SECTOR-BENDING: BLURRING LINES BETWEEN NONPROFIT AND FOR-PROFIT

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Traditional sector boundaries are increasingly breaking down. Everyone has seen the headlines about nonprofit hospitals, HMOs, or health insurers converting to for-profit status, and in some cases being acquired by for-profit chains. But many individuals could not tell you whether their own provider is a nonprofit or a for-profit entity. Most have heard about Edison Schools, a public corporation that manages over 130 public schools in 22 states and Washington, D.C., but few know that Nobel Learning Communities has started a chain of independent, for-profit schools, operating 170 schools in 15 states. And while for-profit health clubs try to stir up controversy over unfair competition from suburban YMCAs, Pioneer Human Services, a Seattle nonprofit serving substance abusers and ex-convicts, quietly provides metal bending operations for Boeing as a means of training and employing their at-risk clients. Further south in Los Angeles, students at Crenshaw High School planted a community garden, began selling produce at the local farmer's market, and now sell all-natural salad dressings and applesauce in regional supermarkets and via mail order. Company profits provide college scholarships for the student owners, and 25% of the produce is donated to the needy in their community.

What is going on here? On small and large scales, in local communities and across the country, for-profits and nonprofits are moving into new territories and exploring uncharted waters. While this kind of sector-bending is not entirely new—remember Goodwill Industries or Girl Scouts Cookies—it is certainly growing in popularity. Increasingly we are turning to business methods and structures in our efforts to find more cost-effective and sustainable ways to address social problems and deliver socially important goods.

Should we be troubled by this behavior? We should not. As with any new development, this one has its risks, but these can be identified, evaluated, and managed. We have entered a very healthy period of experimentation. Some of the experiments will fail, but others will succeed. These successes should allow us to use resources, particularly scarce philanthropic resources, more effectively to serve public purposes. In this way, boundary-blurring activities have the potential to increase the "independence" of the "independent sector." They may even lead us to change the way we think about "sectors." Instead of emphasizing legal forms of organization, such as nonprofit, for-profit, and governmental, perhaps we can focus on communities of practice that include different organizational forms serving a common purpose, such as the improvement of elementary and secondary education or the preservation of bio-diversity.

The Definition of Sector-Bending

Before exploring some of the potential benefits, it is important to understand what we mean when we talk about "sector-bending." Sector-bending refers to a wide variety of approaches, activities, and relationships that are blurring the distinctions between nonprofit and for-profit organizations, either because they are behaving more similarly, operating in the same realms, or both. Some behaviors are more widespread than others; several have been a reality of the social sector for generations; and others represent relatively new phenomena. For simplicity, we define sector-bending around four broad types of behavior: Imitation, Interaction, Intermingling, and Industry Creation. Just as the boundaries between sectors are blurring, the lines between these categories are indistinct. In fact, behaviors falling within one category quite often lead to or are part of activities associated with another.

Imitation and Conversion: Nonprofit organizations are increasingly adopting the strategies, concepts, and practices of the business world. Anyone working in this field sees it regularly. Organizations in which "customer" and "marketing" once had negative connotations are hiring marketers or consultants, identifying their target markets, segmenting their customers, and developing strategies. Tools developed specifically for use in the business world, such as Porter's Five-Forces strategy framework or Kaplan's Balanced Scorecard, are being adapted and adopted by nonprofit organizations. As successful business entrepreneurs become increasingly interested in bringing their skills, as well as their wealth, into the social sector, this trend should continue. Even a highly charitable, community-oriented organization has like Habitat for Humanity has been influenced by the business experience of its founder Millard Fuller, a marketing entrepreneur and self-made millionaire. Habitat builds houses for those who otherwise could not afford a home of their own, but it requires its new homeowners to repay a modest mortgage. Many other nonprofits have become more business-like by finding ways to generate fees for services rendered. In the most extreme case, nonprofits are actually converting to for-profit status. This practice is most prominent in health care, but it also happens elsewhere. For instance, America Works, a welfare-to-work training program, started as a nonprofit and later converted to for-profit status.

Interaction: Another kind of blurring occurs as nonprofits and for-profits increasingly interact with each other as competitors, contractors, and collaborators. Many of these interactions stem directly from public policy shifts away from grant making toward contracting and reimbursement. But private innovations, such as private health insurance, have also played a major role as nonprofits are finding new corporate markets for their goods, services, and assets.

Competitors: For-profits are playing a greater role in arenas formerly dominated by nonprofit and public sector organizations, while nonprofits are entering the domains of business. In the former category, health care provision provides the most obvious example, though even there, the average observer may underestimate the extent of the activity. For example, how many know that the largest single provider of hospice care in the U.S. is VITAS, a for-profit that started as a nonprofit. But the emergence of for-profit players extends beyond the health care arena to a wide range of social services including education, day care centers, rehabilitation services, affordable housing, and even welfare-to-work. Anywhere a savvy business entrepreneur can find a way to make a profit in a market dominated by nonprofit or public agencies we can expect to see for-profits enter and compete directly with nonprofit providers.

