “regional flavor,” which seeks to identify and build on both the business and natural assets of a region to enhance local economic activity. Regional flavor efforts work collaboratively to implement a mix of rural economic development strategies that incorporate microenterprise development, regional tourism, cultural and historic assets, and agricultural product development to help entrepreneurs and area development organizations rethink, redefine and rebrand themselves and their regions.

From a sustainability perspective, industry- or sector-based services offer microenterprise programs an opportunity for income generation

<sup>2</sup> June Holley, *Entrepreneurship with a Regional Flavor* (Athens, OH: Appalachian Center for Economic Networks, undated), 4.

<sup>3</sup> ACEnet, “Food We Love: The Food Ventures Regional Brand Campaign,” PowerPoint presentation.

1985	1991	1996	2002
ACEnet founded to build economy of Appalachian Ohio region.	ACEnet establishes its business incubator.	ACEnet opens kitchen incubator as part of Athens campus.	ACEnet launches Food We Love brand.



that other services may not. Because these services are intended to have a direct effect on the revenues and bottom lines of client businesses, it is not a stretch to expect that entrepreneurs will be willing to pay at least some of the cost of these services. This case describes ACEnet's experience working to derive earned income and greater sustainability through its cluster-based services.

### Why Focus on Sustainability?

**S**ustainability has always been an issue for ACEnet, as it is for almost all nonprofits. Although it is possible to survive solely on grant income, that business model leaves the organization vulnerable to economic downturns that affect both private and public donors, as well as to changing donor priorities and interests. From the launch of its incubator and other specialty food-based access to markets services, ACEnet envisioned charging user fees that could at least help support program costs. Although it made some progress in generating fees from those sources, staff found that there were (and are) challenges in the extent to which clients could fully fund those services. Thus, earned revenues were a small but important part of ACEnet's funding base.

The issue of sustainability came to a head more recently, when a major federal grant that had funded ACEnet's work in student entrepreneurship training ended. As a result, the organization experienced significant retrenchment in its budget and staffing, shrinking from 45 to eight staff. The experience was traumatic, and ACEnet's management team vowed not to repeat it. Management decided that whenever ACEnet considered taking on a new project or activity, there would be discussion and a strong focus up front on the revenue streams that would sustain the program

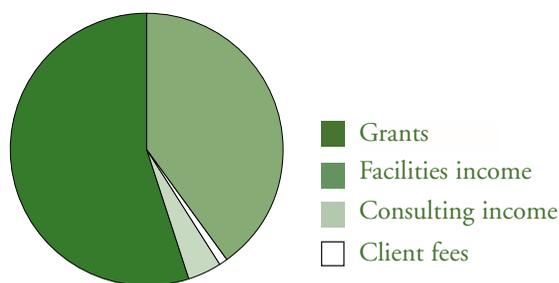
over time. In addition, management sought to create lean staffing and cost structures that also would be more sustainable long term.

As ACEnet has moved forward to increase its level and diversity of earned income, it has looked at two major sources: income from client services, and income from consulting and third-party contracts for service delivery. Each source builds upon the strong reputation that ACEnet has created in its long history of successfully providing entrepreneurship and economic development services.

### Income from Client Services

**A**CEnet generates income from its clients in two areas: facility fees (from its incubators and associated services), and other client fees (largely brokering fees from its two brands, Food We Love and Art of Ohio, as well as fees charged for its training courses). Among these, revenues from facilities provide by far the largest source of revenue.

ACEnet 2007 Revenue



### Business Incubation

ACEnet owns two incubation sites, one in Athens and another in Nelsonville, Ohio. The Athens campus encompasses three facilities totaling 23,000 square feet, which offer office, light manufacturing and warehouse space. One building houses ACEnet's kitchen incubator, a

2002	2004	2006	2007
Begins discussions to acquire Nelsonville incubator.	Implements wood and artisan programs and begins cross-cluster work in "regional flavor" projects.	ACEnet acquires Nelsonville incubator campus, commits to expand ACEnet Ventures.	Art of Ohio e-commerce site launched.



