

Chapter 21

NESsT: A multipronged support structure, multiple countries

NESsT supports and invests in social enterprises that use market-based solutions to create opportunities for viable employment and income generation in Central and Eastern Europe, and South America. The description presents the objectives, rational and key activities of NESsT. It also discusses the challenges faced and the conditions for transferring it to another context.

Summary

NESsT invests money, business coaching and social capital in social enterprises in emerging market countries. Since its creation in 1997, NESsT has accumulated unique social enterprise development experience, creating dignified jobs and income for people facing the greatest barriers to work. It currently works in three Central and Eastern European (CEE) countries – Hungary, Poland and Romania – and two countries in South America – Peru and Brazil. In addition to supporting a portfolio of enterprises, NESsT engages in research, publications, sector-building and relationship-building with funders and policy makers. Social impact is at the heart of each investment, and is measured using a robust performance-management methodology.

NESsT introduced the “social enterprise” concept in response to the sustainability crisis affecting civil society organisations (CSOs) and their search for innovative responses to critical social problems. In its first 15 years, NESsT uses an **engaged-investor approach** and supported very early-stage enterprises. This was vital in CEE countries, where social enterprise and social investment were in their infancy. The initial objectives of NESsT were to: 1) support and showcase high-impact social enterprises; 2) build the capacity of individual social enterprises through training and mentoring; 3) build a social enterprise sector; and 4) create an enabling environment and advocate for policies supporting social enterprises.

Over time, as the local social enterprise ecosystems evolved and NESsT assessed its achievements of the first decade, the organisation added new objectives. Since 2010, the NESsT 2.0 strategy focuses on social enterprises that have validated their business model and are preparing to scale¹ in two social impact areas: dignified jobs and sustainable income. Key objectives now include: 1) increasing the availability and appropriateness of financial instruments; and 2) improving social impact management.

NESsT activities fit under several policy areas:

- capacity-building and skill development for social enterprises
- awareness-raising and general education of all stakeholders
- access to finance, offering own funds and raising third-party sources.

NESsT was – and still is – the first and foremost educator and market-builder for social enterprises in a number of CEE countries.

The NESsT model is replicable providing the following conditions are in place: 1) long-term funding and commitment; 2) groups of skilled, committed and motivated professionals; and 3) an enabling environment, providing friendly regulation and market opportunities fostering social enterprise growth.

Key facts

NESsT is a pioneering organisation founded in 1997 by two social entrepreneurs. In the late 1990s and early 2000s, it introduced a highly innovative approach to social problems in CEE and Latin America, using concepts and terminology that were little known to entrepreneurs, civil society, investors and public sector officials. The social enterprise and sustainability programme launched by NESsT for non-profit organisations brought new content, defined key concepts (such as social enterprise and sustainability), and often created new terms in the local languages. NESsT operates in different geographies (namely, Europe and South America), offering each region a unique opportunity to pilot and adopt initiatives from the other region and devise similar solutions to comparable social problems. NESsT currently operates in 5 countries – Hungary, Poland, Romania, Peru and Brazil – and employs a team of 28 full-time professionals and 4 interns.

NESsT's 2014 annual income totalled EUR 2.3 million (USD 2.6 million), comprising contributions from foundations (47%), earned income from consultancy services (32%), corporate contributions (12%), grants from governments and multilateral organisations (5%), and donations from private individuals (4%) (NESsT, 2015). European Union (EU) funds for social enterprise development programmes were also added in recent years.

Objectives

The NESsT vision is that of a world where all people can improve their quality of life thanks to a stable job generating a living wage. NESsT develops and invests in enterprises that use market-based solutions to create opportunities for viable employment and income generation.

Initial objectives: NESsT 1.0 (1997-2010)

- **Support and showcase high-impact social enterprises:** NESsT introduced the social enterprise model as a new way of solving social problems (e.g. unemployment, discrimination and environmental degradation) and providing sustainable financing for struggling CSOs. NESsT offered grant funding and at least three years of business planning

and mentoring support to start-up and early-stage enterprises wishing to validate their business model and achieve social impact.