In return, nonprofits are competing head-to-head with businesses. Much of this activity is not new. Sheltered workshops have long provided services and produced goods in competition with business suppliers. This concept is being extended as many social services organizations are starting businesses to provide employment and training opportunities for their clientele. These nonprofit-run businesses range from manufacturing to bakeries, restaurants, grounds maintenance, and translation services. Larger nonprofits are moving more aggressively into ventures that compete directly with businesses. The American Association of Retired People offers an alternative to for-profit insurance companies. Harvard Business School Press broke with the image of an academic publisher to aggressively compete with for-profit publishers of business books. The National Geographic has moved beyond the production of branded tour books and maps to having its own cable television channel, competing directly with the Discovery Channel as well as with one of its longtime distributors and collaborators, the nonprofit Public Broadcasting System. Museum catalogues and web sites compete directly with businesses selling similar items.

Contractors: Furthermore, given that nonprofits are engaging in more "business-like" activities, it is not surprising that for-profits are contracting with nonprofits for both "nonprofit-like" goods and services as well as goods and services that were traditionally provided by other businesses. Universities are contracting with corporations to conduct research. Family Services of America sells "employee assistance programs" to companies like Xerox to provide social services for Xerox employees. For-profit players who have become social services providers are also contracting with nonprofits to access their expertise and community relationships. For example, after winning one welfare-to-work government contract, Lockheed Martin hired nearly 30 nonprofit agencies to supply various services. In other arenas, Bay Area business parks, commercial developments, and public facilities contract with Rubicon Landscape Services, an operation run by a nonprofit agency providing employment, job training, and other social services for the economically disadvantaged. Similarly, nonprofits are outsourcing the provision of specialized or capital-intensive services to for-profit providers. Nonprofit charter schools contract with for-profit education management companies to run the whole school or just provide administrative services. Universities contract with technology companies to transfer curriculum to media suitable for distance learning.

Collaborators: Nonprofits and for-profits are also entering into strategic partnerships and joint ventures that aim to be mutually beneficial to both parties. The Nature Conservancy partners with Georgia Pacific to manage forestlands in environmentally sensitive ways. City Year, a youth-service nonprofit, helps teach Timberland employees about team building and diversity and provides an outlet for employee community service, while Timberland offers City Year business expertise, funding, and uniforms. Together they developed a new Timberland product line called City Year Gear. Share Our Strength, an anti-hunger organization, entered into an agreement with American Express to market and raise money for both organizations via a cause-related marketing campaign called the "Charge Against Hunger."

Intermingling: A step beyond the interaction of independent nonprofit and for-profit organizations is the intermingling of organizational structures that occurs in "hybrid organizations." Hybrid organizations, as we are using the term, are formal organizations, networks or umbrella groups that have both for-profit and nonprofit components. For-profit organizations may create nonprofit affiliates, and nonprofits sometimes establish for-profit subsidiaries or affiliates. Nonprofit affiliates of for-profits usually serve purposes and conduct activities that do not fit neatly into a for-profit structure. For instance, two prominent community development financial institutions, Grameen Bank in Bangladesh and Shorebank Corporation in Chicago, were set up as for-profit organizations but over time created nonprofit affiliates and for-profit subsidiaries to attract and deploy resources most efficiently. Nonprofit organizations such as the Girl Scouts and United Way long ago established for-profit subsidiaries to generate revenues for their programs by selling equipment and merchandise to local organizations and licensing the organization name and logos to vendors. Additionally, recently some nonprofits have been looking for for-profit business opportunities explicitly to help generate income for the nonprofit. For example, for this reason Children's Home & Aid Society of Illinois (CHASI) launched Ask4 Staffing, Inc., an affiliated for-profit corporation that provides staffing solutions to social service organizations.

Industry Creation: Finally, as these various forms of sector-bending have evolved, a few relatively new sector-blurring fields of practice have emerged or at least have taken on a distinctive identity. The emerging industries of community development finance, welfare-to-work training, eco-tourism, charter schools, and alternative energy production are all populated by for-profit, nonprofit, and hybrid organizations looking to harness market forces for social good. The charter school movement provides an interesting example. Charter schools are independent public schools that are often run and managed by parent/teacher partnerships, community based nonprofits, universities, for-profit companies, or hybrid forms of organization. Some charter schools are new schools while others have been converted from traditional public schools. In return for demonstrated results, these schools are granted the autonomy and flexibility to operate outside of the traditional rules and regulations of the public school system. This independence will ideally spur innovation while enhancing accountability and providing choice and competition that will lead to reform and educational improvements in the K-12 system in the United States.

Potential Benefits of Sector-Bending

Many have raised concerns about the increasing popularity of boundary blurring activities, though few have explained the potential benefits. This situation is not surprising given the relatively early stage of many of these experiments, the challenges of performance measurement, and the complexity of the issues. Only time will tell whether and to what extent these benefits will be realized, but the potential benefits of new social innovations and experiments are great and should not be neglected.

More Effective and Appropriate Resource Allocation: Both the emergence of for-profits delivering social goods and services and the increase of nonprofits generating earned income can lead to better resource allocation and more effective use of scarce philanthropic funds. At the sector level, the presence of for-profits can allow for a greater division of labor. If for-profits can generate even a minimal profit by serving clients who are willing and able to pay (directly or through a third party), then donor-supported nonprofits can concentrate on serving those who need philanthropic subsidies to cover the costs of serving them. In essence, for-profits would be freeing charitable dollars to be concentrated on those who need them most. This overall market structure functions more efficiently and encourages innovation amongst both for-profits and nonprofits. For-profits have the profit incentive to provide better services to those who can pay. If their quality declines too dramatically due to cost-cutting measures, the nonprofit offers an alternative. For nonprofits, the threat of losing profitable customers to for-profits should also enhance their performance and innovation.

