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GUEST EDITORIAL

Are Social Enterprises Viable Models for Funding Nonprofits?

Thom Reilly

Morrison Institute for Public Policy and School of Public Affairs, Arizona State University, Phoenix, Arizona, USA; Former Clark County Manager, Las Vegas, Nevada, USA

The Great Recession and its aftermath have forced nonprofits to seek out new and different ways to address their challenges. In order to make change that is sustainable and scalable, additional funding sources need to be considered to help nonprofits achieve their core missions. Charity and government support remain crucial but are insufficient to address the magnitude of the task at hand. Solving basic social problems requires a level of sustainable investment that donors and government cannot provide alone. Social enterprise models may well offer an answer.

Nonprofit organizations are vital to the nation's economic well-being and have nearly doubled in the last 30 years (National Center for Charitable Statistics, 2015). More than a million tax-exempt organizations exist in the United States, including public charities, private foundations, and civic organizations—not counting the 220,000 religious congregations that are also registered. However, the traditional reliance of nonprofits on governmental and charitable funding is increasingly unsustainable. Shrinking government budgets and greater competition for ever-fewer dollars are reducing the scale and effectiveness of nonprofits in meeting the nation's growing challenges and intractable problems. It may be time to rethink how these important social organizations are funded.

Should nonprofits become more aggressive in adopting new business models that can add needed revenue? Could this ease nonprofits' dependence on government and charity and better position them to fulfill their missions? What are the downsides and dangers in pursuing new models?

One answer to these questions may be the social enterprise model, which has the potential to revolutionize both the nonprofit and for-profit sectors. Social enterprises are for-profit or nonprofit businesses whose products and services address major unmet needs of society. Social enterprise efforts can range from selling merchandise to support the charitable functions of the nonprofit to creating a new entity that merges the for- and nonprofit operations into a hybrid form. These social enterprise efforts can add a business model by creating sustainable revenue. The core mission is thereby freed from total dependence upon the decisions of donors.

Interest in exploring these models has been rising in the United States, but they are much more common in Europe. The first social enterprise model was documented there in 1990 (Defourny, Hulgård, & Pestoff, 2014). The journal *Impresa Sociale* (*Social Enterprise*) presents new entrepreneurial initiatives that arose largely in response to social needs that had been inadequately met—or not met at all—by nonprofits and public services. These initiatives were credited with influencing the Italian parliament in 1991 to create specific legal forms or "social cooperatives." (Defourny et al., 2014). As these forms spread to other European countries, researchers began to study their effectiveness (Defourny et al., 2014). Eventually, nonprofit and for-profit sectors in the United States began to adopt some of the concepts from the social enterprise and social entrepreneurship movement (Defourny et al., 2014).

Social entrepreneurs argue that they can be change agents in both the for-profit and nonprofit sectors (Praszkier & Nowak, 2011). In contrast to traditional approaches, they are able to recognize and pursue new opportunities to meet socially impactful missions, while implementing funding strategies that ensure that their work has the resources needed to be effective (Praszkier & Nowak, 2011).

CONTACT Thom Reilly thom.reilly@asu.edu Director, Morrison Institute for Public Policy: Professor School of Public Affairs, Arizona State University, Phoenix, AZ, 85004 USA.

Researchers have often referred to social enterprise structures as the “fourth sector” (after private, public, and nonprofit) because they combine charitable missions, corporate methods, and diverse social and environmental philosophies in ways that surpass the traditional business and philanthropy models (Billitteri, 2007). Though the resulting structures can be complex, social enterprises are increasingly transforming traditional nonprofits and corporate philanthropy into new hybrid organizations (Billitteri, 2007).

While businesses have traditionally focused narrowly on generating profits for shareholders, many nonprofits (despite their skills and dedication to their missions) have lacked adequate marketing skills (Billitteri, 2007), often resulting in financial hardship. The social enterprise model that connects marketing and financing has shown some success in addressing social problems with revenue not solely generated from donors and the government (Artz, Gramlich, & Porter, 2012).

Historically, federal and state laws have viewed nonprofit and for-profit entities as mutually exclusive organizations whose work rarely, if ever, overlapped. Entrepreneurs who believe companies can pursue profit while also addressing social problems have challenged this legal distinction. The traditional method of receiving tax-deductible donations is to file for 501(c) status with the Internal Revenue Service, an application for 501(c)(3) status designed for a religious, charitable, or educational purpose.

