

“Retained Earnings Maximizing Nonprofit Enterprises”

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Purpose: The purpose of this paper is to present a new business model called the Retained Earnings Maximizing Nonprofit Enterprise. Specifically, the paper details the nature of the REM enterprise's motivation, organizational control, market interaction with other firms, and obstacles to the growth for the REM. Additionally, the paper outlines a research agenda for experimental and empirical inquiries into nonprofit organizations and the REM enterprise.

Methodology: This paper utilizes standard industrial organization theory in a non-mathematical approach to explaining the nature of the REM enterprise.

Findings: The paper seeks to establish the business model of the REM. By inquiring into the nature of the REM enterprise the paper provides the basis for future research.

Research Limitations: The research was limited in terms of potential case studies because this is a new business model that is being proposed.

Practical Implications: The paper could have large practical implications for increased and more consistent revenues to philanthropic organizations. Since writing the paper we have tried to implement our own REM business model in an on campus coffee shop. Other ventures are being established in a similar vein.

Value of the Paper: If able to spur innovative thought about the Independent Sector which as been underrepresented by economic research this could be very important. Specifically, the value of this paper was somewhat diminished by the L3C legal structure which was adopted by a handful of states. L3C may be more appealing to businesses seeking to make a social impact with profit as secondary importance.

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I. Introduction

The history of monastic beer brewing reaches back into the Middle Ages and because Benedictine “rules” required monks to produce all things they needed to live many monasteries have been financed by a smooth ale. Beer was a popular and profitable drink then and is equally popular today; but, many monastery beers are not widely distributed and are produced only to the extent that monks cover the costs of their essentials. One exception to this zero profit constraint however comes from the Abbey of Scourmont that still produces Chimay Ale. Like other Trappist Orders, the monks at the Abbey of Scourmont make a vow of celibacy, live life in community under an abbot, and renounce all claims on personal possessions. But, they still earn “profit” from the sale of their brew and other agricultural products. With that surplus of money however they supply a public good to the nearby city of Chimay, Belgium. According to their website, “The heart of their life is their work and they try hard by these means to secure aid for the poorest people” (Chimay, 2008).

This may seem somewhat dissonant with the way economists have been conditioned to think about nonprofit organizations because the beer is not actually the public good. Rather, the beer is a private good that competes in the private marketplace with other private goods, but whose earnings will be channeled in a different direction than perhaps the earnings of Budweiser. Early economic work on nonprofit organizations developed the notion of quantity maximization subject to a zero profit constraint because that work focused on nonprofit hospitals (Newhouse, 1970). In this case the output of nonprofit hospitals is the provision of a public good.

Moving along the continuum, others after Newhouse identified that nonprofits could be quite commercial in nature receiving the bulk of their funds from donations while also selling private goods (Hansman, 1980). Since then, the addition of commerce to enhance the mission components in nonprofits has increased. New independent sector scholarship has commented on the murky distinction between the commercial and mission based nonprofit models (Dees and Anderson, 2006). Moreover, Dennis R. Young investigates many of the characteristics and emerging blends of nonprofit organization and private enterprise that have typically been termed “social enterprises”

(Young, 2007). Many of those new emerging nonprofit organizations operate in the private marketplace and simultaneously provide a public good.

Again, these types of organizations have been termed social enterprises, a term which applies broadly to the many facets in which nonprofits operate in the marketplace. Such nonprofits include “New Horizons” an Atlanta, Georgia based lawn maintenance company that works for profit while also supplying jobs to people recently released from the prison system. New Horizon provides an environment for these men and women to develop a better reputation and thus open the door for more future job opportunities (ibid). Another example of this type of social enterprise is Café Reconcile in New Orleans, Louisiana. Café Reconcile provides jobs to at-risk youths and trains them in various hospitality jobs at the restaurant so they can better compete in the extensive hospitality job market in New Orleans (Jones, 2007). These are just a set of the new and emerging nonprofit business models.