Moreover, in health and human services industries, research has shown that nonprofits appear to be slower than for-profits both to grow to meet demand and to contract in response to changes in the environment and declines in demand. Thus, perhaps we need two layers of providers in these industries—for-profits to ensure responsiveness to market changes and nonprofits to preserve access for all, with limited wasted resources overall. Admittedly, for certain capital-intensive industries, there may not be room in some markets for more than one provider, whether for-profit or nonprofit. Hospitals in smaller communities provide a good example. In these cases, it may make sense for the leaders to consider hybrid structures, such as a for-profit hospital with an affiliated nonprofit clinic, to attract the necessary resources and meet the full spectrum of community needs.

At the organizational level, for nonprofits earning more commercial revenues, the revenues can serve as a source of leverage for philanthropic donations. Not only should donors not want to subsidize customers who can pay (either directly or through an interested third party), but they also should be attracted to the possibility of their dollars having greater social impact when combined with the revenues from earned income activities. Ideally, a greater pool of funds will be available to provide social goods and services for which nobody is able or willing to pay, either because these are true public goods or the clients are economically disadvantaged. And if a nonprofit organization can support all or the vast majority of its social mission activities via earned income, donors should shift their charitable dollars to other causes that are more in need of philanthropic subsidy. Again, a more efficient allocation of resources results in maximum social value creation overall.

Furthermore, the use of appropriate business tools has the potential to improve the effectiveness of nonprofit organizations. The discipline of identifying customers, defining how you will create value for them, developing strategies that reflect the organization's competencies and the competitive environment in which it operates, and pushing for more careful tracking of impact can have a very healthy impact on organizational performance even in philanthropic organizations. Of course these tools can be misused, as can any tools. Nonetheless, the potential for improving organizational effectiveness by importing and adapting tools from the business world is great.

More Sustainable Solutions: The blurring of sector boundaries has been accompanied by an increased interest in finding systemic and sustainable solutions to social problems. It is difficult to say which trend is driving the other, but they are certainly intertwined and complementary. Where appropriate, social entrepreneurs are looking to address underlying problems rather than meet needs, empower individuals rather than provide charitable relief, and create sustainable improvements rather than short-term responses. Business methods and approaches provide valuable tools for achieving these goals. Habitat for Humanity requires its new homeowners to pay mortgages. Grameen Bank provides small business loans, instead of grants, to economically disadvantaged villagers in Bangladesh. Pioneer Human Services employs ex-convicts and recovering drug addicts in various enterprises. Each of these approaches requires the individuals receiving help to take an active role in improving their own lives. They need not feel like objects of charity.

Even providing social services through employers enhances the potential for positive, lasting social impact. While the workers do not pay directly for services, they feel a sense of entitlement when these services are included in their benefits package. Covered workers are likely to be more comfortable seeking help for their troubled teen, failing marriage, or alcohol abuse problem than they would if they had to find an appropriate agency on their own and either pay for the care out of pocket or request charitable assistance. The spread of employer-sponsored social service programs represents a systemic approach to addressing a variety of underlying problems. All of these "business-like" strategies empower the individuals and increase the chances of lasting social impact, giving them an advantage over charitable efforts that offer temporary assistance to those willing to accept charity.

When it is possible, aligning social and economic value creation through business approaches provides the most sustainable kind of solution. This principle is not limited to human services. Many environmentally concerned for-profit and nonprofit organizations have recognized the value of this alignment. For instance, The Nature Conservancy has shifted from just buying and preserving lands to finding ways to generate both economic and social value through sustainable harvesting techniques and environmentally conscious development. Some of this work is done in partnership with corporations that are working to find sustainable ways to harvest timber. While these types of initiatives are challenging to implement and require a real sensitivity to the tensions between economic and social goals, they provide valuable opportunities for experimentation and learning. A small number of successes could easily make up for a number of failed ventures.

Increased Accountability: Shifting from a charitable to a customer relationship improves accountability and can bring increased market discipline to the social sector. Paying customers are more likely than non-paying clients to hold organizations accountable by providing direct feedback, expressing their complaints publicly, or taking their business elsewhere. Even third-party payers can provide greater market discipline than most donors. They have greater legal standing to complain and often also have greater incentives to hold providers accountable and better information on performance. They tend to have a more direct obligation to and relationship with the service recipients, and the recipients themselves have a sense of entitlement since the service was paid, not charitable. Thus, employers can act based on input from their employees on the value and quality of the social goods and services delivered; public agencies can expect the same from their constituents.

This improved (though still imperfect) market discipline clearly holds true for for-profits and for nonprofits charging fees for the delivery of social goods and services. For other nonprofit activities, market discipline is only beneficial if the earned income strategies are aligned with effectively serving the organization's mission. For example, the success or failure of a hospital gift shop, a Save the Children brand tie, or a co-branded Starbucks coffee sampler from countries in which CARE operates reveals nothing about the nonprofit organizations' ability to achieve their social missions. These ventures are all subject to market forces, but the market is responding to products and services that are distinct from the organizations' mission-based activities. While these ventures may contribute value to the organizations in other ways, the market feedback will not help them assess or improve their creation of social value.

