

**Pathways to Sector Selection:
A Conceptual Framework for Social Entrepreneurs**

Angela E. Addae

Department of Sociology
The University of Arizona
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Abstract

This paper explains how entrepreneurs choose between nonprofit and for-profit legal forms for their social enterprises. As managers of organizations with both financial and social objectives, social entrepreneurs often struggle with competing logics for governance, stakeholders, and outcomes. The choice represents and interaction among four main factors: organizational lineage, market conditions, individual characteristics of the entrepreneur, and stakeholder influence. Using a qualitative comparative case analysis of four social enterprises, this paper demonstrates that there are competing pathways that result in varying organizational forms. The research shows that specific routes of sector selection exist and the determination of legal form is dependent on organizational points of entry—that is, the factor that the entrepreneur considers the highest priority. For those choosing nonprofit forms, organizational lineage turns out to be determinative. For those operating in the for-profit context, the personal orientation and traits of the entrepreneur are of greatest predictive power. This paper concludes with a conceptual framework for sector selection and a discussion on the advantages of delaying the formal sector declaration process.

Nothing seemed unusual. Preparing for the lunch crowd, the staff at Hope Bistro completed tasks that by now had become a daily routine. Melodies of dishes clamoring and aromas of bread baking filled the small space as the employees eagerly awaited their customers—usually high profile attorneys who worked in the downtown district, steps away from the restaurant. The employees worked diligently for something much more valuable than their wage of \$7.80 an hour: the opportunity to take back control of their lives. Perhaps, no one could put a price on self-confidence and a sense of purpose.

Introduction

Over the past few decades, social enterprises have rapidly emerged as hybrid organizations that utilize market strategies to enact social change. By combining structural elements of non-profit and for-profit organizations, social enterprises seek to fill the gap left by the public, private, and non-profit sector. At first glance, the organizational structure of social enterprises appears ideal. Social enterprises generate financial profit while ‘doing good.’ However, social enterprises must balance competing logics from the business and service sectors, which offer contradictory strategies for governance, stakeholders, and outcomes. Despite the hybrid nature of their organizational goals, social enterprises are forced to ‘box’ themselves into existing organizational forms by legally incorporating as either a non-profit or for-profit organization. Therefore, organizations with similar missions can have logically different organizational forms. While organizational forms serve as categories that allow us to predict organizational behavior, the sector selection process often results in ambiguous organizations whose behaviors and goals counter sectoral norms. The complex sector selection process for social enterprises leads me to question: *What factors determine whether social enterprises legally incorporate as a non-profit or a for-profit organization?*

This paper explains how social entrepreneurs select a legal form for their nascent organizations. Engaging organizational theory and entrepreneurship literature, I develop

a theoretical model that presents sector selection as the result of interaction between the individual characteristics of the entrepreneur, organizational lineage, stakeholder influence, and market conditions. These factors are presumed to be more influential in the sector selection process than the internal motivations or primacy of objectives of the social entrepreneur. To test the model, I conduct a comparative case analysis of four social enterprises that are similar in mission but embody opposing institutional logics.

Organizational scholars have studied the field and structure of hybrid organizations, but none have directly researched the specific strategies that social entrepreneurs utilize in determining structure at the inception of the organization. An analysis of the decisions made by entrepreneurs at inception provides insight into the factors that directly contribute to sectoral choice. This research establishes a conceptual framework that identifies competing pathways toward sector selection as social entrepreneurs navigate the boundary between the nonprofit and for-profit sectors. Results show that specific pathways toward sector selection exist, and an organization's point of entry—that is, where it begins on the path—ultimately determines the sectoral choice.

Literature Review

The body of literature on social enterprises is vast, yet fragmented. The academic study of social entrepreneurship began in the late 1970s, surrounding the emergence of microfinance institutions in developing countries. Institutions such as the Grameen Bank in Bangladesh are best known for their microcredit lending practices to poor, rural citizens—particularly women. Unlike traditional banks where the poor are unqualified for credit, the Grameen Bank gives small loans to people with little or no collateral to

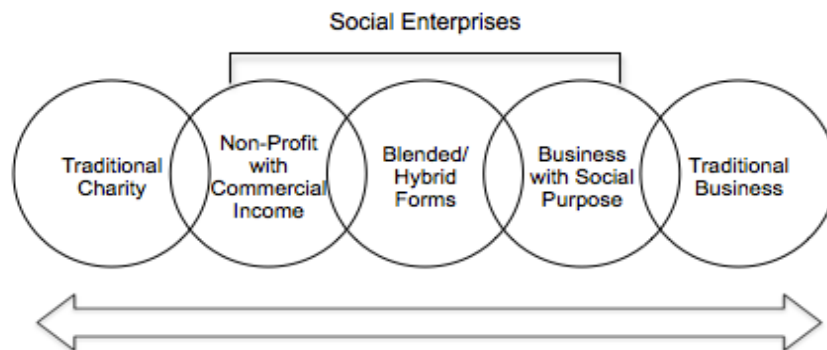
establish small businesses. In the 1980s, this concept of empowering disadvantaged individuals through employment and market access sparked the creation of work integration social enterprises (WISEs). Many WISEs began as sheltered workshops, where disadvantaged individuals engaged in piecework projects contracted by corporations. Today, most WISEs are functioning enterprises that equip individuals with labor market experience and transferable job skills.

Microfinance institutions and WISEs are components of a much larger, multifaceted phenomenon: social entrepreneurship. The conceptualization of social entrepreneurship continues to evolve, gradually approaching a concrete theoretical framework for its academic study. The term ‘social entrepreneurship’ was first formally conceptualized by Dees (1998) and his definition is considered to be the idealized model of social entrepreneurship. According to Dees, social entrepreneurship is “adopting a mission to create and sustain social value; recognizing and relentlessly pursuing new opportunities to serve that mission; engaging in a process of continuous innovation, adaptation, and learning; acting boldly without being limited by resources currently at hand, and; exhibiting heightened accountability to the constituencies served and for the outcomes created” (p. 4). However, the definitional debate within social entrepreneurship scholarship is ongoing and extensive. While Dees formulated a broad definition to encompass the many facets of social entrepreneurship, scholars have also constructed narrow definitions that include the use of market strategies or identify a target population. For example, Hibbert et al. (2001) define social entrepreneurship as “the use of entrepreneurial behavior for social ends rather than for profit objectives; or an enterprise that generates profits that benefit a specific disadvantaged group” (p. 288). For

Galaskiewicz and Barringer (2012), organizations are categorized based upon organizational inputs and beneficiaries, and social enterprises are “private organization[s] working toward a social welfare goal while participating fully in the marketplace” (p. 52).