Also under the social enterprise umbrella are nonprofits that are almost indistinguishable in any way from a for profit firm. Given the inherent instability of voluntary contributions many nonprofit organizations are headed towards the marketplace to establish steadier streams of revenue¹. In 2007 the *Wall Street Journal* published an article titled “Profits on the Side” that discusses the increasing phenomena of “social franchises”. Nonprofit organizations like Share Our Strength who combat world hunger have negotiated with chains such as WineStyles to purchase a franchise. The difference between any other WineStyles and the WineStyles owned by Share Our Strength is not noticeable and the business generates surplus for the benefit of the traditional nonprofit organization (DeBaise, [2007]).

Now we have reached the edge of the continuum of social enterprise which the Abbey of Scourmont and a fictional business we will call Rem-Mart occupy. The businesses started (Chimay Ale) and will start with their roots as nonprofit organizations. Also, they produce private goods, for private enjoyment, but the money retained from the sale of those goods is intended for another nonprofit and has an obvious public goods component. The non-distribution constraint of the nonprofit organization prohibits

¹ In fact, Community Wealth Ventures, Inc. was founded in 1997 “on the premise that every organization can increase its social impact by building its own internal assets, rather than relying on support from external organizations.” For more information see Austin and Pearson, 1998.

redistribution to residual claimants and to opportunistic payment of agents inside the nonprofit (Hansmann) but it says nothing of the way a nonprofit must operate in the marketplace. In fact, the importance of social and commercial combinations for the increase and benefit of mission activity has been discussed in the context of ancillary fee income (James and Young, 2006).

Many nonprofit organizations are seeing their roles expanding; but, their donations are shrinking or holding constant (Wasley, 2009). The nonprofit business type that is proposed here exists for their benefit and is called a “Retained Earnings Maximizing Nonprofit Enterprise” (REM)². The hope is to introduce the REM enterprise as a legitimate and emerging business model that can offer a profitable pipeline from the private sector to undercapitalized philanthropy with more mission-based objectives. The remainder of the article will be devoted to raising key questions regarding the nature and growth of the REM enterprise, especially with regard to some conjectures and/or questions that admit the need for empirical and experimental testing³.

II. Command and Control

The established economic wisdom of command and control in an organization viewed shareholders as disciplinarians for the actions of managers in a corporation. But, the possibility that shareholders would be uninterested in day-to-day operations called into question their effectiveness as agents of control in an organization (Berle and Means, 1932). While it may be costly for any individual to organize action against a misbehaving manager (Olson, 1974) there are some stories of pension funds such as TIAA CREF and other companies (most notably Disney) indicating that, if the interests of shareholders and the larger pension funds are aligned, effective action can take place (Deutsch, 2003)⁴. Nevertheless, in more decentralized setting where interest is high, individual shareholders (or people in a parallel role) may be effective agents of control.

² The REM has been discussed in the nonprofit literature on nonprofit organizations but has been broadly defined as a “social enterprise”. The name REM hopes to specify one particular business model among the social enterprise classification.

³ The L3C legal arrangement or low-profit limited liability company is also an up and coming model provides benefits of both a limited liability corporation and more options to raise capital. As of September 2009 these legal structures are only available in a handful of states. For a more extensive discussion of the L3C legal structure see Americans for Community Development (Americans for Community Development, 2009).

⁴ Shareholder interaction with the Disney Corporation is a well-documented example.

However, it is unlikely that interest alone will equip individuals with the knowledge to form their support or criticism of an organization. They must be provided with the information. Individual Americans collectively gave 222.89 billion dollars to philanthropic organizations in 2006. Like publicly traded companies, nonprofit organizations are growing towards understanding the importance of information provision to their donors, especially as the stakes have increased (Beatty, 2007).

In order to provide that information organizational transparency has been made a center-piece topic in the discussion for nonprofits. Since the emergence of nonprofit “watch dogs” like Charity Navigators and Wall Watchers the cost of withholding information for nonprofits has increased⁵. In 2007 *Business Week* said that Charity Navigators was “revolutionizing the process of giving” by providing efficiency ratings on their fellow nonprofit organizations (Charity Navigators Overview, 2008). Those ratings are based in part on each charity’s IRS Form 990 and several financial and performance ratios. But, even though the ratings are useful they are not without debate because there is the possibility for widely different objective functions among nonprofits.