- **Build the capacity of social enterprises:** extensive research conducted by NESST in four CEE countries in 1998 showed that considerable skill and resource barriers hindered social-enterprise development among CSOs (NESST, 1998). The study uncovered considerable efforts on the part of CSOs to diversify their financial resources and build sustainable models, often including enterprising solutions. However, tools, training and capacity building were urgently required to assist organisations embarking on the social-enterprise journey (NESST, 1998).
- **Build a social enterprise sector:** NESST wished to contribute to the field and share the experience of more advanced social enterprises from other countries by introducing business planning, organisational development and impact-management tools, numerous training and capacity-building events, new research and publications, and networking and partnership opportunities. The organisation's workshops and tools on social enterprise readiness and business planning for early-stage enterprises became the benchmark in CEE, and were later widely used and adopted by other stakeholders.
- **Engage in policy advocacy and develop appropriate financing facilities:** NESST hoped that funders and other stakeholders would join the social enterprise ecosystem once the model had proved effective. When this did not happen – or happened much later than expected – in many NESST countries, NESST began to engage with policy makers and the public sector on the one hand, and private sector financiers on the other hand, to push for a more enabling environment for social enterprises.

Policy approach

When NESST was created, the CEE region did not have a social enterprise ecosystem. The multi-layered policy approach applied by NESST follows the evolving needs of the sector across all CEE countries. Its integrated package includes providing funding, capacity building and networks, education and training, coaching and mentoring, and research and market support.

Rationale

In its early years, NESST approached the “social enterprise” concept from the civil society perspective. CSOs recognised “enterprising” as an effective alternative to grant-funded projects. By the late 1990s, CSOs in CEE had already suffered the consequences of diminishing funding. Foreign funders had begun to withdraw their support, while the underdeveloped local philanthropy was reluctant to fund organisational development, enterprise planning or core costs. In the transitioning CEE economies and societies, people had a huge appetite for new, increasingly market-oriented approaches, as well as new methods and skills. NESST considered this a propitious time to introduce a rigorous methodology for social enterprise development. The early funders of NESST were innovative foundations (e.g. the Rockefeller Brothers Fund, the Charles Stewart Mott Foundation and the Soros Foundation) and individuals (mostly with a business background), who believed in the social enterprise model and the need for diversifying CSO funding.

In 2004, when the Czech Republic, Hungary and Slovakia joined the European Union, NESST hoped that significant amounts of pre-accession and structural funds would be used to promote social enterprises. The EU and national-government funding programmes did little

to strengthen the organisational capacity and governance of impact-delivery organisations; instead, they channelled most of the funds directly to the beneficiaries. As a result, CSOs became accustomed to an abundance of public funding, and depended heavily on project grants. In Hungary, for instance, 35% of the income of traditional CSOs in 2006 came from government subsidies (KSH, 2008) and an additional 23% from public sector grants targeting their “core programmes”.² The government had not reformed public procurement, so CSOs specialising in service provision could not build sustainable business models based on delivery contracts with the public sector. Consequently, the desired social enterprise boom did not take place.

The key challenges during the design of the programme were as follows:

- **Lack of awareness of social enterprise concepts and examples:** NESST had to design and fund regular awareness-raising and educational campaigns targeting CSOs and funders.
- **Lack of financial and human resources for social enterprise development:** the local philanthropic scene numbered few domestic donors; public sector agencies and governments were uninterested, or insufficiently skilled; the rare academics studied foreign social enterprises; and CSOs mostly employed grant-funded, project-focused staff, who lacked the business know-how or time to become effective social entrepreneurs.
- **Lack of partners:** In the early pioneering phase, NESST lacked partners. Local donors, the public sector and academia were not interested or did not have the human resources to investigate the social enterprise concept and collaborate with NESST. Its key allies were mostly CSOs – who had a forward-looking strategy, yet lacked the resources to fully embark on the social enterprise journey – and businesses from the private-equity and finance industry, who embraced NESST longer-term “investment” approach.

Activities

Through its engaged-investor approach, NESST invests in social enterprises by providing long-term, tailor-made capacity-building, mentoring and financial support. These are the key components of the venture-philanthropy³ toolkit – featuring exercises, tools, manuals, workshops and one-on-one support methodologies – first introduced by NESST in CEE in 1999-2000,⁴ with the primary expectation of maximum social return on investment. This impact-focused approach is still very innovative in the region.

The NESST methodology for social enterprise development comprises the following stages:

- NESST invites **early-stage** social enterprises to participate in its workshops on social-enterprise readiness and business planning to help them create a viable business model.
- After rigorous due diligence, NESST selects the most promising businesses for inclusion in its **incubation** portfolio. These social enterprises pilot and prove their business concept during an incubation period of five to seven years.
- In the **scaling/replication phase**, NESST provides further investment through a variety of financial instruments (e.g. blended finance, debt and equity).
- Throughout the investment process, NESST builds the social enterprise’s ability to **measure and manage its performance and social impact**, using a tool developed over 15 years of portfolio experience.

