



REID AND RIEGE, P.C.

NONPROFIT ORGANIZATION REPORT - SPRING 2009
SPECIAL SUPPLEMENT

Reid and Riege, P.C. - 2009 - © ALL RIGHTS RESERVED

Social Entrepreneurship: When Worlds Collide or the Best of Both?

During his campaign President Obama promised to create a network of nonprofit “social entrepreneurs” to tackle the nation’s social welfare problems. This promise was fulfilled by the recent enactment of the Edward M. Kennedy Serve America Act which, in addition to its many volunteer initiatives, creates the Social Innovation Funds Pilot Program. This Program commits \$360 million of federal money (to be matched from other sources) to nonprofit organizations which meet two criteria.

The first is mission related – the Program only funds nonprofits working on specified social welfare issues including elementary and secondary education, child development, poverty and crime. There is not much new here, as nonprofit organizations have historically been one of the major devices used in America to address these issues. The second criterion is that the nonprofits applying for these funds must follow social entrepreneurship operating principles. While social entrepreneurship has been a part of the nonprofit lexicon for several years, and has gained recognition worldwide, its newfound prominence as part of the Act justifies critical analysis.

The basic principle underlying the concept of social entrepreneurship is easy to articulate: harnessing the creativity and drive that motivate for-profit business entrepreneurs and applying them to social welfare problems will yield measurable and better outcomes.

Perhaps the best example of the successful application of this thinking is the use of “micro-lending” to combat poverty. The 2006 Nobel Peace Prize was awarded to Bangladeshi economist Muhammad Yunus and his Grameen Bank. The bank has disbursed loans averaging less than \$100 each to over six million borrowers. The concept is intuitively simple – an impoverished woman is loaned \$50 to buy chickens so she can sell eggs – and as the chickens breed she has more eggs and then chickens to sell and a route to increase her standard of living. The heart of the transaction is the obligation to repay the loan – which (unlike handouts) affirms the dignity of the borrower – who is entrusted with the obligation to repay so that the funds can be used to help others.

While social entrepreneurship has achieved significant traction (an internet search identifies the many books, articles, college courses, seminars and associations dedicated to the concept) and some bona fide success, if one drills down below the basic operating principle cited above things become murkier. At this deeper level one is left with the impression that while there is much good here that deserves support, the concept is still largely a grab bag of disparate ideas in search of definition and common ground. This point is demonstrated by a search of the numerous writings on the topic.

The web-based Free Management Library defines a social enterprise as “an organization or venture that advances its social mission through entrepreneurial, earned income strategies.” The Social Enterprise Alliance (an association of social entrepreneurs) has a somewhat different take, stating that the movement includes both “nonprofits that use business models to pursue their mission” and “for-profits whose primary purposes are social,” while acknowledging the criticism that nonprofit attempts to run income producing businesses often lead to frustration and failure. Ashoka (a global organization of social entrepreneurs) uses language that is as inspirational as it is rhetorical: “[s]ocial entrepreneurs are individuals with innovative solutions to society’s most pressing social problems...[who] find what is not working and solve the problem by changing the system, spreading the solution, and persuading entire societies to take new leaps.” A Spring 2007 article in the *Stanford Social Innovation Review* (“*Social Entrepreneurship: The Case for Definition*”), notes that “[a]lthough the potential benefits offered by

social entrepreneurship are clear to many of those promoting and funding these activities, the actual definition of what social entrepreneurs do to produce this order of magnitude return is less clear,” and that “social entrepreneurship has become an immense tent into which all manner of socially beneficial activities fit.”

If we push the analysis even deeper it becomes clear that the movement germinated in the frustration with the lack of success the traditional nonprofit operating model has had in dealing with social problems (that have proven to be intractable); and perhaps even more so in dissatisfaction with the bifurcation of private associations (non-governmental entities) between those whose purpose is to create wealth for their owners and those whose mission is to advance the “common good” with wealth given to them. Evidence of this point is found in the emergence of “hybrid” entities – so called “B Corporations” or “L3Cs” (low profit limited liability companies). These entities issue shares to private owners who expect a return on investment – but have governance provisions committing the entity to socially “good things” as well – which invariably will reduce the return on equity. The gambit here is that investors will accept the lower return because they also support the mission.

To its enthusiastic proponents, social entrepreneurship is a formula with world-changing potential. Its detractors believe that the tension between the drive to make a profit (the entrepreneurship part) and the seemingly bottomless problems of the human condition (the social part) makes co-existence under the same tent impossible in the long run. However, if we step back from the depths of the detail and take a bird’s eye view, the image that comes into focus is the impression we started with – there is much good here that deserves support – but with a few caveats.

First, social entrepreneurs should temper their enthusiasm, critics should park their cynicism at the door, and both should recognize this as an experiment worthy of pursuit but not a sure thing. Second, the law usually plays catch-up to social change, and that is certainly the case here as to the law of charitable entities. Hybrid organizations are a round peg to the law’s square hole – and legal reform will be needed if this experiment is to work. Finally, the biggest obstacle to success may be the historic prejudice against commercial activity in parts of the exempt sector – the notion that profit always comes at the expense of virtue. Medieval thinkers believed that the amount of wealth in the world was finite such that one person’s profit could only come from another person’s loss. Wealth creation is not a zero sum game, and the nonprofit world would be a lonely place without someone making a profit. If nonprofits can figure out a way to make a few bucks while making the world a better place everyone will be better off in the long run.

The Reid and Riege Nonprofit Organization Report is a quarterly publication of Reid and Riege, P.C. It is designed to provide nonprofit clients and others with a summary of state and federal legal developments which may be of interest or helpful to them.

This Special Supplement of the Nonprofit Organization Report was written by John M. (Jack) Horak, Chair of the Nonprofit Organizations Practice Group at Reid and Riege, P.C., which handles tax, corporate, fiduciary, financial, employment, and regulatory issues for nonprofit organizations. While this supplement provides readers with information on recent developments which may affect them, they are urged not to act on this report without consultation with their counsel. For information or additional copies of this supplement, or to be placed on our mailing list, please contact Carrie L. Samperi at 860-240-1007 or info@reidandriege.com, or other members of Reid and Riege, P.C., One Financial Plaza, Hartford, CT 06103. For other information regarding Reid and Riege, P.C., please visit our website at www.reidandriege.com.