Nevertheless, scholars do agree that social enterprises lie on a continuum—with traditional charities and businesses as the ‘pure’ organizational forms—and organizations outside of the traditional sectors create problems for credibility and legitimacy (Galaskiewicz and Barringer, 2012). Because a concrete definition has yet to be agreed upon, I incorporate my previous research and experience to adopt a working definition of social enterprises as *organizations that utilize market strategies to enact social change*. This definition is inclusive of organizations that exist outside of the traditional sectors, such as non-profit organizations with commercial income, businesses with a social purpose, and it encompasses new hybrid forms (e.g. low-profit limited liability companies (L3Cs), Benefit corporations, etc.).

Figure 1



An overview of the literature reveals several possible factors that contribute to the sectoral choice of social enterprises, from the external isomorphic pressures of the

institutional environment to the internal underlying motivations of the social entrepreneur toward either profit-maximizing or mission-oriented goals.

Constraints and Privileges

The notion of constraints is pertinent throughout the literature and entrepreneurs weigh the disadvantages or constraints to eliminate specific forms. When expressing the goals of the institution, a hybrid organization must ‘choose’ between profit maximization and social benefit maximization. Barkley et al. (2001) suggest that hybrid organizations “seek to maximize social benefits or returns while earning an IRR [internal rate of return] that is sufficient to ensure the institution’s long-term sustainability” (p. 8). When considering the selection of organizational form or legal structure, social entrepreneurs must evaluate the privileges and constraints of non-profit forms and for-profit forms (e.g. limited liability partnerships and corporations). For the non-profit sector, tax-exempt organizations are legally constrained to restrict the distribution of financial profit and their interactions with for-profit firms (Weisbrod, 1998). The non-distribution constraint ensures stakeholders that organizational funds are used directly for its intended purpose. Additionally, the non-distribution constraint discourages engagement in activities that are socially detrimental, even if they maximize profit. The underlying assumption is that the advantages of the non-profit form outweigh the disadvantages of the non-distribution constraint, suggesting that the non-distribution constraint itself cannot be fully credited for distinctions in sectoral choice (Weisbrod, 1998; Dart, 2004).

There are also several privileges accorded to non-profit organizations. Non-profit organizations receive reductions on property, sales, and income taxes and are eligible to receive tax-deductible donations. They oftentimes face lower supply costs due to the

availability of volunteer labor. Additionally, non-profit organizations may also experience higher consumer demand due to consumers willing to pay a premium to feel as though they are contributing to a higher, altruistic purpose. Because the enforcement of constraints is often lax, nonprofits can behave like for-profits, i.e., appropriate surplus for private gain, or, in other words, act as “for-profit-firms in disguise.” This means that the non-distribution constraint is a weak deterrent discouraging profit-oriented organizers from selecting a non-profit organizational form (Weisbrod, 1998; Weisbrod, 1988). There is also the benefit of furthering social welfare. That non-profit managers tend to work for less compensation than for-profit managers, suggests that the social benefits accrued from working in the non-profit sector negate the differences in salary (Wise 2001).

Nonetheless, apart from the main differences between Weisbrod’s (1998) profit maximizer and bonoficer (social maximizer) models such as objectives and diversity of revenue, he cautions that organizations often behave quite similarly—particularly with the presence of industry regulatory constraints.

Market conditions

The advantages and disadvantages of defined objectives and regulatory constraints are directly manifested in the entrepreneur’s perception of market conditions. For-profit organizations determine that there is a market for a specific good or service, while non-profit organizations provide social needs by responding to the absence of a good or service in the private and public sectors. For nontraditional organizations, it can be difficult to appeal to private investors when profit maximization is not the only objective of the organization. Barkley et al. (2001) observe that “private investors interested solely in earning high IRR [internal rate of return] are unlikely to invest in

venture capital institutions with dual objectives or in institutions where expected returns are below traditional venture capital market targets” (p. 14). Kittilaksanawong et al. (2012) add that sources of funding can be restricted by donors, which prevents the organization from engaging in for-profit activities. For example, “the private equity firms or commercial banks may be reluctant to provide their funding to non-profit enterprises. By law or social norms in many countries, for-profit financial institutions may not be able to retain a portion of residual or other rights over the non-profit enterprises. Therefore, these for-profit resource providers may choose to share their interests in for-profit ventures” (p. 42). The ability or inability to obtain private funding or commercial loans may be a determining factor in sectoral choice. The authors propose that an organization’s reliance on less restricted commercialized funding is related to the selection of a for-profit organizational form, while an organization’s reliance on more restricted non-commercial funding is related to a non-profit organizational form (Kittlaksanawong et al., 2012). A classic chicken-egg tale, it has yet to be determined whether an organization’s reliance on specific types of funding is the cause or the result of organizational form.

Individual Characteristics of the Entrepreneur

In addition to financial capital, human capital also may be influential in the sector selection process. In a study of human capital and hybrid organizations, Meyskens et al. (2011) find that “previous experience (measured by work status) is positively related to start-up hybrid ventures” (p. 62). However, the study does not specify the role of prior experience in the establishment process, only that “[i]n the context of ventures with both economic and social goals, the professional experience, and skills of venture founders are

generally thought to be important” (p. 58). For sector selection, social entrepreneurs may be likely to select an organizational form with which they are most familiar based upon prior experience.

Seemingly obvious factors in the sectoral choice of social enterprises are the objectives of the social entrepreneur. If an organizer is primarily interested in profit maximization or pursuing a social mission, then he or she will seek a for-profit model or non-profit model, respectively. This assumes that the social entrepreneur, at least internally, has a hierarchical order of motives (Kittilaksanawong et al., 2012). Arguably, if a social entrepreneur is predominantly motivated by social or economic goals, with one holding significant primacy over the other, then it is not necessary to establish a social enterprise. The dualistic social enterprise model would be insufficient in fulfilling his dominant goal and he would be better suited with a traditional private firm or charity.