We may assume here that the average customer at an REM would not see the lack of one uniform performance measure as a looming issue. There is significant evidence that people follow expert advice and people see Charity Navigators as both expert and credible. Whether or not people incorporate Charity Navigators into their charitable gift decisions could motivate future empirical studies⁶. Nevertheless, if consumers are willing to accept that the REM chooses to support a nonprofit that rates well on the system used by Charity Navigators and that particular charity carries credibility with customers then the residual questions for customers must be about the level at which the REM gives to those charities.

The objective function of the REM ought not to be obscure to customers given that it is identical to a profit maximizing firm. Instead, there are two types of questions

⁵ This increased cost of withholding information has a simple explanation based on the concept of signaling. As more nonprofits provide information, the nonprofits that do not provide information transmit a more negative signal in terms of their resource stewardship quality.

⁶ One recent study in the *Rand Journal* posed the question of whether people responded to Medicare report cards issued to consumers by the government. Despite large market-based learning the authors find a separate effect of those government report cards on plan selection (Dafny and Dranove, 2008). A similar study could be conducted on the importance of Charity Navigators and other so-called watch dog nonprofits.

of control that might be of interest to customers of a REM. First, there are questions of organizational efficiency –the “reasonableness” of executive compensation at an REM is a good example. Second, customers may be interested in how much of the retained earnings are kept to fund internal growth, and how much is actually paid out to recipient nonprofits. My conjecture is that, in the absence of shareholders and with organizational transparency, REM customers will act as the agents of control. A general experimental study testing the conjecture is included later in this volume (Isaac and Norton, 2009)⁷.

Questions about the specific levels of giving necessary to differentiate the product from the average socially responsible firm and the impact choice of charity has on REM patronage remains untested. Imagine two stores side by side, one store is a local store with a sterling brand reputation that advertises its social responsibility and another store is local and established as a nonprofit organization that advertises its donations, at some level of its retained earnings, to charity. If all other characteristics of the two stores are held constant, will customers, on average, prefer to buy goods from the REM (as long as the amount the REM gives is above the social responsibility of the for-profit firm)?

The answer for many people would likely go in favor of the REM. Although purchasing a good they would ordinarily buy, they make a larger contribution to digging clean water wells in Africa or educating orphans. I will return to these good deeds later on in the section on market interaction. But, if the perception of the REM is that it does not give “enough” of its retained earnings to charity the customers may choose to discipline the REM by buying goods at the other store. What this represents in standard economic theory is a principal-agent problem in which each customer implicitly writes a contract with the REM over the level of charitable gift. The question of size, “How much is enough?” is an empirical question that could be addressed.

Again, the lynch pin feature of the customers as the agents of control in an REM enterprise is the transparent environment where the level of giving, the recipient of the gifts, and the efforts (whether success or failure) of the organization are known. Without

⁷ The Isaac and Norton experimental design employs the standard voluntary contributions mechanism for public goods and consists of one manager and four customers. The manager chooses the production technology (or the group multiplier) while the customers allocate a stock of tokens between their individual and group exchanges. The two treatments of interest are the presence of information to the customers in the style of a quarterly report and the importance of an outside option in signaling managerial credibility.

the transparent environment the agent (firm) will be unable to signal to the principal (customer) that they are making the appropriate charitable decisions.

III. Donations and Quasi-rents

There are different expectations for the way people interact with for-profit and nonprofit firms. One significant difference is the receipt of donations which are foundational to many nonprofit organizations whether or not they chiefly procure capital from the sale of goods. If the nonprofit is sufficiently small they may be able to receive physical donations from other surrounding businesses, volunteer labor, or lower cost rental space. Some of these donations reduce fixed costs, while the potential for volunteer labor effectively reduces the marginal cost for the REM enterprise compared to its for-profit counterpart.