In other cases, the benefits of market discipline can extend into more commercial activities such as nonprofits' operating businesses to employ their clientele. The success or failure of these businesses, and the feedback from customers, can provide valuable information regarding the effectiveness, strengths and weaknesses of their job training and employment programs, much more so than merely asking the trainees if they were satisfied with the training. Thus, for mission-related activities, the value of market feedback can help overcome some of the performance measurement and accountability concerns in the nonprofit sector.

Greater Financial Strength and Capacity: Boundary-blurring activities have the potential to help build a social sector with greater financial strength and capacity than currently exists. For-profits entering the social sector increase the sector's access to capital, allow for faster growth and increased flexibility, and increase the capacity of the sector overall. For nonprofits, if earned income and other business methods can provide more diverse and sustainable revenue streams, then the financial strength of the organization will be improved. Granted, earned income streams are not necessarily more sustainable than donations or grants, and diversification can lead to fragmentation and loss of focus. But developing an appropriate earned income strategy can free up and even create new capacity, in the form of both financial and human resources, to be dedicated to direct delivery on the mission.

Overall, healthy competition among organizational forms has the potential to improve the effectiveness of the social sector. The diversity of options gives clients, paying customers, and funders a choice. Keeping in mind the genuine risks outlined below, we should let these experiments flourish and have the participants decide what works best for them. Some of the experiments will fail, and others may even prove detrimental in the short term. We should work to reduce the chances of irreparable harm, but acknowledge that progress has its costs. We must allow enough time for learning and for making adjustments.

Risks and Concerns

Though we are attracted to the potential benefits from sector-bending activities, we are not endorsing all activities or encouraging every organization to pursue sector-bending approaches. Bridging sectors is challenging and necessarily creates some tensions within organizations and the sectors. Increased commercial activity is not appropriate or feasible for every nonprofit, nor is a shift to providing social goods and services suitable or desirable for every for-profit. Not every individual or organization, no matter how successful and competent in certain arenas, will be adept at merging social goals with business activities or at operating in different political and cultural environments. In addition to the practical challenges, sector-bending activities pose some inherent risks. Without addressing the specific risks associated with each type of activity described earlier, we have identified three broad categories of significant, cross-cutting concerns: threats to direct social performance, potential loss of indirect social benefits, and further bifurcation of society into haves and have-nots. As we move forward with this boundary blurring experimentation, these areas must be vigilantly monitored and managed.

Threats to Direct Social Performance: Perhaps the greatest concern about the blurring of sector boundaries is that, despite the potential benefits mentioned above, these activities will actually result in a decline in social value created. Three specific concerns pose potential threats to direct social performance: business approaches may cause mission drift; profit emphasis may lead to lower quality services overall; and blurring of sectors may provoke a decline in advocacy by nonprofits.

<u>Mission Drift:</u> Business structures and methods could pull social-purpose organizations away from their original social missions. Social service organizations that intended to serve the very poor may find that it is easier to generate fees or contracts by serving clients who are less disadvantaged than to raise funds to subsidize their charity work. Similarly, a homeless shelter that starts a business to train and employ shelter residents may find that it is too difficult and costly to make this option available to the homeless who are hardest to employ. An environmental group that wants to produce products using nuts from a rain forest cooperative may discover that the cooperative cannot deliver enough high-quality nuts to meet demand and switch to other suppliers. A university attracted by lucrative funds from licensing practical developments emerging from its labs may shift resources away from the humanities and basic sciences toward applied sciences. Though, in theory, generating this kind of fee income should help an organization serve its intended audience through cross-subsidy or just by covering overhead expenses, the relative ease of bringing in commercial fees or the market pressures exerted on earned income activities may slowly draw an organization away from its mission. On a practical level, it may be easier to grow and fund an organization by giving up on its original mission and target audience. Strong leaders, engaged funders, active boards, and clear mission statements should help keep organizations focused, but these mechanisms are not perfect and mission drift could well occur despite them. The situation is made worse by the lack of clear performance measures in this sector as it is difficult for customers, payers, donors, and sometimes even board members and managers to recognize when certain activities are actually causing a decline in social impact.

<u>Lower Quality Services:</u> Moreover, many people worry that the presence of a profit motive or a strong emphasis on efficiency will lead service providers to cut corners, lowering both costs and quality. Various studies have looked at this issue in sectors where nonprofit and for-profit players compete directly. The results are inconclusive, as some studies have found differences in quality while others have not. However, even if research overwhelmingly found lower quality of care on average in for-profit versus nonprofit providers of health care and social services, one could not fairly conclude that having for-profit players is a bad thing unless the industry has excess capacity or the service quality has fallen below some morally acceptable minimum. For instance, we are familiar with a small nonprofit hospice for people with AIDS that offers very high quality care and is reluctant to expand for fear that the quality will decline. Yet many people in that community are on waiting lists for AIDS-related hospice care. Is it better to maintain very high quality and stay small, or would it be more socially desirable to lower quality but expand capacity to serve more of the people in need? If a for-profit enters the market and offers to pro-

vide a lower quality of care but serves the unmet need, is that a bad thing? It is bad *only if* the quality is so low that the customers would have been better off receiving no care at all. When quality is costly, as it is in many social services, providers may have to make a trade-off between the quality of care provided and the number of people served. While a profit incentive may pull a for-profit provider towards quantity rather than quality, if demand is greater than current supply, this bias may actually be socially desirable and superior to offering high quality care to a small number of people while others get no care at all.