The true hybrid form of a social enterprise equally embraces concurrent objectives. In case studies of the Grameen Bank and Cherished Dream China Education Foundation, Kittilaksanawong et al. (2012) counter the hierarchical/internal motivation argument and determine that it is, in fact, the concurrent missions that dictates the organizational form: “the necessary concurrent economic and social mission will elevate the importance of pressing external institutional forces that create uncertainties to the choice of organizational form such motivation. Specifically, under the concurrent economic and social mission, the organizational form is contingent upon the social entrepreneur’s perceptions of the institutional environment with respect to resource acquisition, stakeholder alignment, and legitimacy attainment instead of internal motivation” (p. 39). The concurrent motives force the social entrepreneur to carefully

consider the institutional environment and select the organizational structure based on what is perceived to be best for the organization, not the merits of a particular sector (Kittilaksanawong et al., 2012; Rubin, 1999).

Theoretical Framework

Weisbrod (1998) addresses the differences in behavior for alternative institutional forms, but does not speak directly about hybrid forms. The theoretical assumptions about the comparative behavior of private firms and nonprofit organizations have resulted in conflicting behavioral predictions and policy outcomes (p. 70). For example, people are suspicious about the motives of profit making service providers (e.g. hospitals, medical services) (Arrow, 1963). It is assumed that non-profit organizations behave differently, which justifies their special privileges. The receipt of subsidies is based on the notion that non-profit organizations are pursuing public interest over self-interest. While institutional form should allow us to predict which decision an organization will make, Weisbrod suggests that the organization's decisions "reflect the interplay of its goals and the constraints on it" (Weisbrod, 1998:70). Economists assume that profit motivates all entrepreneurs and managers, resulting in efficient decision making by private firms. However, the managers of non-profit organizations face a non-distribution constraint that does not allow them to benefit from organizational profit or surplus, so they are not subject to competitive pressures and are susceptible to inefficiency.

This paper examines the sector selection process of social enterprises, or, in essence, the categorization of these hybrid organizations. Hsu and Hannan (2005) discuss how categories become legitimated into organizational forms through the process of labeling. Galaskiewicz and Barringer (2012) extend the logic of Hsu and Hannan

(2005) as it applies to the social categories of social enterprises. First, Galaskiewicz and Barringer argue that the hybrid nature of social enterprises makes it difficult for audiences to categorize them, which also makes it difficult for them to be held accountable. Secondly, the social enterprise model is a “high risk strategy” because audiences are left confused and distrustful when they cannot validate social enterprises’ claims of authenticity.

Organizational identity has been an increasingly important element to organizational form because it shapes the legitimacy and social boundaries for organizations. However, these boundaries have become increasingly blurred and it is unclear whether this is a positive or negative change. Audiences and stakeholders categorize organizations using established labels (Hsu et al., 2009) to assign traits or attributes to the organization. Categories allow organizations to be held accountable based upon the dimensions affiliated with the assigned category (e.g. products, types of customers, prices, types of workers, etc.). Organizations are then evaluated based upon their adherence to or deviance from the rules and standards of the category (Hsu and Hannan, 2009). When an organization is ascribed to a particular category, it is assumed to possess the other traits—a safe assumption as long as the organization does not violate expectations. These assumptions benefit producers, who do not have to bear the costs of actually possessing all of the traits. However, hybrid forms are problematic for audiences because they do not fit neatly in a category and cannot be held accountable.

The solution to understanding the variation in sectoral choice for social enterprises may lie in context of the institutional environment. Because social enterprises embody elements of at least two types of organizational forms, they are subject to cross-

sectoral institutional isomorphism. DiMaggio and Powell (1983) refer to institutional isomorphism as the constraining process during which organizations in the same organizational field begin to resemble each other. Social enterprises are susceptible to isomorphic pressures from both sides of their hybrid identity. Both the non-profit sector and the for-profit sector could influence the organizational structure, depending on the institutional environment in which the social enterprise is situated and competes for resources, stakeholders, and legitimacy (Garrow and Hasenfield, 2012). Social enterprises are subject to isomorphic pressures that, according to DiMaggio and Powell's theory, cause the organizations to become more similar. However, homogeneity in the social enterprise field is not necessarily a desirable outcome, especially because the social enterprise model emphasizes innovation. (Sud et al., 2009; Nichols and Cho, 2006).

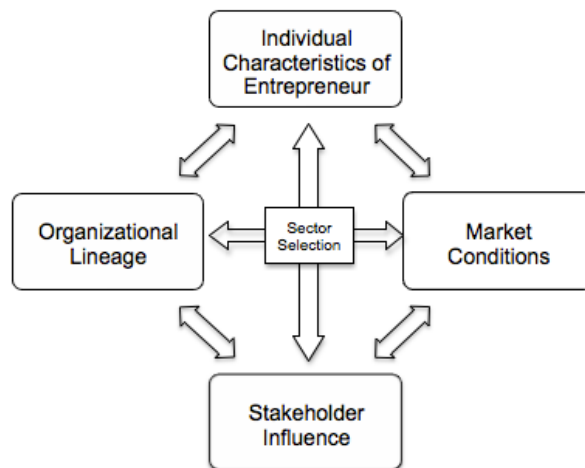
Kittilaksanawong et al. (2012) perceive the conflicting isomorphic pressures as the cause of the ambiguous structure: "In contrast to the traditional thoughts of institutions as to reduce organizational uncertainty, the hybrid social entrepreneurial venture instead, creates conflicting perceived institutional isomorphic pressures that lead to ambiguity in the choice of organizational form" (p. 39). Overall, it is the conflicting isomorphic pressures that give social entrepreneurs the flexibility to choose organizational form (Kittilaksanawong et al., 2012). Contrastingly, because social enterprises are so diverse, isomorphic pressures may not influence them. After all, the social enterprise model was birthed in rebellion to the status quo of traditional institutions and the isomorphic pressures that shaped them (Sud et al., 2009; Nicholls, 2006).