Another way to consider size of the REM is the proportion of the market that operates from the REM business model. With small amounts of REMs we can imagine that these cost-reducing donations will persist. However, the support of for-profit businesses to REMs may dwindle as the proportion of REMs in the market increase. Imagine you are a paint store owner who has already donated paint buckets to three REMs this month. The fourth REM may cross the threshold of your willingness for to pay for charitable activity. With a critical mass of REMs in the market for-profit businesses may be less inclined to donate.

The idea of the REM as the inframarginal firm with a lower marginal cost due to input subsidies strikes at the heart of what Marshall called “quasi-rents”. Marshall took Ricardo’s concept of rents as returns from nature (“the free gifts of nature”) and focused on the transitional state of the market before complete adjustments. Those extra profits were called quasi-rents and he said they would disappear in the long run as all costs became variable (Blaug, 1968). Likewise I will soon discuss how these quasi-rents gained in the short-run picture will evaporate in the long-run as the REM enterprise grows in size.

To be clear, the receipt of donations is an important characteristic of the REM enterprise but it is not imperative. The receipt of donations simply helps the REM enterprise to more quickly cover its costs. That also quickens the ability of the REM

enterprise to give its retained earnings to charity which from the aforementioned section is what customers will demand (all else equal).

IV. Economic Growth and the REM Enterprise

Before we discuss why or how REMs may grow, it will be useful to step back and think about the general topic of firm growth. And in order to do this, I am going to briefly digress from the ideas of why a firm, any firm, exists, and ask whether or not there are any problems with thinking about the REM enterprise in particular.

The REM enterprise is an organization that sells typical consumer goods in established markets using inputs for which there are well known prices. Based on this description, it might appear that there is very little Knightian uncertainty to provide returns to the REM entrepreneur⁸. However, there may be more uncertainty upon second glance. In the last sections I wrote that the small scale REM entrepreneur may have an entrepreneurial function like a) gathering the quasi-rents from donated inputs and b) capturing demand that is based not only (in part) on price but also on customers' desires to support, and also see through, the charitable purpose of the REM. Furthermore, there may be even more uncertainty on these issues for the path-breaking entrepreneur who seeks to extend the REM to a larger scale.

Because the REMs have not developed into large scale operations we say that there is some Knightian uncertainty that goes along with increased size. But, because the REM entrepreneur is working in a well developed market with significant certainty in input costs (if the firm is large) we can regard the REM entrepreneur more as a Coasian manager⁹. The Coasian manager organizes the inputs and input quantities in a manner that minimizes cost while seeking other strategies to maximize profits. Thus, the REM entrepreneur is a participant in both Coasian and Knightian theories of the firm. With these models in mind, I identify three possible barriers to scale expansion of the REM.

First, there seems to be a fairly substantial barrier to an increase in the size (or even scope) of the REM due to the evaporation of the procurement of quasi-rents from subsidized or donated inputs. Few people, if anyone, would sign up to work at Wal-Mart

⁸ Knightian uncertainty represents immeasurable or extremely difficult to measure risk under which an entrepreneur inventing a market must operate, see (Knight, 1921).

⁹ For a discussion of the difference between entrepreneurs as seen by Frank Knight and managers as seen by Ronald Coase see (Boudreaux and Holcombe, 1989)

as a volunteer or at below-market wage¹⁰. Why is there no willingness to volunteer for Wal-Mart? Is it Wal-Mart's size, for-profit status, public perception or all of the above? Suppose we consider a not-for-profit REM of equivalent scale to Wal-Mart, we call it Rem-Mart. As the "social distance" grows between Rem-Mart and company volunteers, the incentive to free-ride may increase¹¹. Even with willing volunteers, the coordination of volunteers may become much more difficult at a larger scale. Also, the amount of donated paint needed for a small enterprise is typically less than the paint needed for a large enterprise and therefore is more costly to the owner of the paint store.

Thus, my working hypothesis is that quasi-rents are likely to evaporate as the size of the REM increases. The disappearance of those quasi-rents does not mean that a Rem-Mart could not exist. In the previous section I noted that quasi-rents were an important bonus but not necessarily an imperative for the REM.