With the emergence of the social enterprise movement in the United States, new forms of corporate structure are being created to ensure that these new hybrid approaches are operating legally. A growing number of states have prepared the ground for the creation of such enterprises by recognizing a new class of business entities. The two most common are the benefit corporation (B Corp) and the low-profit–limited-liability company (L3C).

Both represent “forms of for-profit business,” but “they represent a shift toward greater consideration of the environmental and social concerns of an enterprise’s stakeholders” (Artz et al., 2012, p. 232). The L3C is a partnership or joint venture between a for-profit and a nonprofit, with the charitable component of the organization being freed from income taxes and maintaining its separate identity (Billitteri, 2007). In 2008, Vermont became the first state to permit the creation of the L3C (Powell, Jackson-Zapata, & Kammerling, 2014), an entity that allows companies to achieve modest profits while operating under a business model that emphasizes impact over profits. L3Cs were specifically designed to help social entrepreneurs raise capital from a much broader range of investors.

Benefit corporations, created in Maryland in 2010, differ from L3Cs in that they are required to operate under specific standards set forth by B Lab, itself a nonprofit organization (Powell et al., 2014). The B Lab “promotes socially aware business practices by providing an opportunity for a business to voluntarily adopt responsible standards of decision making” (Hiller, 2013, p. 290). By meeting the levels of social responsibility set by B Lab, any entity can become a B Corp (Hiller, 2013)

Being certified by B Lab recognizes the good intentions and social responsibility of companies, encourages responsible investing by providing sustainable ratings, and promotes a new legal entity meant to be more socially responsible, purposeful, accountable, and transparent (Hiller, 2013). A certified B Corp uses a set of rating standards that support corporate responsibility in crucial areas of business endeavors that are not based solely on a profit-seeking model (Hiller, 2013). While both L3Cs and B Corps can be used to support emerging social entrepreneurs, each fails to address challenges addressed by the other; namely, L3Cs do not offer the transparency and legal protections of B Corps, while B Corps will not receive the broad capital-market access enjoyed by L3Cs.

Efforts supporting social enterprises can range from selling merchandise to creating a separate for-profit enterprise, or even a hybrid structure, to support the core mission of the non-profit. The number and variety of selling opportunities presented to nonprofit organizations, especially through the Internet, is growing rapidly. One of the best known and most visible social enterprise models of nonprofit merchandise sales is the Girl Scouts and their selling of cookies. The Heart Association matches their commercial enterprise with the maker of Lean Cuisine® to align closely to their mission.

Another example is Goodwill, a nonprofit that sells merchandise to support its core function of finding jobs for hard-to-place individuals. Edgar J. Helms founded Goodwill in 1902, described it as an “industrial program as well as a social service enterprise.” His vision and business model set an early course for what today has become a $4 billion organization (Goodwill Industries International, 2015). Goodwill is able to achieve its core goal because of its diverse revenue portfolio. In 2014, Goodwill received $3.94 billion from retail sales, $666 million from industrial and service contract work, $104 million from government grants, $33 million from corporate and foundation grants, $48 million from individual gifts/endowments/fees for services, and $393 million from government support for its mission services (Goodwill Industries International, 2015).

Clean the World is a nonprofit organization that collects and recycles discarded soap and hygiene products (Clean the World, 2015). It donates the products to impoverished people, preventing millions of hygiene-related deaths each year and encouraging vigorous childhood development (Clean the World, 2015). Started in 2009 in Florida, Clean the World Foundation began as a global humanitarian organization registered as a 501(c)(3). However, the impact of the "Great Recession" in 2009 and 2010 left its founders with dwindling funds. Banks were not lending. Charitable endowments sank to an all-time low and were unavailable to start nonprofits. Then a social enterprise approach opened the door to social investing, especially bank financing, for an otherwise unattractive opportunity. The organization became the first Benefit "B" Corporation in Florida. (Clean the World, 2015).