Townsend and Hart (2008) agree that concurrent goals emphasize the importance of the institutional environment. Sector and organizational form must be chosen carefully

to ensure that the goal in alignment with the logic of the environment does not dominate over the (equally important) complementary goal. Gidron and Hasenfield (2012) point out that social enterprises take advantage of their ambiguous identity to “exploit institutional contradictions in [their] heterogeneous and contested environment to further their interests” (p. 5). Sectoral choice is contingent upon the social entrepreneur’s assessment of the institutional environment. Ironically, institutional forms should reduce uncertainty for entrepreneurs, but the conflicting logics create ambiguity and confusion for social entrepreneurs (Townsend and Hart, 2008).

Expounding upon the existing theory, I propose that sector selection is the result of interaction between the individual characteristics of the entrepreneur, organizational lineage, stakeholder influence, and market conditions (see Figure 2). At the inception of the organization, social entrepreneurs make critical decisions that ultimately influence the legal form and outcomes of the organization.

Figure 2



Methodology

The data for this project stem from in-depth interviews with current founders and managers of four social enterprises, as well as unstructured interviews with beneficiaries of the organizations—totaling 13 interviews. The initial contact was made through an online forum for social entrepreneurs in a city in the West. I contacted the administrator of the forum via email and follow-up phone calls. We discussed the premise of the project and he recommended possible participants. From his recommendations, I generated a list of possible organizations and conducted Internet searches for each. Based on the organizations' websites, online news articles, and other web content, I narrowed the selection of organizations to those that fit within the realms of my preliminary criteria: mission or target population, age, and legal form. Organizations with similar mission and target population were selected to account for variation in organizational form that may be attributed to mission or target population. Younger organizations were sought because of the likelihood that individuals who were familiar with the decisions surrounding the formation of the organization were still actively involved in its current operations. Thirdly, paired organizations were required to have competing dominant logics, if not in operations, at least in legal form or structure.

After the four organizations were selected, I 'scoped' each enterprise by visiting the establishment and posing as a customer. Because of the unique nature of the social enterprise model, it was easy to inquire about how long it had been in operation, how the enterprise was started, and by whom. Once I had the names of the founders, I contacted them via email, phone, and/or personal visits to request participation. Managers were only solicited if the founders were unavailable. Interviews ranged from 45 minutes to 90

minutes, and were followed by a detailed tour of the facility (where possible). A semi-structured interview questionnaire was constructed as a guide for the interview, and it was pre-tested on similar hybrid organizations. Questions were freely inserted and eliminated during the progression of the interview, but the general topics of the idea/concept, the development and launch, the structure of the organization, and the organizational environment were consistently covered. Following the scheduled interviews with the founders or managers, casual interviews were conducted with beneficiaries of the organizations. Each interview was recorded using a digital voice recorder; handwritten field notes accompany the recordings. Additional information gained from field notes, websites, brochures, news articles, and other printed materials also supplemented the interview data. Data were transcribed using *Transcriptions* © software and coded using dual focused and open methods (Emerson et al., 1995). Open coding was used to identify patterns in the data that were not targeted in the focused coding process. I coded the data along the following factors:

I conceptualize the *orientation* of the organization based on both the legal form (non-profit or for-profit) and its goals (profit maximization or mission-oriented). An organization is classified as a for-profit if it is currently incorporated with a for-profit legal form such as LLC or LLP. An organization is classified as a non-profit if it is a tax-exempt organization with a 501c3 status. The goals of the organization were determined by the organization's primary activities and expenditures.

Market conditions are operationalized using the variable *sources of funding*. Sources of funding are the supply of any income, revenue or capital made available to the organization for the start-up or operations of the organization. Sources of funding include

donations, contracts, grants, gifts, or personal funds from either individuals or institutions.

Stakeholders are individuals or groups that maintain an invested interest in the enterprise, either financially or voluntary. They either play a role in or are affected by decisions and changes within an organization. Stakeholders include, but are not limited to: customers, clients, donors, investors, employees, managers, regulators, and boards of directors.

Constraints are operationalized as the legal, regulatory, or social rules and codes of conduct that restrict organizations from engaging in specific behaviors. Constraints can be applied to a particular sector, industry, or activity.

Organizational lineage consists of the presence or absence of a parent organization. A parent organization is an over-arching or umbrella organization of which the social enterprise is a subsidiary.

Individual characteristics of the entrepreneur are indicated by the prior career and educational experience of the entrepreneur. The experience of the organizations' founders fell into two categories: those who had experienced both for-profit and non-profit careers, and those who experienced *solely* non-profit careers.

The findings were compared and contrasted on two dimensions. First, the organizations with competing logics were compared within an activity (for example, non-profit job training program vs. for-profit job training program). Secondly, the organizations were compared more broadly by legal form (for example, for-profit social enterprises vs. non-profit enterprises).

Cases

Work -Integrated Social Enterprises

Hope Bistro is a non-profit restaurant that serves as a job-training program for individuals with mental illnesses. Founded in 2004, Hope Bistro assists ‘trainees’ in developing restaurant skills to prepare them for competitive employment. Hope Bistro operates as a subsidiary of the non-profit organization, Wildcat Unit. The restaurant helps individuals progress in their recovery and learn how to function with their mental illness. Instead of receiving traditional counseling, trainees acquire culinary and janitorial skills, experience customer service, and are supervised by job coaches. Operating adjacent to its parent organization, Hope Bistro prioritizes its mission to provide skills to trainees and reduce the stigma surrounding mental illness. Yet, as an operating restaurant, Hope Bistro often encounters many of the challenges of traditional restaurants. The profits from the restaurant barely cover the costs of staff wages, so the restaurant relies on subsidies from the state to cover operating expenses.

Labor of Love, an employment services and digital scanning enterprise, was originally founded as a consulting firm to connect companies and social services agencies. Beginning in 1983, Labor of Love connected companies with social services agencies to create contracts for companies to employ people with disabilities enabling them to work in real work environments and get real paychecks. The concept was to create supportive employment and worksites in industry. Overtime, Labor of Love transitioned into an agency, taking on state government contracts for job training programs for individuals with disabilities. Labor of Love has a myriad of services in addition to job training, such as computer skills classes and health and wellness

programs. To support the program, Labor of Love has also tapped into the consumer market, offering competitive services in digital document and data processing. Though Labor of Love was founded over 25 years ago, the original founder and president currently remains actively involved in the organization.