Charter schools represent a case where quality is more crucial. These schools are replacing existing capacity rather than serving an unmet need. Thus, the question is whether these schools improve on the public schools they replace. We must monitor this situation with careful oversight and standards. Even so, we need realistic benchmarks. These experiments should be judged a failure only if they are not successful at delivering a better education than the existing alternatives. Since for-profit charter school operators want to maintain their contracts and even expand their markets, they have every incentive to perform at a high level and should be expected to do so. The challenge, again, is in finding the right measures, but parents and school boards face this same challenge in assessing public schools. Quality measurement problems should not automatically wed us to the *status quo* or rule out experimentation.

<u>Decline in Advocacy by Nonprofits:</u> Finally, advocacy is one of the crucial functions that nonprofit organizations can play. It is natural to worry that if nonprofits are contracting and collaborating with for-profits, it may compromise their roles as advocates and critics. Yet nonprofits have been striking this balance for quite some time when receiving corporate donations, gifts from wealthy individuals with their own business interests, or even grants and contracts from government agencies. Very few nonprofits are supported totally by grassroots fundraising. It is a matter of selecting the right partners and being clear on the terms of engagement. It is possible that nonprofits that have traditionally engaged in both service delivery and advocacy may have fewer resources to dedicate to advocacy if they are trying to compete with for-profit service providers or develop other streams of earned income. However, if successful, earned income activities should actually generate or free up other resources for advocacy activities. And even if there is some decline on these fronts, nonprofits dedicated solely to advocacy will not face these concerns and may even gain from a greater perceived need for their presence.

Corporate collaborations such as McDonald's and Environmental Defense Fund working together to address waste management issues have raised concerns that nonprofits are jeopardizing their legitimacy as watchdogs and social advocates by becoming too cozy with the business sector. But we cannot have it both ways. We cannot urge businesses to be environmentally conscious and socially responsible and then deprive them of access to the best resources for addressing our concerns. Groups particularly concerned about their independence need to limit their financial dependency on the corporations they should be watching and tailor their sector-bending activities to avoid conflicts of interest. Some nonprofits will, and should, always exist as advocates primarily working outside of and against the system. But as long as it is done carefully, having some advocates also work across sectors with for-profits and government agencies should enhance the success and overall social impact of their efforts.

The risk of reduced social impact is real, but it is unclear how serious it is. Little empirical data is available to help us assess the potential magnitude of this problem. Do new commercial revenues help an organization achieve its social objectives or do they pull the organization away from its mission, provide incentives for objectionably low levels of quality, and undercut its role as an independent advocate? We do not know for sure. However, we do know that these risks are not unique to boundary-blurring activities. Mission drift is a real issue for philanthropic organizations as they work to attract and satisfy different donors with agendas that may not perfectly match their original mission. We also know that donor-supported nonprofit organizations can be slow to respond, inefficient, and wasteful. Is the risk worse with sector-bending activities? The answer is unclear. Finally, we also know that many nonprofits do not serve the most needy or address the toughest social problems. It is an open question whether boundary-blurring activities will pull those who do away from these difficult populations and issues. But while these concerns are legitimate and need to be monitored and managed, in some instances, sector-bending activities' risks to direct social impact have been exaggerated. In others, it is just too early to tell.

Undermining Indirect Social Benefits: In addition to directly serving social objectives, many nonprofit organizations facilitate the creation of social capital in communities, and the nonprofit sector provides an outlet for expressing charitable impulses. It is conceivable that sector-bending activities on the part of nonprofits endanger both of these roles.

Nonprofits as Creators of Social Capital: Community-based nonprofits, particularly those with high levels of volunteer involvement, can serve as vehicles for building social capital—trusting connections between community members who might otherwise not have any contact with one another. Some observers are worried that sector-blurring activities in nonprofits will change the character of the interactions they spawn in a way that undermines social capital creation. Goodwill and mutual concern will be replaced by more arms-length business relationships. On a more practical level, as business skills become more valued, the level of volunteer engagement may decline, as might the diversity of the volunteers and board members.

While social capital should not be undervalued, one must consider how organizations create social capital and the types of organizations that create significant amounts before expressing major concerns about the effects of sector-bending activities on this front. Organizations can create social capital by offering a venue for members of the community to get acquainted through some common interests or activities. Only a small proportion of nonprofit organizations do this now. Many of them are professional organizations with limited volunteer activities. These professionally staffed nonprofits may not play this role any better than, or even as well as, a local grocery store, diner, neighborhood bar, or professional sports team. Nonprofits that do create a great deal of social capital include membership organizations, clubs, churches, amateur sports leagues, and service organizations with large numbers of volunteers. For many of these organizations, sector-bending is not a serious risk and is unlikely to drive out their social capital building activities. Will the local Rotary Club, Junior League, or little league become too business-like and drive out voluntary participation by their members? It seems unlikely. They may try to generate revenues through quasi-commercial events, such as candy sales or auctions, but these events are unlikely to undermine their capacity to build social capital.