Another example of an effective social enterprise is Chrysalis, a California organization made up of two components: a social enterprise through its nonprofit side and a for-profit business (Social Enterprise Alliance, 2016). Chrysalis is dedicated to creating pathways to self-sufficiency for homeless and low-income individuals by helping them find and retain employment (Social Enterprise Alliance, 2016). One of its divisions, Chrysalis Works, is a professional street-maintenance and cleaning service; the other, Chrysalis Staffing, is a full-service staffing agency. Clients obtain valuable work experience as well as a variety of skills needed for the job market (Social Enterprise Alliance, 2016). Triangle Residential Options for Substance Abusers (TROSA) is a licensed, comprehensive, 2-year residential substance abuse recovery program in North Carolina. TROSA is another example of a social enterprise model that employs former clients by operating eight separate for-profit businesses including a moving company, a frame shop, a lawn maintenance business, a used furniture store, catering services, temporary labor, and a Christmas tree lot (Chronicle of Social Enterprise, 2009).

For social enterprise models such as Chrysalis and TROSA to be effective, there is a need for the development of a viable business plan for how to produce a sufficient return on investment. Human service managers often lack the skill set for these types of business practices so it is often necessary to employ individuals with both training and experience in the for-profit sector.

While there are clear benefits to social enterprises, such as those organized through the Benefit Corporation and L3C, clear risks also exist. Some IRS rules, for example, severely limit the circumstances under which L3Cs can be used for donations and tax exemptions (Billitteri, 2007). This supports the perception that "social enterprises organized as for-profit businesses find it difficult to attract donations because individual donors do not receive the same tax benefits compared to donating to a 501(c)(3) nonprofit organization" (Artz et al., 2012, p. 232). Such concerns about raising capital led to the creation of the L3C, but tax benefits for donors can still be questionable for social enterprises. This issue demonstrates that "given social enterprise's lack of guaranteed shareholder primacy, social enterprise faces inherent challenge in attracting capital from profit-seeking investors" (Artz et al., 2012, p. 232).

Among the tasks faced by social entrepreneurs and their corporate partners is finding the balance between creating a true social enterprise and constructing an organization whose purely profit-making goals are masked as a social enterprise (Billitteri, 2007). Such organizations may be motivated more by the public-relations value and commercial returns of the relationship than the charitable mission (Billitteri, 2007). So far, the advantages of social enterprise organizational structure include minimal restrictions on configuring the type of capital and funding needed for their organization. As noted earlier, however, the United States has been slow to adopt this model. However, local governments and foundations can be key in accelerating growth of social enterprises by providing capacity building and developing the management expertise within nonprofit organizations. For example, both the Rockefeller Foundation and the Shell Foundation provide financial and technical support for early-stage innovation for social enterprises. They also facilitate the cross-sector collaboration of nonprofits, governmental agencies, and corporations. As funders for an array of human service programs, both local governments and foundations can use their convening power to advance these social enterprise models to address an array of issues impacting their communities (OECD netFWD, 2014; Shell Foundation, 2014).

Another factor worth noting regarding the need for nonprofits to adopt the new social enterprise models is the identification and recruitment of board members with relevant experience. Nonprofits have a unique governance and regulatory structure designed to ensure that the board is accountable to society through their donors, funders, staff, clients, and the larger community (Jones, 2013). Their board members typically include, among others, members of the organization, individuals who share the same goals, donors, business partners, and legal counsel. Social enterprises should reflect a similar composition along with an emphasis on board members who possess both business acumen and a social awareness that fits with social entrepreneurship. In Europe, many social enterprises have a board that is legally accountable for fulfilling the organization's mission as well as supervising its financial performance (Social Enterprise UK, 2012).

The blending of for-profit and nonprofit organizational characteristics reflects an integrated hybrid form that could address the serious burnout factor and problems with talent retention in many nonprofits (Stecker, 2014). According to a recent survey, the greatest staffing challenges faced by nonprofits include insufficient time to recruit qualified staff and inadequate resources to compensate staff in a competitive environment (Otten, 2014). These survey findings reflected worker dissatisfaction with wages and with the organization's inability to retain employees who could go elsewhere for better compensation. In this context, it is conceivable that social enterprises could offer staff, especially millennials, both the prospect of a challenging career choice and the opportunity to customize their careers based on experiential learning and maximizing choice (Stecker, 2014). In other words, the social enterprise model could attract a wider range of individuals who are interested in doing good by acquiring entrepreneurial skills to also do well and assist the human service field by pushing forward on improved client outcomes and impacts.

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