Consumer Resale

Double Take was an upscale resale shop that selectively sold designer clothing, handbags and jewelry that were barely used, if used at all. Double Take was the brainchild of the Board of Directors of the Warren Foundation (with assistance from a university business college) to provide a sustainable source of income to support the Warren School District's programs. Over time, Double Take became much more than a resale shop. It became a community for women to connect. As the subsidiary of a non-profit organization, Double Take ran into issues when seeking to adopt a consignment model, forcing the organization to operate on a donation only basis. Much to the chagrin of the community and Board members, Double Take was unable to sustain the thrift model and closed in January 2013.

Rachel was a hired manager in Double Take at the time it got rid of the consignment model. Realizing the earning potential of upscale resale consignment, Rachel branched out to establish her own venture, Dress for Effect. Having experienced the constraints of the non-profit model, Rachel opened a for-profit model hoping to avoid the tax issues associated with consignment. Her experience at Double Take, coupled with her previous corporate background, enabled her to utilize the best practices to create a successful store. Dress for Effect provides a unique experience for both consignors and customers. Double Take is associated, but not legally affiliated, with a non-profit

organization that benefits from proceeds and unsold clothing at Double Take. After six years, Rachel's yearly profits for Dress for Effect are nearly triple that of Double Take during her time there.

Analysis and Findings

The analysis of the four cases suggests that not only are funding sources, stakeholders, and prior experience correlated with the selection of legal form (Figure 3), but also that specific pathways exist toward for-profit and non-profit organizations (Figure 4). As will become clear in the analysis of the cases below, the individual characteristics of the entrepreneur, market conditions, stakeholder influence, and organizational lineage affect sector selection in a sequential and reverse sequential order.

The source of start-up capital proved to be influential in determining of organizational form. The entrepreneurs in the study who had access to start-up capital (i.e., their own personal funds) chose for-profit models. On the other hand, the non-profit organizations in the study did not have access to private capital. Instead, the initial funding came in the form of grants. Social entrepreneurs who had previous experience in the private sector established for-profit organizations. Social entrepreneurs who had prior experience solely in the non-profit sector established non-profit organizations. Organizations whose stakeholders were affiliated with a parent organization pursued a non-profit form, while organizations with private investors pursued a for-profit form. However, the situation is not as clear-cut as this summary suggests, and it is necessary to read the more detailed analysis to understand these effects.

Figure 3

	Outcome	Condition 1	Condition 2	Condition 3	Condition 4
	NP=0; FP=1	SelfFunded=0; OtherFunded=1	NoNPParent=0; NP Parent=1	NoFPEXper=0; FPEXper=1	NoGrant\$=0; Grant\$=1
Dress for Effect	1	0	0	1	0
Labor of Love	1	0	0	1	0
Double Take	0	1	1	0	1
Hope Bistro	0	1	1	0	1

Non-Profit (NP); For-Profit (FP);

Use of personal funds (SelfFunded); Use of non-personal funds (OtherFunded);

No Non-Profit parent organization (NoNPParent); Non-Profit parent organization (NP Parent);

No prior experience in the For-Profit sector (NoFPEXper); Prior experience in the For-Profit sector (FPEXper);

Grant money was not initial source of funding (NoGrant\$); Grant was initial source of funding (Grant\$)

For-Profit Organizations

Individual Characteristics of Entrepreneur

The selection of cases was unique in that each of the social entrepreneurs had experiences in the non-profit sector. However, it was the entrepreneurs who had also experienced the private sector who selected for-profit models for their organizations. This division could be explained in one of two ways. First, the experiences in the non-profit sector deterred the entrepreneur from continuing in the non-profit sector. For Dress for Effect, “lots of rules and regulations” in the non-profit sector were frustrating, contributing to her selection of the for-profit model. Secondly, the entrepreneurs gained a special skill set in the private sector that they intend to apply directly to their social enterprise. Rachel’s corporate expertise in best practices evaluation and process efficiency was seamlessly transferred to effective practices in her for-profit enterprise, Dress for Effect:

“Six Sigma [is] a high-end process improvement project... Honeywell uses it. Raytheon uses it. We were using it in [previous for-profit employer]. I ran the Six Sigma process improvement for the whole organization here in [Western city]... There isn’t anything you could ask me that I wouldn’t know about my own store. Not one thing. It’s the corporate background, especially the Six Sigma, it’s very in depth—you know how to take it from start to finish and each piece all the way through.” Rachel, Founder

Similarly, Labor of Love became a for-profit primarily due to its founder’s desire to continue her work in for-profit consulting and utilize the skills and networks she had gained:

“At [previous organization], I was the Marketing Director and I went out and got jobs for people to do in the sheltered workshop... we had contracts for everything from packaging and assembly, we had an industrial selling department, a wood shop, and all different kinds of things. So what I would do is go out to the companies and get work to do. I had so many contacts and relationships with business people because I’d been doing it for so long. When I started my company, the original plan was for me to be the marketing person, just like I had been for [previous organization]. I had all these connections with companies and I had connections with the agencies so my thought was, put it together.” -Beth, Founder

The reaction to negative experiences in the non-profit sector or the possession of skill sets best suited for the for-profit sector encouraged these entrepreneurs to pursue a for-profit legal form.

Market Conditions

The entrepreneurs in the study who had access to personal funds and assets ultimately chose for-profit models. Because the entrepreneur had his/her own financial capital, the for-profit organizations did not consider seeking external funding. For Dress for Effect, choosing a for-profit model entailed a significant level of financial risk:

“...my husband said take all our 401K money, do whatever you need to do it, do it....[Dress for Effect] came to be with my 401K money for our capital... All of it.” -Rachel, Founder

Similarly, despite its mission-oriented nature, Beth, founder of Labor of Love used “personal money” to establish and incorporate the organization as an LLC. Because of

the lack of financial return on investment, social entrepreneurs are unwilling to independently take on substantial financial risk to establish their organizations as non-profits. The selection of a for-profit model reflects the entrepreneurs' belief that a market indeed exists that could support the enterprise. While social entrepreneurs may be socially invested in their mission, there is a hesitancy to financially invest in the mission without pursuing profit.