Nonetheless, for the few organizations in a community that create social capital broadly, it is possible that moving away from a charitable economic model to one based more on business principles could result in a change in the organizational model that reduces the opportunities for volunteers and others to interact. However, such a consequence is certainly not inevitable. A church that uses business methods to start a day care center to serve its members may create new social capital by inviting members to volunteer at the center or bring their business knowledge to a diverse board that includes some of the parents served. A for-profit charter school can still have an active PTA that facilitates interactions between parents and teachers. Habitat's mortgage requirement does not reduce the social capital created by a house-building project. The sale of Girl Scouts cookies, if handled well, can foster positive relationships amongst the girls, their parents, and their neighbors (and sometimes even between parents and co-workers!).

Furthermore, the intelligent adoption of business practices could make many nonprofit organizations even more effective in creating social capital. For instance, marketing techniques may allow the organization to reach new audiences, increasing the diversity of participants and improving it social capital creation. Professionalization, the increasing emphasis on placing credentialed professionals in key service positions, is probably a greater threat to social capital creation than is commercialization. It would be a mistake to conflate the two, especially given that many social sector professionals, such as teachers, social workers, doctors, nurses, and environmental scientists, have been vocal opponents of bringing businesses or business methods into their domains.

Charitable Character of the Nonprofit Sector: The nonprofit sector provides a variety of ways in which people can express their charitable impulses. If it became sufficiently widespread, sector-bending could reduce the opportunities to give back by leading organizations away from relying on donations and volunteers. However, we need to be careful. The nonprofit sector has long been dependent on fee-based income for much of its revenue. Of course, the prevalence of fees varies widely from one sub-sector to another. However, if charging fees is corrupting to the charitable character of the sector, we have already crossed that bridge. Imagine colleges being prevented from charging tuition or performing arts groups being prohibited from charging for tickets. Could they raise enough in donations to provide the quality of services that they now provide? It seems unlikely. In any case, many nonprofit organizations, such as major universities, have found ways to blur sector boundaries and still provide opportunities for alumni to get involved and to give back.

Admittedly, some studies have suggested that increases in earned income tend to slow the growth rate in donations and, in extreme cases, may lead to a decline in donations. While intriguing, this finding should not be worrisome. This correlation is open to a number of explanations. It could reflect a conscious decision by the organization to pursue a strategy of being less dependent on contributions. The shift to earned income could also be designed to compensate for the anticipated loss of a major grant that was due to expire. The leaders of the organization may have had less time to dedicate to fundraising as they were launching an earned income strategy. Or they may simply have failed to market their new earned income plans effectively to their donors. In any case, at the sector level, increased earned income by some organizations should result in more efficient use of donations overall. If one organization successfully shifts to a heavy emphasis on earned income, its donors can shift their funds to other organizations that require a greater philanthropic subsidy.

Neither the rise of earned income nor the entrance of for-profits into the social sector has reduced the number of nonprofits looking for donations or volunteers. Vast opportunities still exist for donors and volunteers to experience the psychological benefits of supporting their favorite causes. Moreover, the rise of "venture philanthropy" and other forms of engaged philanthropy that explicitly draw on individuals' business skills and expertise appears to be attracting a new breed of donors to the sector who are interested in contributing significant time and money to generating social impact. These donors do not seem to be discouraged by earned income strategies. Indeed, many of them welcome them.

It would also be a mistake to assume that charity is somehow morally or socially preferable to commerce. Being the recipient of someone's charity can be demeaning, making recipients feel helpless and powerless. Many individuals are too proud to seek or accept charitable assistance except as a last resort. By comparison, as we described when discussing the potential benefits of sector-bending, treating clients as customers can be empowering, giving them standing to complain and a sense of ownership and accomplishment. Protecting the charitable purity of the sector is not necessarily a good thing.

The blurring of sector boundaries does not have to undermine the indirect social benefits associated with the nonprofit sector. In fact, in some cases, these types of activities may actually enhance them. Yet given the concerns that have been expressed regarding the decline of social capital in US communities, social sector leaders should pay close attention to the indirect social impacts of boundary blurring activities and consider these effects as they pursue the direct creation of social value.

Bifurcation into Haves and Have-Nots: With respect to sector-bending activities, one of the powerful benefits mentioned above was the potential unbundling of activities to allow philanthropic resources to be devoted to activities and individuals that are in the greatest need of charitable support. However, this benefit has a potential dark side. It could result in two classes of service in the social sector: one for those who can pay or are eligible for third-party payment and the other for those who need charitable assistance. This market differentiation could reinforce class differences in society at large. Again, this bifurcation is not a necessary consequence of sector-bending activities, but it is a possible consequence. Creative social sector leaders can take steps to avoid this consequence using some of the very business structures and methods that might have contributed to it. Better marketing to those who are willing and able to pay can increase the amount of money available to cross-subsidize those who cannot afford to pay. Clients can be offered the same services with a sliding price scale or with "scholarship" opportunities. Thus, sophisticated sector-bending organizations may be able to use business methods to improve their ability to serve all of their clients seamlessly, without any publicly apparent difference between those who can and cannot pay. However, doing so will require a diligent effort. Social entrepreneurs, funders, and public policymakers must be careful to consider and monitor all of the effects of these activities to assure that sector blurring does not lead to greater class divisions.