7,700 square foot facility that includes food preparation, packaging and warehousing areas, as well as support services in areas such as food packaging and pH analysis, recipe batch up, and nutritional information analysis. Tenants in all three buildings can access ACEnet's core services, such as business consulting, technology training and access to financing, as well as benefit from collaboration with other entrepreneurs in the regional food, wood and art industries with which ACEnet works.

ACEnet's Nelsonville facility provides basic business incubation facilities. Located in a former warehouse, the incubator has almost 95,000 square feet, of which about 60,000 is currently available for lease. ACEnet improved the facility to include space for shared business services, such as a mail room and copier, tenant offices, a conference room and break area, and a fiber optics backbone.

ACEnet charges fees for use of its facilities and support services, based on time used. In 2006, ACEnet generated just under \$400,000 in total revenues from its incubator facilities; this represented an increase from approximately \$275,000 in 2004. About \$325,000 of its 2006 revenues were from rental fees for physical space, and the remaining \$70,000 was for services such as bottling and labeling services, as well as hourly renting of the kitchen facilities related to the kitchen incubator (the Food Ventures Center).

### **Client Fees**

ACEnet also generates fee income from clients through its regional brands and its training and technical assistance services. Fee income associated with the brand comes from upfront assessment fees and commissions. Art of Ohio charges a \$25 fee for an initial client intake and assessment. Once an artisan is accepted and on the Web site, all sales made through the Web site include a 30 percent commission to ACEnet. Galleries also place their pieces on the Art of Ohio Web site, paying a 15 percent commission on all sales.

The Food We Love brand uses a similar pricing structure, including an initial \$35 fee for client assessment. If the client signs with Food We Love, there is a 15 percent brokerage fee for all sales through the brand. However, it

is not mandatory that all businesses sign a contract with Food We Love, and often members of the brand work directly with retailers and therefore don't incur the brokerage fee. Clients who affiliate with the Food We Love brand also often receive assistance, such as packaging, labeling and pricing, however, the fees for these services are attributed to the Food Ventures Center, not tracked to the Food We Love brand.

At present, client fees associated with the regional brands are ACEnet's smallest area of client-generated income: total revenues were just over \$7,000 in 2007. Yet staff believes there is strong potential for growth. Food We Love was understaffed in 2007; in addition, the Athens Kroger store has been undergoing a major renovation that will include increased space for the brand. With the addition of another part-time staff member, and the completion of the Kroger renovation, brokering activity under Food We Love is increasing. Furthermore, the Art of Ohio brand and Web site are still relatively new, and again it is hoped that revenues will grow as the brand becomes established.

### **Consulting and Third-Party Contract Income**

**A**CEnet's consulting services are similarly built around its expertise in access to markets services. Because of its national leadership in regional brands, kitchen incubation and regional flavor strategies, other economic development organizations interested in these strategies are willing to pay ACEnet to share its knowledge and experiences. They find it is cheaper to learn from ACEnet than to make expensive mistakes on their own.

ACEnet's consulting services fall into three categories – work on the national level, work within its broad region and work emanating from tours of its incubator. Regarding its national consulting, ACEnet works with organizations from outside its service region that are interested in replicating its programs and services. These services may involve very targeted exchanges – such as phone consultations that are charged on an hourly basis (at \$100 per hour) – or more extensive multiyear engagements in which they advise



organizations that are starting a kitchen incubator. ACENet has also provided national consulting services focused on two other hallmarks of its work, namely network building and regional flavor initiatives. These services may involve on-site work or trainings.

These consultancies provide a specialized set of services that few organizations can offer. ACENet staff is aware of only perhaps two other organizations that provide consulting services on kitchen incubators. ACENet's services in these areas can be very specific and hands-on. Current consulting services include feasibility studies for incubation and branding projects in Southwest Virginia, Charlottesville, Virginia and the Arkansas Delta.