Capacity building

Highly trained and experienced NESsT staff deliver capacity building during workshops, portfolio events, conferences, seminars and one-on-one consultations. Early-stage enterprises are taught basic business-planning and financial skills, while enterprises in the incubation and scaling portfolio are coached to become investment-ready and take on repayable finance. Capacity-building support averages EUR 7 500 a year for each organisation; portfolio enterprises consider it the most valuable aspect of the NESsT package.

Impact measurement and management

All portfolio social enterprises use the NESsT performance management tool, which sets goals and targets, measures baseline and monitors performance regularly, based on agreed indicators tailor-made to each social enterprise in four areas: 1) enterprise (business) performance; 2) organisational capacity; 3) social impact; and 4) financial sustainability. The tool also contains a few common indicators (flagships) on which all portfolio enterprises must report, so that NESsT can aggregate performance at the portfolio level. While NESsT enterprises compare performance to their own targets, NESsT also uses external benchmarking, comparing data to the global IRIS data set.⁵

Financial support

NESsT invests EUR 22 000 on average in each social enterprise. Start-ups or very early-stage enterprises receive grants to finance seed capital and operating costs during the launch period. While this amount may seem low, it is crucial for most social enterprises in CEE, which still struggle to obtain start-up funding from other sources.⁶ As growth enterprises in the NESsT portfolio need larger amounts and different types of finance, NESsT pilots loans and equity transactions targeting EUR 88 000 on average in the incubation phase and EUR 220 000 in the scaling phase.

Innovative features

In an effort to expand the range of available resources and engage new stakeholders, NESsT created a **Business Advisory Network**⁷ of local and international business professionals, who offer their expertise and networks to NESsT and its portfolio on a pro bono basis. This advisory role was an innovative way of involving stakeholders who could later become donors and investors. The NESsT “Private Equity Shares”⁸ initiative proved exceptionally successful in that light, raising EUR 877 000 in funds and the equivalent of EUR 175 000 in pro bono support from investment professionals and their funds.

NESsT was the first to use competitions in CEE in order to attract social enterprise proposals. In 2007, it introduced the first “NESsT-Citi Social Enterprise Competition” in partnership with Citibank.. The competition had a highly innovative format: 1) it provided an opportunity for long-term co-operation with a multinational bank, offering both funding and volunteer support by its employees; 2) it promoted the social enterprise model to the wider public; 3) it provided a rigorous process and timeline for organisations to complete and present their business plans; and 4) it allowed comparing and selecting proposals (including, for the first time in CEE, proposals submitted by for-profit social enterprises), based on their potential business viability and social impact.

Changes in the NESST approach: NESST 2.0 (from 2011 onward)

NESST believes the social enterprise model has now proved itself. Consequently, the agency has shifted the emphasis to working with high-impact enterprises that are ready to validate and scale their business model. NESST now focuses on specific impact areas, such as labour inclusion, sustainable income and affordable technologies, to achieve more social impact by providing significant long-term support to a smaller number of social enterprises addressing the root causes of a social issue.

- **Validate, scale and replicate successful social enterprises:** the most successful members of the NESST portfolio receive further investment, advanced capacity building and tailor-made technical assistance.
- **Increase access to finance:** consolidated and growth enterprises need more – and different – types of capital than start-ups. To fill the financing gap, NESST: 1) provides a more diverse range of financing instruments, including recoverable grants for growth plans, patient loans for infrastructure investments, working capital and loan guarantees to help leverage third-party investment sources; 2) offers larger amounts of blended capital, ranging from EUR 88 000 to EUR 132 000; and 3) identifies other financiers who could offer the missing debt or equity component, and engages with them as co-financiers in specific transactions.
- **Improve impact measurement practices:** to determine whether employment, placement and sustainable income have indeed resulted in improved quality of life, NESST is piloting indicators (e.g. income improvements over time and job longevity) relative to social enterprises' beneficiaries. The Agency is also tracking environmental impact indicators, in a bid to ensure that its portfolio of enterprises are reducing their carbon footprint and adopting environmental best practices.
- **Demonstrate the crucial role of intermediaries and incubators:** as an intermediary itself, NESST advocates allocating sufficient financial and other support to intermediaries, as their sustainability is vital to the survival and growth of the overall social enterprise sector.