Stakeholder Influence

For Dress for Effect, external stakeholders were not a priority in the selection of organizational form. On the contrary, the entrepreneur chose an organizational form that counters the desires of the consignors. However, the founder of Dress for Effect realizes the importance of tax write offs for high-end consignors, so she takes advantage of organizational loopholes to maintain a for-profit status and provide tax receipts for clients. By donating the clothing to an affiliated, external organization with a 501c3 status, Dress for Effect appeals to high-end consignors while circumventing the non-profit sector:

“We donate to the Assistance League and we provide tax receipts. That’s what kind of seals the deal for [people]. It’s one stop shopping. They’re done with their clothes. They’re either gonna make some money or they’re gonna give it a try... They’ll get a tax receipt for that and it’s going to a good organization. So it saves them a trip, two trips.”
-Rachel, Founder

Similarly, Labor of Love did not prioritize appealing to external stakeholders. For the for-profit enterprises, the entrepreneur is the primary stakeholder and their financial interests override external stakeholder influence.

Non-profit Organizations

Organizational Lineage

The for-profit organizations in the study were free-standing, but the non-profit enterprises were established as subsidiaries of existing parent organizations. For the non-profit organizations, the mission of the parent organization dictates the activities and form of the social enterprise. Hope Bistro was a direct extension of the parent organization, Wildcat Unit, thus taking on the organizational identity of the parent organization was natural:

“Wildcat Unit is the organization with the Board of Directors. They are the 501c3. We are just activities of Wildcat Unit.”-Stan, Manager

Josannah, the founder of Double Take, also notes that the parent organization’s (the Warren Foundation) mission was a primary factor in the selection of a non-profit enterprise:

“...we can't just have a mission of running [for-profit] stores... There was a connection to already our mission of having a clothing bank and then having the shop. It just seemed to fit. So basically it was born out of the Warren Foundation Board.”-Josannah, Founder

Though a subsidiary and fund-raiser of a non-profit foundation, Double Take was autonomous as an organization, with general oversight from the foundation’s Board of Directors.

Stakeholder Influence

Stakeholders are individuals or groups that have an invested interest in the organization. Stakeholders can be influential in the establishment and structure of the organization. With a bulk of its income primarily from state contracts, Hope Bistro recognizes that the State government is key stakeholder that mutually benefits from the restaurant’s program:

“...as long as we're training people and getting them jobs, [the State] keeps giving us money. Because ultimately, whatever they pay us, they save a lot of money in the long run. The people that we put into jobs aren't receiving as many benefits because they're working. That generally saves the State a lot of money then. So it's cost efficient for the state to support programs like this.” –Stan, Manager

In the consumer resale industry, consignors are also key stakeholders because they are financially impacted by the success of the store. Because of this, Double Take initially selected a non-profit form to appeal to high-end stakeholders:

“... We thought we were doing the right thing. People could come in, they could donate, they could get a tax write off for the donation... We thought that would be the ticket. And it was. Because if you come up with a Coach purse, and you're gonna donate it, I can give you a tax receipt, even if you don't like it just because it's pink. That's what we were getting [whispers: it was crazy!...]... and these people in this bracket, they need those tax write offs. That's why we started as a non-profit.” –Josannah, Founder

Whether the stakeholders were the state government or consignors, the non-profit organizations selected a legal form that deliberately appeals to external stakeholders.

Market Conditions

Because the non-profit entrepreneurs perceived a lack of market opportunity, they did not access private capital. Instead, the initial funding for the non-profit organizations came in the form of grants. The state provided start-up capital to Hope Bistro that was specifically designated to create the enterprise:

“[the founder] wrote for an establishment grant from the state and what that does is it pays for all the build outs and all that kind of stuff to get it up and going.” –Dan, Manager

While Hope Bistro’s establishment grant was from the public sector, Double Take received a grant from a private company, yet still chose a non-profit model. The grant did not specify the parameters of use for the funds, as long as the money was used to create a method of providing sustainable income for the foundation.

“The Warren Foundation was very fortunate, and the reason I say that is because XYZ Mining gave us a grant of \$300,000 of which a portion had to be used to build some sort

of sustainability element for the funding. So what we determined was that we would like to open a store.” –Josannah, Founder

However, when the initial source of funding comes from an external source, the entrepreneur establishes an organization that may not be profitable, because they do not personally bear the loss if the organization does not succeed. The pursuits of non-profit models with external funding are rational actions. If the entrepreneurs had self-funded non-profit enterprises, there would not be any private return on investment. In essence, the start-up capital for a self-funded non-profit enterprise would be akin to a generous donation.

Constraints

Based on the data, none of the organizations mentioned legal constraints as a factor in the sector selection process except Double Take. Ultimately, the constraints associated with the non-profit model complicated the sector selection process for Double Take. To remain in compliance with the Internal Revenue Service, Double Take attempted to declare both for-profit and non-profit forms. Josannah explains how efforts to circumvent the IRS constraints proved costly to the organization:

*“The idea of consignment came up, which was problematic because we found as we went through the process, there are issues with the Internal Revenue Service and with consignment shops and non-profits. So we attempted to then divide it so that we would have two businesses operating in the same location, which somehow became legal. Then it just got to the point where we either had to completely go consignment, form a whole new board, separate it completely from the 501c3 or we would lose our 501c3 and we decided we didn't want to do that. You have to completely separate it, like we had an upscale resale **shop** and then upscale resale **consignment**. In order to keep it that way, we would have had to have, almost literally, two different doorways into the shop, two different cash registers. If you had gone into shop, and you bought consignment items versus buying resale items, you would've had to buy your consignment items at one register and your resale items at another.”-Josannah, Founder*

The constraints imposed on Double Take forced the organization to select the thrift model, rather than the more lucrative consignment model. While the organization did consider and attempt alternate methods to maximize profit, the violation of legal constraints would have resulted in the loss of their 501c3 status.