ACENet also provides "consulting services" to organizations within its broader region. Some of these organizations operate within ACENet's service area; others in nearby metropolitan areas. In these relationships, ACENet will provide food sector-based training to entrepreneurs in a city such as Cleveland or Oberlin, working through a local nonprofit that can access local foundation funding. In other regional relationships, local economic development organizations within ACENet's service area have hired the organization to work with local retailers, food producers and bed and breakfast owners on a regional flavor/tourism strategy. These "consulting services" are similar to what other microenterprise organizations called "third-party contracting" strategies, in which rather than raising funds directly, the organization provides services using public or private funds provided or raised by another nonprofit or a municipality. ACENet also earns consulting or management fees for the staffing and management services it provides to ACENet Ventures, a community development financial institution that it created (but which is not formally affiliated with ACENet).

ACENet's third area of consulting services is generated through tours of its incubation facilities. The primary draw here is the Food Ventures Center, although visitors often also learn about its more traditional incubators as well. ACENet charges \$100 per hour or \$500 per day for a tour for between one and 10 people; tours that involve between 10 and 35 individuals cost \$1,000 per day.

In 2007, ACENet generated just over \$35,000 in consulting fees from all of these sources. This was actually a decrease from previous years. The decline in consulting revenues stemmed from two sources. First, management fees from ACENet Ventures declined, in part because that organization took a hiatus from lending. In addition, ACENet's founding director, June Holley, left the organization in 2006, and about half of the national consulting revenues followed her. As a result of her departure, the composition of ACENet's consulting revenues also have changed: While national consulting services represented almost 60 percent of total consulting revenues in 2005, they comprised only 44 percent in 2006; regional consulting increased from 34 percent to 49 percent of total consulting revenues. ACENet staff members project this trend will continue, as they believe that they can increase both the level and percent of their revenues that come from local and regional consulting or contracts.

## Working the Cost Side

To increase its sustainability after losing key grant-funded programs, ACENet's primary strategy has been to develop and maximize earned revenue. However, a second and complementary strategy for increasing cost recovery is to reduce costs, and ACENet also has taken steps in that direction. Some cost reduction was the natural result of losing a major grant and laying off staff affiliated with it. However, the organization also has taken a very deliberate approach to staffing, and as programming has expanded or existing staff have left, careful and creative thought has been given to how to secure needed staff skills.

ACENet's approach to staffing is in some ways common among nonprofits: It looks very hard at whether it has the resources to bring on and maintain new staff. In addition, the organization seeks to use consultants – often their clients – to provide some services. Thus, for example, much of the logo and label design, as well as other marketing assistance, provided to Food We Love businesses comes from one of ACENet's clients with a graphic design business. Similarly, ACENet clients provide the photography for content that is posted to the

Art of Ohio Web site. Finally, ACENet also seeks to use local volunteers and subsidized resources to provide administrative and custodial support for its activities.

One unique approach to service delivery comes through in some of ACENet's regional flavor activities, where the organization works more as a facilitator than a service provider. ACENet sees its role as supporting collaborative efforts among networks of local entrepreneurs who are working to develop new markets and marketing efforts. Thus, for example, ACENet staff helped to support the creation of a farmers market and a restaurant association. As they work with these nascent groups, assisting with the development of collaborative events, ACENet staff also provides advice to the member businesses on marketing, promotion, and so forth. The idea, however, is that eventually these collaborative efforts will be able to function largely without ACENet staff input, thereby freeing the staff to work on other efforts.

As a result of the above staffing approaches, ACENet is currently a very lean organization. It is important, however, to note the potential for such a lean staffing structure to diminish the organization's capacity to fulfill key functions. Over the past year ACENet leanness has led to several staff members taking on multiple roles. For example, for a while the Chief of Operations served as the Director of the Food Ventures Center due to staff turnover, while also providing loan fund administration services to ACENet Ventures. Recognizing the challenges inherent in asking one staff member to play those multiple roles, the organization recently hired an additional person to take on a number of his accounting and financial management duties.