There is at least one recent historical example of a functional and somewhat successful Rem-Mart albeit the context is atypical. Formed in 1868 in Salt Lake City, Utah, "Zion's Co-operative Mercantile Institution" was the fulcrum of the co-operative movement in the LDS (Latter Day Saints) church. These smaller retail co-operatives however required a large wholesale storehouse and so ZCMI was built for their distribution. The financial success of ZCMI as a wholesaler was immediate and lucrative. Within two years they dispatched many of their competitors who were viewed by LDS leadership as "opposed to the true interests of Utah." (Arrington, 1958) Other smaller retailers wilted or were bought out by private investors. Throughout the transition from the co-operative movement towards private enterprise ZCMI maintained and parlayed their success as a wholesaler into also being a retailer. This lasted until ZCMI was purchased by May Department Stores Company in 1999 after two years of negative profits (ZCMI Sold to May Company 2000).

¹⁰ Perhaps except for the special case of retired persons who enjoy being greeters

¹¹ Surprisingly, to my knowledge, there has been little experimental public goods research with respect to social distance. There are some reasons to believe increased social distance negatively effects the level of voluntary contributions to the group exchange. For instance, group size increasing (which is a form of social distance) may be associated with a decrease in lower marginal per capita returns (people benefit less on average from contributions) which induce free riding (Isaac and Walker, 1988). Other partial glimpses at the effect of social distance are increased contributions from face to face strategic communication (Isaac and Walker, 1988) and public goods games with an intentional Christian community (Norton and Isaac, 2008).

The construction and execution of this project by the LDS church make it atypical for a number of reasons, but it is proof of the existence of a large REM at least for some time. Like ZCMI, an REM may become large, but, after the evaporation of the quasi-rents it will be subject to the same market forces of competition as any other firm.

A second barrier to REM growth exists with regards to customer expectations. Earlier I stated that the objective of the REM was to provide money to other charities. And, I mentioned that the quasi-rents of inputs moved the point of REM profitability (the point at which the earnings are transferred to charity) forward in time. This had the additional effect of allowing an early demonstration of the success of the REM to the customers. If quasi-rents for the REM disappear, the REM may take longer to achieve the point at which their donations to other charities occur. Without being able to observe these donations in an earlier time period, it is unclear how consumers of goods at the larger REM will adjust their expectations. Consumers must be willing to continue to purchase goods at the REM until it is able to rise above the up-front costs and begin to donate retained earnings.

There are two methods that may prove useful for larger REMs to signal to customers about correct expectations for the time-frame of transfers. One method is for the manager to advertise this fact by communicating with customers directly: at ground level upon start-up or by an advertising campaign. Another method that may prove useful in retaining the REM's credibility is the existence of Charity Navigators and Wall Watchers. If the growing REM is open and transparent to these organizations, their statements and rankings may correctly reflect the progress of the REM towards future transfers.

The third potential barrier for REM growth is capital to finance growth. A fundamental characteristic of entrepreneurs seeking to grow their businesses is that the funds required for expansion typically exceed the capabilities of what can be financed internally (Cooper and Carleton, 1979). But, this is increasingly not an obstacle for nonprofit organizations because prudent and passionate nonprofit entrepreneurs are able to attract money from venture capitalists.

The incidence of venture capitalists involved in business with social rather than profit maximizing goals has increased in past years. And, there is no reason to believe

that they would not welcome a hybrid that is commercial in nature but supports donative models. For example, Jeff Skoll, former President of eBay, developed the Skoll Foundation because, “[he] believes that strategic investments in the right people can lead to lasting social change,” (Skoll Foundation, 2008). But, what type of investing is preferred?

The venture capitalist that deals with nonprofit organizations can only invest on a debt basis because there is no equity investment to be had¹². Even if equity investments were available there is much literature that suggests that some debt financing is preferred to 100% equity financing for the venture capitalist (Cooper and Carleton). For the REM, whose objective is to give their retained earnings to charity, debt financing is good news because as it became larger it would not have to send a larger absolute amount of their retained earnings to the venture capitalist. However, 100% debt financing creates an incentive for the social entrepreneurs to engage in more risky ventures. Venture capitalists may see this as either a good or a bad thing (But, if they’re like the Skoll Foundation description of betting on people, giving the social entrepreneur more liberty may be preferred). Laboratory economics ought to be able to provide more insight into the nature of contractual arrangements between social entrepreneurs/nonprofits and venture capitalists¹³.