Challenges encountered and impact

Challenges

The NESST 2.0 strategy continues to build on the organisation's many strengths and take advantage of opportunities in the European and global contexts. On the one hand, the increased interest in social enterprise and social investment, combined with social enterprises' will to engage private-sector resources in their development, means that skilled intermediaries will play a crucial role in matching successful scaling social enterprises and social investors. On the other hand, crowdfunding has opened a window to an extraordinary resource – retail investors – whose numbers and commitment to social value can be harnessed by investment-ready social enterprises and support organisations such as NESST.

Many more partnership opportunities exist today than 10 or 15 years ago, and NESST is in a good position to capitalise on its know-how and reputation. It could find ways to share its methodology with others while remaining at the cutting edge, focusing on scaling and replicating social enterprises.

Table 21.1. shows a strengths, weaknesses, opportunities and threats (SWOT) analysis of the NESST programme.

Table 21.1. **SWOT analysis of NESST**

Strengths	Opportunities
<ul style="list-style-type: none"> ● Robust methodology in social enterprise development and social impact ● Almost 20 years of social enterprise and investment experience ● Highly skilled, innovative and committed staff ● International as well as local expertise ● Extensive professional network ● High quality of activities, strong reputation ● Consultancy business 	<ul style="list-style-type: none"> ● Continued interest of the public and private sectors in social enterprise and social investment ● Increased focus on social impact by investors, public-sector commissioners and social enterprises ● New EU programmes, e.g. EU Programme for Employment and Social Innovation ● Availability of social investment funds and repayable finance ● Success of crowdfunding platforms ● Partnerships with support organisations, and private and public sector stakeholders ● Increased need for intermediaries ● NESST Partners Programme¹
Weaknesses	Threats
<ul style="list-style-type: none"> ● Small team compared to operational needs ● Portfolio social enterprises are smaller compared to other social enterprises worldwide ● Financial sustainability ● Communication of achievements 	<ul style="list-style-type: none"> ● Competition among intermediaries and incubators ● Lack of global/local funding for CEE ● Inability to raise sufficient investment funds meeting donor and investor conditions

1. For more information, please refer to: <http://www.nesst.org/join-nesst-partners-new/>.

Even though NESST will celebrate its 20th anniversary in 2017, financial sustainability continues to be its most important challenge. To achieve its goals, NESST will need to raise more funds and create a sustainable financing model for itself by raising awareness among a growing number of actors. A commitment to high-quality, targeted communication will help NESST meet the heightened competition among incubators and intermediaries.

Raising funds to invest in the scaling portfolio could also prove challenging, as very limited patient capital is on offer in the EUR 25 000-250 000 range. NESST wants to raise funds to supply the combination of debt, long-term equity-type funding or blended finance its portfolio needs to prepare for higher levels of social investment going forward.

Impact

As of 2015, NESST supported a portfolio of 167 social enterprises worldwide, reaching 540 000 low-income individuals. It had invested over EUR 10 million in financial and capacity-building support, provided training in social entrepreneurship and business planning to 12 000 leaders from 5 300 organisations, and helped generate over 33 000 employment opportunities (NESST, 2015). NESST enterprises are viable businesses, achieving a 25% revenue growth on average.⁹

NESST has been very successful in its sector-building efforts. It has developed a robust methodology for early-stage social enterprises, and published books, manuals, legal assessments and case studies in 16 languages. NESST has laid the foundations of the social enterprise sectors in all of its countries of operation. It has helped train and prepare hundreds of professionals and organisations, who later became multipliers and future social entrepreneurs or investors. It has helped transform a large part of the CEE finance and investment community, whose members now understand and support social enterprises. Thanks to its international contacts, CEE social enterprises now participate actively in global networks and the flow of ideas.