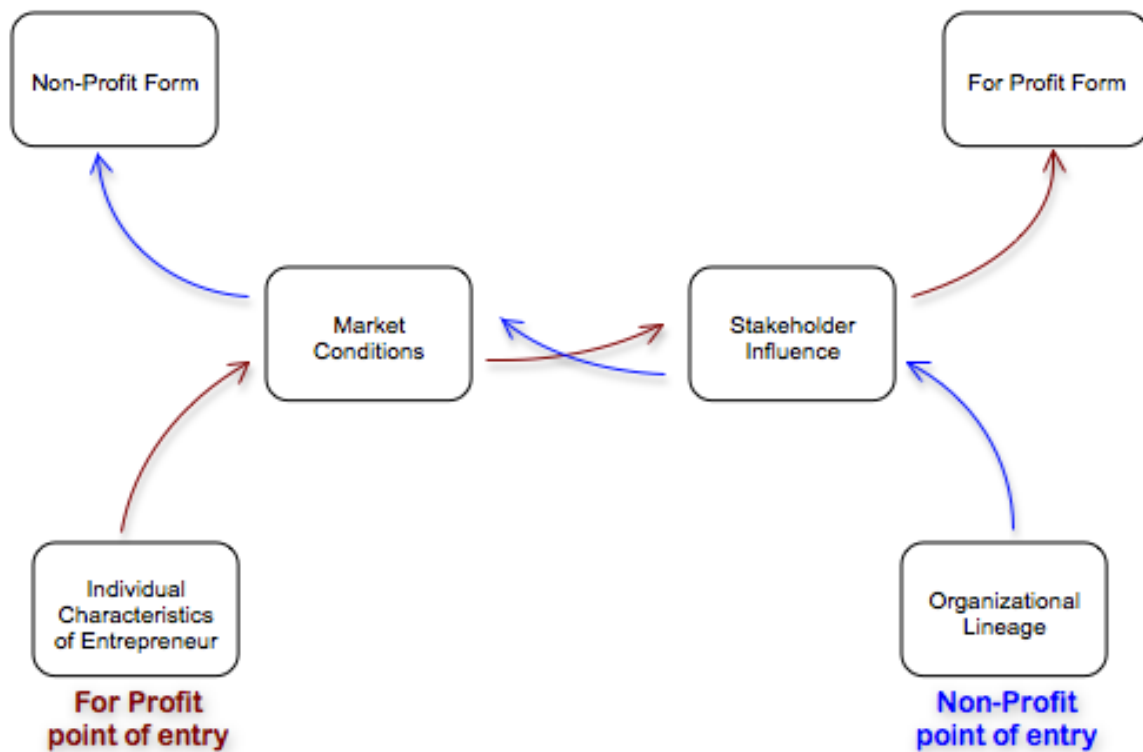
Conceptual Framework

The findings show not only that a sequential pathway toward sector selection exists, but also that the organizational form outcome depends on the point of entry along the path. Interestingly, non-profit and for-profit organizations experience these factors on competing pathways that exist in reverse sequential order. For the non-profit organizations that had a parent organization affiliation, the next step was to select an organizational form that would appeal to external stakeholders. Only then did the organizations assess the market conditions and determine that a profitable market did not exist, thus acquiring capital from grants to fund the enterprise. Because the non-profit social entrepreneurs only had non-profit experience, they placed the least priority on individual characteristics and the usage of existing skill sets to determine sectoral form. The non-profit social entrepreneurs did not mention anything about the lack of business skills or skills particularly relevant to the nonprofit sector as factors contributing to their choice of form. Having a specific skill set only seems to matter to the for-profit social entrepreneurs. In fact, the prior experiences of the for-profit social entrepreneurs served as the initial determinant of organizational form. The organizations then determined that their good or service could succeed in a consumer-based market. As the primary financial

stakeholders, the for-profit entrepreneurs placed little emphasis appealing to external stakeholders and identifying with a parent organization.

The factors of organizational lineage, stakeholder influence, market conditions, and individual characteristics interact in order of priority to affect sector outcomes. The factor that is initially prioritized by the social entrepreneur, or the point of entry along the pathway, determines whether the social entrepreneur will select a for-profit or non-profit legal form.

Figure 4



Discussion

Behavioral Responses to Sectoral Contradictions

Organizations often behaved in contradiction to the norms of their ascribed form, particularly in the areas of profit-maximization, cost-efficiency, and competitor

interaction. Furthermore, even if organizations initially selected a form that was not the best fit, entrepreneurs hesitated to pursue better alternatives. Legal forms allow audiences and stakeholders to make inferences about an organization's motives and behavior. The organizations in the study did not always adhere to the ascribed norms of the legal sector with which they were affiliated. Contradictions in cost-efficiency, competitor interactions, and success measurement resulted from conflicting logics and tensions between mission and profit.

For example, though it is incorporated as a for-profit organization and is expected to maximize profit and efficiency, Labor of Love prioritizes mission. To offer continuous job-training experiences for clients, Labor of Love provides digital scanning services for the consumer market. However, it is impossible for Labor of Love to run a competitive and cost-efficient business as long as the mission takes precedence:

"I could spend \$14,000 on a scanner that does everything, but then there would be no jobs for my clients. Sometimes there are things that are more expensive to do because you're doing them with people instead of robots or computers, but our mission is job training... Costco does videotapes. You take them in, drop them off at Costco, pick them up and it's all done. They have that. They just take their cassette, pop it in, push two buttons, they go off and do other stuff and a few minutes later it's done. They charge you \$19.99. In order to compete with them, we too have to charge \$19.99, but it costs me a whole lot more to do it because we're actually doing it manually, [rather] than have the computer do it all. The bottom line is people are being trained, they know how to do it. So if they wanted to get a job at Costco, they could go there and say I know how this works."- Beth, Founder

Although Weisbrod (1998) assumes that non-profit organizations are insulated from competitive pressures, the relationship between social enterprises and their market competitors is complex—especially for non-profit work-integrated social enterprises. Though their main goal is to prepare people for the workforce, they must also compete

with organizations in the same field. For Hope Bistro, Stan describes how this relationship affects their competitor interaction and marketing strategies:

“We don't do advertising because we're non-profit and we want to place people at other restaurants... Even though we are directly competitive with them, we don't want to have an adversary relationship. We want to have a collaborative relationship. A lot of how you advertise a restaurant is affected by that. That's actually why we don't advertise. Every other restaurant down here notices what the other one is saying in their advertisement, and where they're advertising and how much they're advertising. So we keep a very low profile that way.”-Stan, Manager

At times, organizations did not act in their best interest when it came to maintaining a form. After the initial selection of form, entrepreneurs continued with that form, even if it was detrimental to the organization. For example, Labor of Love is a for-profit organization, but feels the financial pressures of a social service agency:

“Just because you're incorporated as a for-profit doesn't mean there is one. It costs me more as a regular corporation to run the business than it does [non-profit organizations], some of the ones we work with, because I pay taxes and they don't. I think if I had it to do over, I might have made it into a not-for-profit. It would've been a lot cheaper, that's for sure. So you know, it is what it is. You just deal with it.”-Beth, Founder

What would becoming a non-profit organization mean for Labor of Love? From a financial standpoint, Labor of Love could benefit from the tax subsidies and volunteer labor that accompany a non-profit status. Also, a non-profit status would provide a renewed focus on the mission. One could say that by changing to a non-profit model, the distribution of profit would be constrained. In this particular case, however, the current operation of the company is barely profitable enough to make ends meet, so it is not a major concern. Labor of Love's story reflects one of path dependency, where historical decisions prevail, even if the circumstances surrounding the initial decision change and better alternatives are available (Arthur, 1989).