Before completing this section on growth in the REM let us return to the Coasian manager discussed earlier. One of the chief characteristics of the Coasian manager is that they scan the choice set and make decisions for the firm that reduce transaction costs and increase profits. Specifically, here, I will discuss two considerations for the Coasian manager of the REM enterprise who must choose between markets or hierarchies.

If the REM uses an internal salary lower than the market wage, which is common practice for nonprofits (Ruhm, 2003), the employee may be signaling two different kinds of information. The first signal is one of alignment where the employee signals that their values are aligned with the values of the non-profit. This is consistent with a literature

¹² The Economist Magazine recently featured a short article that discussed the idea of “philanthropic equity”. People buy shares of a nonprofit organization and hold onto the shares as they produce “a significant social return on investment.” For the venture capitalist this should not change their preference.

¹³ The third barrier (financing for increased expansion of the REM size) could also be handled via an L3C legal structure which would allow for shareholder investment (with small returns) if size does reduce the likelihood of pure charitable donations as conjectured.

that suggests trade-offs nonprofit employees make with lower salaries for providing a social good (Bacchiega and Borzaga, 2001). The second signal is one of incompetence where the employee signals that they are low skilled and have not or can not succeed in the for-profit world. This is particularly harmful to the nonprofits since not having a quality manager increases the ex-ante production function because they cannot efficiently allocate inputs. In an effort to shield themselves from the second type of signal, nonprofits may be led to choose a hierarchy, developing an internal “farm system” for upper management. The author is aware of at least one local example of adverse selection into a lower paying nonprofit job and a more formal study could be interesting for future empirical study.

One area where the market may be more useful than the hierarchy for the REM is in the promotion of transparency. But, the additional strength of the market may be in the strength of the signal to potential donors. Signaling is about perception. For instance, despite the informational advantage inherent in the hierarchy, there may be a stronger signal to the customer if the REM hires a recent MBA from Wharton. Undoubtedly, nonprofits experience the tension between the adverse selection problem caused by lack of information and the type of signal they send to donors in their promotions as well as contracting of technical services.

V. REM Enterprise and Market Interaction

The output of the REM enterprise is not itself the public good. Rather the sale of a private good generates the revenue that allows the nonprofit to cover costs and donate the retained earnings to charity. This requires the REM enterprise to compete in a market with other for-profit firms. From the previous discussion about quasi-rents we know that the inframarginal REM enterprise may possess some marginal cost advantage over a for-profit firm. Also, I noted that there may be positive sentiments for shopping at the REM enterprise because the retained earnings are channeled towards helping the impoverished in local and/or international communities. Therefore, the REM enterprise, although selling an identical good may have a differentiated product due to its firm structure.

Even with the differentiated product based upon firm structure I believe we should assume as a working hypothesis that the product is identical in other respects. The attractiveness of the identical goods assumption is that the REM enterprise is subject to

the same market forces as other firms. Even if customers shop at an REM enterprise because of the way the retained earnings are distributed, they will most likely not shop there while simultaneously settling for a significantly lower quality product. The products must be at least on par with the competitors.

So what is the evidence? There is some evidence that consumers are willing to pay a higher price for a good where a portion of the proceeds are given to charity (Elfenbein and McManus, 2009). However, the frequency of purchase and the level of the greater price they are reported to pay lead me to conjecture that people on average cannot be counted upon to pay significantly higher prices for goods associated with charity. Thus, the idea that an REM could exercise monopoly power, charging a substantially higher price to maximize profits in order to supply the greatest amount of capital to charity (Eckel and Steinberg, 1992) is unlikely.