## The Total Picture

Where has this strong focus on earned income and sustainability led the organization? As the table indicates, ACENet has achieved very high levels of total cost recovery over the past several years for an organization

focused largely on business development and access to markets services.

Year	Total Cost Recovery <sup>4</sup>
2004	31.2%
2005	42.7%
2006	48.1%
2007	44.9%

However, the challenge for any organization seeking to achieve sustainability through a cost-recovery strategy that includes a focus on efficiency and the pursuit of consulting income is to balance the benefits of these strategies against the strains they place on organizational capacity. ACENet is wrestling with these challenges, and is moving to enhance staffing levels in order to strengthen its capacity to reach larger numbers of clients. As it does so, it may see a decrease in its total cost-recovery levels, at least in the short run.

## Lessons Learned

As ACENet has worked to move toward greater sustainability, it has learned some important lessons regarding the opportunities and challenges presented by a strategy focused on increasing cost recovery. These include:

- It takes time and money to make money.** Although incubation can generate significant revenues for an organization, it is a long-term strategy that requires significant capital injections. ACENet generates significant revenues from its Athens campus, however, it took many years to pay off the debt incurred in its development. And, as noted above, the facility has additional income-generating capacity that cannot be tapped without raising new capital to upgrade the current facilities. Similarly, the newer Nelsonville campus is generating some revenues, but to date has required a significant capital investment - much of it, fortunately from ACENet's perspective, in the form of federal grants, although some debt was incurred to

<sup>4</sup> Figures provided by ACENet. These calculations represent total earned revenues divided by ACENet's total expenses for the fiscal year. It is important to note that this definition for total program cost recovery differs somewhat from the definition FIELD uses for its MicroTest program, in which only revenues and expenses related to the microenterprise program would be included. In short, the MicroTest definition would involve a different treatment of ACENet's consulting income and expenses.



complete the build out and to open the facility. The organization is currently seeking to raise \$1.6 million to fund upgrades at both facilities. And although they are smaller in scale, additional funding is needed to realize the potential of ACEnet's other earned-income strategies. For example, while the organization anticipates that its brands will have strong income-generating potential, their growth will also require additional capital.

- **Costing and record-keeping are challenging but essential parts of a successful effort to increase earned revenue.** When developing an earned-income strategy, organizations need to create systems for tracking the costs and revenue associated with that activity. This is often a challenge for nonprofits, whose accounting systems may be built around funding streams, rather than lines of business. While ACEnet has long recognized the need to better track costs and revenues, it is still working to develop systems that will allow it to track costs and revenues associated with each of these earned-income streams. This process has been complicated because ACEnet's lines of business have changed and expanded over time, and it has taken time to adjust the accounting system to reflect the changing nature of its activities.
- **One means to strengthen revenue generation and sustainability is by maintaining long-term client relationships.** Microfinance organizations that have reached high levels of self-sufficiency have learned this lesson – it is more profitable to keep an existing client (especially one that is taking on increasingly larger loans), than to recruit a new one. Similarly, ACEnet has found with its incubation services that many clients can't and don't want to “move out” of the incubator after a minimal period of time. In some cases, this is because locations with adequate water and sewer capacity, for example, are not easy to find in rural areas; in others it is because the business does not want to grow to the scale required to afford certain types of kitchen facilities. The key is to retain these clients. ACEnet also seeks to

find ways that more experienced and successful clients can provide expertise and services to, or to co-venture and collaborate with, early-stage clients. This approach not only creates new market access opportunities for ACEnet's clients, but it also helps to reduce ACEnet's cost of providing services to new clients.