Rather than adopt a for-profit form, Double Take chose to close the organization because it could not sustain the thrift (donation only) form. Josannah explains how remaining as a non-profit would lead to an inevitable store closure:

“Should we have started as a for-profit? Well, we could have. If we would have started as a for-profit, we wouldn't have been having to worry about the consignment part. And we could've switched over to a for-profit in the end...But we didn't... We got rid of the consignment in the final months. We had to. So we ended up with just donations. We had done that before so we knew what was going to happen. We were right.” –Josannah, Founder

To maintain the profitable consignment model, Double Take would have had to adopt a for-profit form. Their short-lived experience with consignment revealed that it adequately sustained the enterprise and their income greatly exceeded their expenditures, resulting in substantial financial profit. Instead, Double Take applied for grant funding to eliminate their greatest expense, commercial rent, and purchase their own building. They were unsuccessful in that attempt. Adopting a for-profit model would have eliminated the constraints that prevented Double Take from operating a consignment enterprise, increasing the chances of sustainable funds for the foundation. As a for-profit organization, Double Take would have to redistribute the assets of the non-profit, and would lose the 501c3 status and tax subsidies. Apart from the potential loss of its benefits, a major concern for Double Take was the loss of its altruistic identity—the Double Take “brand”:

“People liked [our store] because we were clearly non-profit. They liked the idea of it. The idea that maybe they were helping--maybe they were getting a really nice shirt, but they were also contributing to something bigger.” –Josannah, Founder

Brand and organizational loyalty was not uncommon among social entrepreneurs. Both the owner and the lead manager at Dress for Effect have small tattoos of the store’s logo.

When anticipating the trajectory of his career at Hope Bistro, a manager responded,

“They will bury me. That's when I'll leave.” Thus, the investment of people in their organization often goes beyond the rational and the enterprise becomes part of their identity, even if it is to their detriment in the long run.

Conclusion

This comparative case analysis has several implications. Though sector selection is often thought of as a primary choice, the cases show that waiting to choose a legal form may be a better, practical solution. Operating a social enterprise without formally declaring the legal form allows the entrepreneur to have a better understanding of the direction of the social enterprise—affording him or her the opportunity to better assess the proper sectoral placement of the organization. Likewise, delaying sector selection may be fundamentally advantageous in avoiding being ‘stuck’ in the wrong sector.

In this paper, I do not attempt to make widespread generalizations about social enterprises, but rather I reflect the realities and dilemmas of the four social enterprises in the study. Without a true position in the organizational field, social entrepreneurs must draw upon elements within the organizational environment in order to situate themselves. For social enterprises, selecting a legal form is analogous to fitting the idiomatic square peg in a round hole. The conceptual framework presented in this paper reveals specific routes for entrepreneurs as they prioritize various elements, which serve as points of entry on the path of sector selection.

Further research is needed on newly emerging forms designed to bridge a gap between the nonprofit and for-profit sectors, as well as the sector selection process and the benefits and consequences of associated with these hybrid forms. As the social

enterprise sector continues to expand, traditional organizational forms may become a thing of the past.

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Appendix A: Interview Questionnaire

A. Idea/Concept

1. Please describe the natural history of _____.
 - When was _____ founded?
 - Who founded it?
 - How did the idea come about?
 - Who was responsible for the idea?
 - How was the idea launched?
 - How was the idea financed?
 - Were there any other organizations involved in the establishment of _____?

2. Tell me about yourself.
 - What is your educational background?
 - What was your occupation prior to the founding of _____?
 - What is your current role in _____?
 - Did you have any previous experiences that contributed to your role in the establishment of _____?

3. What is unique about _____?
 - Is it technically *what* you do or *how* do you administer it?

4. What is the mission of the organization?
 - What exactly are you doing?
 - Who does _____ seek to help?
 - Is there a mission statement?
 - What are your goals for the year?
 - What are your operational goals?
 - How are you going to achieve these goals?

B. Development and Launch

1. What type of organization is _____?
 - a non-profit, a for-profit, or a governmental organization?
 - Does _____ have 501(c)3 status?
 - Is it a standalone or a subsidiary of another organization?
 - What was the reason for choosing this status?
 - Has the organization run into any issues with the _____ status?
 - If you could go back in time, would you select the same status?
 - Have you had any prior experience with organizations of this status?

2. Is _____ based on any other models?
 - If so, how are they similar?
 - If so, how do they differ?

3. How are the current operations at _____ primarily funded?

- Grants? Donations? Financial profit?
- Is it the same as the initial funding?

C. Organization of Enterprise

1. Since the launch of _____, how has it expanded?
2. Describe an average day at work for an employee of _____.
3. How would you describe the structure of _____?
 - Who governs the organization? Board of Directors? CEO?
 - Tall or flat?
 - Centralized or decentralized?
 - How are tasks delegate/distributed throughout _____?
4. Have there been any changes in the structure or status of _____ since it was established?
5. How is success measured?
6. What are the consequences of failure?

D. Organizational Environment

1. Who are the key stakeholders?
 - Customers, donors, employees, regulators, clients, board of directors?
2. Who are your current investors?
 - How much power do they have over organizational decisions?
3. Here's a list of stakeholders:
 - Customers
 - Donors
 - Employees
 - Managers
 - Regulators
 - Clients
 - Board of Directors
 - Investor

Which one is most likely to solve the problem if something goes wrong?