However, if customers have some modest preferences over firm goals, products differentiated on levels of charitable giving could cause increased competition among firms where each firm competes over who is most charitable in order to win customers. This would create a market where at the limit even a for-profit firm approaches the “social responsibility” of an REM enterprise¹⁴. The opposite outcome is segmentation of firm responsibilities where all for-profit firms assume the Friedman charge of fiduciary responsibility (Friedman, 1970). Then, the REM enterprise is the only type of business the public expects to deliver a portion of its earnings to charity (though this is less likely if we consider charitable acts to be a form of advertising).

Notice that the REM business model does not invalidate traditional Industrial Organization theory. The public goods component to the sale of a good that is private in character does nothing more than differentiate the product. The intellectual structure therefore is the same as competition amongst differentiated products.

VII. Conclusion

The Retained Earnings Maximizing Nonprofit Enterprise is a structural and operative specification among the set of commercial nonprofits termed social enterprises.

¹⁴ Firms are becoming more “socially responsible” in terms of their level of giving to charity. One question for publicly traded firms is how shareholders respond to the increases in socially responsible activity. The question of whether this increased charitable activity by firms causes a decrease in individual charitable gifts through more traditional avenues has been addressed at least theoretically (Baron, 2007).

The REM is physically indistinguishable from the average for-profit firm save the “nonprofit” that might be scripted across the entry doors, but in operation there are several differences. Such differences are most easily visible in table format.

	Commercial	REM Enterprise	Donative Nonprofit
Motivation	Profit Maximization for Shareholder Benefit.	Profit Maximization for Supported Nonprofit Benefit.	Quantity Maximization for most quality coverage.
Competition	Other Firms	Other Firms	Other Nonprofits
Obstacles to Growth of the Firm	Entrepreneurial loss of control.	Difficult to manage consumer expectations, lack of equity investment and quasi-rent loss are associated with growth.	Increased problems with coordination.
Organizational Discipline	Shareholders, Large Funds, Board of Directors and Customers	Customers and Board of Directors	Donors and Board of Directors
Capital Formation	Venture Capitalists and Shareholders	Venture Capitalists, Social Entrepreneurs and Donors	Social Entrepreneurs and Donors
Labor	Hired	Volunteer and Hired	Volunteer and Hired

Table 1: Similarities and Differences between REM and Others

To summarize the table the REM contains a mixture of a standard commercial firm and a traditional donative nonprofit. Like the traditional nonprofit the REM benefits from the quasi-rents received in the form of volunteer labor and donated materials. Likewise, because of its charitable mission the REM may, like the donative nonprofit, also receive donations from social entrepreneurs. Venture capitalists may also choose to invest in the REM enterprise; however, if the REM were considering the need for capital formation beyond the amount it could receive from a social entrepreneur it may consider changing to an L3C legal arrangement. The benefit would be the ability to accumulate capital via shareholders with small rates of return. The drawback however to an L3C arrangement would be that the donations would no longer be tax exempt. This is an empirical question about how much those individual donations would likely decrease.

In other ways the REM has an objective similar to its traditional commercial counterpart, profit maximization. Also, its competitors are other firms selling products in a private market. All three types of firms have board of directors as control over the organization. The customers receiving the goods in the REM and the standard for-profit

firm also represent a control of the organization due to the discipline they bring to the market. Similarly, donors in the REM and donative nonprofit bring discipline to the actions of organizations.

This paper constructs a foundation for both field and laboratory empirical testing of theories about the organization growth and market performance of the REM. Such conjectures include the impact of organizational transparency, contractual arrangements between social entrepreneurs and venture capitalists, and the tension between hierarchy and the market.

The prospects for growth in the REM enterprise are exciting because REMs have the potential to increase overall levels of charity and funding to independent sector activity. Moreover, if successful in their increase in the overall level of charity, the REM enterprise may be a crucial catalyst for a reversal in government provision of various welfare goods and services, a phenomenon called “reverse crowd out” (Norton and Isaac).

Finally, why is this better than a for-profit company like Newman’s Own? In the long run there are potential problems with both Newman’s Own and the REM. The destiny of a for-profit company is in the hands of shareholders which may change across generations and the nonprofit organization could be prone to mission drift. But, this is true of any organization. Because the nonprofit is legally bound with a non-distribution constraint this may represent stronger and more reliable signal in the marketplace.

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