Lessons learnt and conditions for potential replicability

Lessons learnt

- **Social enterprise development takes time.** NESST had to streamline the process by announcing an annual competition. This increased participants' motivation, resulted in stronger proposals and shortened the development phase to 8-12 months. By using referrals and focusing on more advanced social enterprises, the current due-diligence and investment-decision processes have been much shortened, and currently last three to four months.
- **Social enterprises experience similar success rates as start-ups.** NESST has learnt that only one or two out of ten early-stage social enterprises succeed, and that it needs to be more selective during the initial investment and first-year evaluation stages. This benchmarking exercise helps NESST keep the scalable enterprises in its portfolio.
- **Grants are crucial.** Since most social enterprises will always need them to fund working capital, development or innovation, NESST has decided to continue to offer grants, either as a smaller percentage of the total funding or as part of a blended-finance package.
- **CSOs and social enterprises lack strategic skills, good governance and an impact-measurement culture.** Support organisations' capacity-building and mentoring agendas need to include these skills.
- **Leadership is key to success.** Even if it offers the best products and services and has a well-structured business model, a company that lacks a strong management team will ultimately fail to consolidate and grow.
- **The lack of access to public sector markets is a major impediment to social enterprises specialising in service delivery.** Social enterprises and their support organisations, including NESST, must continue to push for public procurement processes emphasising social value, so that social enterprises have a better chance of competing in tenders.
- **The involvement of corporations and foundations is critical.** In today's shared-value approach, corporations should see doing "business" with social enterprises as a "win-win" opportunity to respond to the needs of both employers and service providers. Foundations can support the innovative aspects of this investment-oriented approach, for example by seed-funding the research and pilot stages.
- **Sector-building activities are essential.** Social enterprises cannot thrive in a vacuum – they need markets and financing. Government support is crucial, as it can help develop the infrastructure and promote the concept of social enterprise. Consequently, engaging with public sector agencies, policy makers and funders must remain on the agenda, even though it is very resource-intensive.
- **Viable intermediaries and incubators are vital to a healthy social enterprise sector.** They act as translators, conveners and matchmakers, and share the risks. Both funders and regulators have an interest in supporting their viability, either directly or indirectly, through contracts. Intermediaries must work together to avoid duplicating efforts; they must see each other as part of a value chain.

Conditions for potential replicability

1. **Funding and understanding of the local realities.** Because of the deep, long-term relationship between investors and investees, the NESST approach requires significant financial commitments over a 10-15 year period. If such funding is not available,

the intervention may remain an isolated incident, and potentially successful social enterprises will never make it to the growth stage. Local funding realities (i.e. the types and sources of funding available) and conditions for enterprise development (e.g. regulation, support structures, market conditions) influence social enterprise development, market penetration and commercial viability.

2. **Staff.** One key to the success of NESST is its staff, who deliver the bulk of its value, i.e. capacity-building support.
3. **Environment.** To be financially viable, a social enterprise targeting either the private or public sector market needs to compete on at least a level playing field with other businesses.

While it is possible to replicate its model, NESST has concluded that it is neither necessary nor sustainable for one organisation to replicate the entire model. Today's CEE social enterprise ecosystem is such that NESST can now leverage a number of partners (accelerators, universities) to support its start-ups, and rely on a growing community of impact investors and innovative funders to provide financing. As a result, NESST now positions itself as an investor, focusing on the validation and prepare-to-scale stages, and working intensively with a smaller portfolio of social enterprises to maximise their social impact.

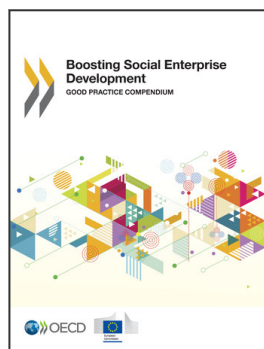
Notes

1. The Monitor Group's research identified four stages of enterprise development: blueprint, validate, prepare and scale. **Blueprint** refers to the enterprise design phase. **Validate** means testing the commercial viability and sustainability of the business through market trials. **Prepare** means preparing the conditions within the enterprise, as well as in the market, for scaling a sustainable business model. **Scaling** is the growth phase intended to reach a wide customer base and scale the social impact. See Koch et. al (2012).
2. Core activities or programmes (*alaptevékenység*) is a legal and statistical term in Hungary that refers to the basic activities defined in an organisation's statutes. In statistical reports, this category is used to denote an income category, namely, all the income the organisation receives from core activities, regardless of source. The bulk of such income tends to derive from public-sector grant programmes.
3. The European Venture Philanthropy Association (EVPA) defines venture philanthropy as a "high engagement and long term approach to generating societal impact through three core practices: tailored financing, organisational support and impact measurement and management" (EVPA, n.d)
4. The NESST venture-philanthropy toolkit was developed over time and provides non-financial support to its portfolio, in combination with finance. Some of these tools (e.g. publications) have been published and are available on its website.
5. IRIS is a generally accepted set of performance metrics used by impact investors to measure social, financial and environmental success. For more information, see: <https://iris.thegiin.org/>.
6. Some exceptions exist in Hungary or Poland, where social co-operatives were favoured by special European structural funds or government funded programmes, as they were seen as effective vehicles of employment creation, rather than market-oriented enterprises.
7. For more information, please refer to: www.nesst.org/advisors/.
8. For more information, please refer to: www.nesst.org/equity.
9. Ibid.

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