Given that many of the effects of sector-bending activities are uncertain, the impact of business practices on the decisions and activities of nonprofits should continue to be monitored closely in hopes of developing better mechanisms for measuring social performance and assessing the impact of various innovations. In fact, business methods may actually be able to help address some of the challenges of managing and measuring these risks. As we have already described, marketing techniques can help nonprofits attract resources and penetrate target markets more effectively; accounting tools may be adapted to measure performance; developing customer, as opposed to charitable, relationships should enhance customer market discipline and accountability. We are not proposing that business methods are the ultimate solution for addressing some of the shortcomings already inherent in the nonprofit structure, and we recognize that the adoption of business techniques will cause additional complications and implementation issues. But we are not convinced that sector-bending activities significantly increase the risks of poor performance, declining societal benefits, or further class division. We embrace transparency and evaluation as tools to help us assess these experiments, but we do not see a case for inhibiting activities that further blur the lines between nonprofit and for-profit.

Pitfalls to Avoid in Making Assessments

Though the risks are real, they seem manageable if we are realistic in our assessment of them. In evaluating the potential social impact and assessing the risks of sector-bending activities, we encourage researchers, public policy makers, and sector leaders to be careful to avoid three very natural pitfalls.

Focusing on Individual Organizations Rather than the Sector or Society: What happens within individual firms is certainly relevant to assessing the impact and risks of sector-bending activities. Understandably, much of the research takes this organization-level focus. However, for policy purposes, the emphasis should be on the overall performance of the sector and the overall impact on society, not just on performance by individual organizations. As we pointed out above, the fact that donations decline in a nonprofit organization that increases its earned income does not imply that donations decline overall in the sector. The donations may just flow to a more appropriate use, an area of greater need. This outcome represents a positive result.

Moreover, if for-profits or more commercial nonprofits are shown to offer lower quality services than more philanthropic nonprofits, this finding does not imply that users of the services are hurt by the presence of these lower quality providers. Lower quality services may serve excess demand that cannot be served by the limited capacity of high-quality providers. They may even represent a more cost-effective way of serving an unmet need. Not every car needs to be a Rolls Royce, and not every drug rehabilitation center needs to be comparable to the Betty Ford Center.

Finally, a study may show that a hospital provides less charitable care or does less research or provides less education after it converts from nonprofit to for-profit status. This conclusion neglects the fact that at the time of conversion, a fair price must be paid for the net assets of the nonprofit hospital and the proceeds must stay in the nonprofit sector. Usually a new health-related foundation is created. The social impacts of the old nonprofit hospital should be compared to the performance of the new for-profit hospital in combination with the new foundation that has been created. The issue is whether the conversion served society well, not whether the new for-profit hospital alone serves society as well as its nonprofit predecessor.

Assuming What is Must Be: Another danger is to assume that the kinds of average differences that are documented in descriptive studies must be the case. Consider again the decline in donations that may accompany an increase in fee-based revenue. If the organization could still put donations to good use, this decline may just reflect poor marketing to donors. Better marketing might correct the situation. This kind of effect may also reflect the tendency of major donors, such as leading foundations, to move on after a certain period of time. That practice could be changed, not by the nonprofit, but by the foundations. Similar reasoning applies to the issue of quality differences. Even if we found that on average nonprofit hospices provide better care than for-profits, we should not assume that this must be true in all cases. In many samples, even with statistically significant differences, the comparison groups will overlap. Some for-profits are likely to out perform some nonprofits, despite the statistical differences. If we believe it is socially desirable to improve the performance of for-profit hospices, we might look at the high performing for-profits to see if there are practices that can be profitably transferred to those that are not performing as well. Indeed, we could do the same across high performing and low performing nonprofits. We cannot neglect the different incentives and operating environments associated with different organizational structures, but we should use research findings productively to help improve overall performance. Structure does matter, as we will acknowledge below, but it alone may not determine behavior and impact.

Comparing New Forms Against a Fictional Ideal: Finally, it is natural to compare some of the new sector-bending structures to some kind of ideal organization built on principles of charity and funded exclusively through philanthropy. As we already mentioned, the nonprofit sector was never purely charitable. Many of the sector-bending changes are simply extensions of past behaviors into new arenas. It has been argued that people can trust nonprofits more because of the "non-distribution constraint" - nonprofits cannot pay profits out to those in a controlling position. However, this constraint is a crude and often ineffective instrument. It may inhibit certain forms of self-enrichment, but it is no guarantee against corruption and it does not ensure effective performance. We have enough examples of corrupt behavior in the sector to recognize that corruption is not unique to the for-profit sector (or government). The non-distribution constraint eliminates an incentive to maximize profits, but it does not replace that incentive with anything in particular. Power, politics, and money play important and potentially corrupting roles in any sector. People are people, and no one sector is morally superior. The attitude of moral superiority sometimes apparent in the nonprofit sector just serves as a barrier to creative problem solving.