- **Clients may resist paying fees to nonprofit organizations.** ACEnet has periodically faced difficulty getting clients to pay, particularly for incubation services. This reluctance stems from some clients' view that ACEnet is a nonprofit organization that receives grant funding to finance its operations, and therefore should not charge fees. At several points, ACEnet has had to place a significant focus on collecting back rent from tenants who had fallen in arrears.
- **It is a challenge to capture the full value of access to markets services.** While ACEnet receives brokerage fees for some of the sales made by its Food We Love and Art of Ohio clients, it is difficult to create mechanisms that cover all of the sales that result from participation in the brand. For example, Art of Ohio charges a commission on all pieces sold through the Web site. However, in some cases an individual identifies a piece on the Web site, but wants to physically see it before purchasing. If the piece is purchased directly from a gallery or the artist, Art of Ohio does not receive any commission – even though the buyer originally located the piece through the Web site. Similarly, Kroger will now stock (at least on a test basis) any product that is part of the Food We Love brand. However, if clients go directly to the store, again no commission is collected. ACEnet is currently working to expand the transportation and distribution components of the services it offers through Food We Love. It hopes to work with a larger-scale client who already own trucks and would deliver to area retailers Food We Love items made by other producers. Producers will be charged a fee for these services; some of that revenue would come back to ACEnet, and some would also go to the business doing

distribution. This mechanism may allow ACENet to increase its fees from the brand.

- **There is a hidden cost to consulting.** ACENet has been able to leverage its national expertise and reputation into a source of revenue. But generating this revenue entails costs as well, in that it draws staff time away from the local work and mission of the organization. ACENet's consulting services draw primarily on its three most senior staff – individuals who are key to day-to-day operations, as well as to raising the capital required to maintain and grow its core programs (and its other sources of earned revenue). Any attempt to measure the extent to which such consulting services support the organization and its core mission needs to factor in both the financial and opportunity cost of diverting key staff away from the organization's core mission.

## Looking Forward

While ACENet has leveraged its industry-leading expertise to achieve high levels of cost recovery, it has been neither a short nor an easy road. The incubation strategy generates revenues, but significant levels of both fund-raising and debt financing are required to acquire and maintain the facilities. Thus, ACENet is currently embarking on a capital campaign to refurbish and upgrade the kitchen incubator, as well as to make additional

improvements to its Nelsonville facility. Realizing the full income-generating potential of these facilities will require success in those fund-raising efforts. This fact reiterates a lesson explored in an earlier FIELD forum: that adequate and appropriate capitalization is a key component of sustainability.<sup>5</sup>

ACENet's history of achievement also has created expertise – intellectual capital – that it can sell to others in the microenterprise and economic development fields. This consulting work creates revenue for the organization, and also advances the field as a whole, by enhancing the learning curve of other organizations. On the other hand, a revenue strategy built around consulting also has potential to draw staff focus away from the organization's own clients and mission.

Finally, ACENet has responded to the struggle to maintain a large, grant-dependent organization by focusing on cost reductions as well as earned income generation. It has created a lean staffing structure, which while efficient, may limit its sustainability in other ways. ACENet is now looking to bring on new staff, a move which may paradoxically increase its sustainability even as it reduces its overall cost recovery - demonstrating again that the road to sustainability is often not a straight path.

<sup>5</sup> Elaine Edgcomb, *FIELD forum* Issue 20: *Capital Structure - Getting it Right to Increase Sustainability* (Washington, D.C.: The Aspen Institute/FIELD, April 2008).

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**Acknowledgments:**

The author would like to thank the staff of ACENet, particularly CEO Angie Hawk Maiden, Director of Programming Leslie Schaller, and Director of Operations Larry Fisher, for their support in the development of this case study. This *forum* is based on a review of documents and program records, and interviews with staff, board members, consultants and clients conducted in late 2007 and in 2008.

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For additional information about and products on sustainability in the microenterprise field, see: <http://fieldus.org/Projects/direction7.html>.

This publication is made possible by a grant from the Charles Stewart Mott Foundation.