Because of the non-distribution constraint, complacency, inefficiency, and waste can be serious problems in nonprofit organizations. At least for-profit organizations depend on the voluntary choices of customers to pay for their product to help assure they are creating value in an efficient way. In the more "pure" philanthropic nonprofits, donors are the primary payers, and they are rarely in a strong position to evaluate the efficiency and effectiveness of the organization. Few of them invest any serious effort in an assessment process. A nonprofit can survive, even thrive, and yet be very inefficient and ineffective in creating social value and serving its mission. In the absence of reliable impact measures, a common condition, who would know? In comparing sector-bending activities with more "traditional" nonprofits, we need to use an honest benchmark, not some ideal.

Implications: Organizational Structure Still Matters

If nonprofits and for-profits are engaging in increasingly similar activities and practices, are we moving into a world in which organizational structure doesn't matter? Not at all. Nonprofit and for-profit organizations will continue to co-exist and have distinct characteristics. Every social sector actor should be aware of these differences, and the associated strengths and weaknesses, in order to choose the best structure or combination of structures given a particular mission and operating environment. Different structures are tools with different qualities. Following are a few of the central distinctions:

Potential Profitability: For-profits are limited to engaging in activities that will yield sufficient profits for their investors. Even social-purpose businesses that raise funds from socially oriented investors must have an economic model that can generate at least modest profits to be sustainable. Nonprofits are not only freed from this constraint but are actually prohibited from distributing any profits. Surpluses can be created by nonprofits, but they must be used to further the mission of the organization.

Access to Resources: For-profits can use equity ownership to raise capital and reward performance, are generally better able to access debt markets, and if successful, can be "self-sustaining." Nonprofits can solicit donations and attract volunteers, but they have fewer options for incentive pay, no access to equity, and limited access to debt.

Market Discipline: Both for-profits and nonprofits are subject to market forces, but capital and consumer market discipline is much stricter and more effective in the for-profit sector. Nonprofits cannot create wealth for investors, and their missions often cannot be served by simply creating consumptive value for customers. Donors are rarely in a position to assess value creation or efficiency. Moreover, social performance is hard to measure in timely and reliable ways and is also subject to differences in individual values, further blunting the effects of market discipline for both for-profit and nonprofit operators who truly have a social mission.

Governance and Control: Boards of directors govern both for-profits and nonprofits, but investors own for-profits and, at least in theory, control the boards. Given the absence of investor-owners, the lack of strict market discipline, and the difficulty of performance measurement, the accountability of a nonprofit rests heavily on their boards and managers. For-profits are directly accountable to their investors. They can curb profit maximization and pursue social objectives if they maintain control by seeking out socially oriented investors and keeping their business closely held. Many businesses operate in this manner, although this approach greatly restricts the pool of available capital, offsetting some of the benefits of being a for-profit.

Culture and Norms: While not mandated by the particular organizational form, there are certain norms associated with each sector. Many nonprofit employees, and even some donors and volunteers, are uncomfortable with the language and practices of business and may be skeptical of the values and motives of people trying to introduce business concepts. Nonprofits also often rely heavily on "psychic income" to compensate for traditionally lower salaries. The sector overall also seems to have a bias towards smaller organizations, local autonomy, and consensus-driven decision-making.

Taxes. Under current tax laws, for-profits are generally subject to both income and property taxes on both the state and federal levels. Nonprofits are broadly exempt from these taxes as long as the property is used primarily for the nonprofit's social purposes and the income is generated from activities related to their primary mission. Nonprofits are subject to Unrelated Business Income Tax (UBIT) for ongoing activities that are not substantially related to their social purpose, though it is often difficult to differentiate taxable and nontaxable activities, and even then, there are significant opportunities for cost and revenue-shifting to minimize taxation.

We mention taxes here because current tax policy creates distinctions between nonprofit and for-profit structures that cannot be ignored. However, the complex interactions between tax policy and sector-bending activities are beyond the scope of this paper. That said, we are compelled to address briefly the common complaint that tax exemptions and ease of avoiding UBIT give nonprofits engaging in business activities an unfair competitive advantage. These concerns are exaggerated. Most nonprofits have inherent disadvantages with regard to social mission costs, size inefficiencies, difficulty attracting people with valuable business skills, and limited access to capital. We suspect these inefficiencies more than make up for the difference in tax status. If for-profits find that nonprofits have a clear competitive advantage, then perhaps the for-profit competitor has chosen the wrong organizational form. Indeed, if nonprofit status provides such an advantage, why haven't we seen more for-profits converting to nonprofit status to gain this advantage? Conversions, in fact, usually run in the other direction.

Thus nonprofits should not be prevented from engaging in potentially socially beneficial business-like activities merely because we have not determined how to monitor and tax them effectively. In any case, the limited profitability of many nonprofit business activities is unlikely to generate significant taxes. Moreover, any tax losses from nonprofit business activities could be made up by for-profits entering the social sector. They are bringing social sector activities into a taxable structure. All things considered, sector-bending could well increase overall tax receipts.

Given the above distinctions and the abundance of social issues and problems that need to be addressed, it is reasonable to assume that different organizational structures will continue to both be necessary and evolve as time progresses.

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