THE SUSTAINABILITY OF SOCIAL ENTERPRISES: HOW HYBRID BUSINESSES CAN IMPROVE SOCIETY WHILE ALSO BECOMING FINANCIALLY INDEPENDENT

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Abstract

Given that financial constraints often stifle the impact of nonprofits, some social organizations have started to incorporate commercial aspects to avoid financial dependence. Such social enterprises innovatively combat global problems by fusing market-based strategies and philanthropic structures. Although its potential is uncontested, the social enterprise field is still relatively young and, to date, few hybrid companies have been effectively scaled. Specifically, social businesses face the unique challenge of operating in an interim sector with limited infrastructure development. This thesis investigates the sustainability of social enterprises by isolating specific variables associated with organizational success. This dissertation empirically tests for the correlation between financial health and access to leverage, use of a market-based strategy, board size, inclusion of women on the board, and business background of board members. This research also draws from interviews with prominent social entrepreneurs to elaborate on additional factors related to sustainability, such as strategic allocation of value to stakeholders, transparency of vision, brand development, and the organizational structure of the company. Overall, this thesis finds that board size is inversely correlated with financial success and demonstrates how cause-driven businesses can utilize stakeholder research to develop a competitive advantage.

KEYWORDS: (social enterprise, non-governmental organization, cause-driven business, financial sustainability, stakeholder research, board of directors, Abraham Path Initiative)

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CHAPTER I

INTRODUCTION

This introduction presents a brief background of the social business field, which is comprised of hybrid companies that utilize commercial strategies to address global issues in an innovative way. This chapter also underscores the significance of this study for the evolution of academic research and the development of additional social enterprises. The overview section elucidates the motivation for this thesis, which is to unearth specific determinants of financial sustainability in the context of the social enterprise. Finally, this section briefly depicts the ensuing chapters.

Background

As businesses are increasingly expected to include a greater environmental and social regard, old paradigms are giving way to more responsible conducts in the commercial world. The concept of corporate social responsibility, for example, has become ever more imperative as firms expand their engagements in society and realize the importance of building a positive image. Many companies also reap the benefits of cause marketing whereby businesses establish strategic partnerships with respectable nonprofit organizations to achieve specific objectives such as "positioning their products, motivating their employees and improving their public relations, by associating themselves with charitable causes."[1] In addition, socially responsible investment (SRI) is thriving in recent years as demonstrated by the 2010 European Sustainable Investment Forum Study, which shows that European SRI increased by 87% in two years and reached an astounding five trillion euros.[2] A similar trend can be seen in the United States as the Social Investment Forum estimates that one in eight professionally-managed U.S. dollars is invested according to SRI protocols. These examples demonstrate that the business world is increasingly balancing the necessity to maximize profits with the understanding that companies possess an essential role in preserving the environment and assisting society.

Even with the gradual rise of social conscientiousness, some argue that the dawning corporate notion of "profits with principles" does not sufficiently address the severity of current worldwide issues.[3] Although its numerous advantages are evident, "free-market capitalism, celebrating individualism, consumerism and excessive insatiable acquisitiveness, not only creates a yawning gap between the rich and poor but it also threatens ecological sustainability and human well-being."[4] While businesses are becoming greener, the reality is that some of the most egregious global problems such as poverty, warfare, pollution, deforestation, and global warming still continue to proliferate.

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[1] Gordon Shockley, Peter Frank and Roger Stough, *Non-market Entrepreneurship: Interdisciplinary Approaches* (Massachusetts: Edward Elgar Publishing Inc., 2008), 178.

[2] Thomas Friemel, "Sustainable Investment," *Enorm*, (2010): 9.

[3] Alexander Schieffer and Ronnie Lessem, "Beyond Social and Private Enterprise: Towards the Integrated Enterprise," *Transition Studies Review* (2008): 713-725.

[4] Ray Hudson, "Life on the edge: navigating the competitive tensions between the 'social' and the 'economic' in the social economy and in its relations to the mainstream," *Journal of Economic Geography* (2009): 494.

Meanwhile, governmental institutions and nonprofit organizations, which are generally the agencies that attempt to fulfill the role of promoting positive global change, often face severe financial pressure that stifles their operations. Although more than 1.5 million nonprofits operate in the U.S. alone,[5] many of them are extremely inefficient because, ironically, charitable foundations are often as reliant financially as the very marginalized groups that they intend to assist. Funding issues stem in part from the fact that non-governmental organizations (NGOs) must often pay high costs to attain capital from foundations and corporations. McKinsey & Company contends that NGOs spend anywhere from 25% to 40% of the acquired funds on grant-writing procedures and fundraising expenses compared to the typical 2% to 5% that for-profits pay for their revenue.[6] In addition, Muhammad Yunus, a renowned social activist, claims that eleemosynary motives in the public sector are often tainted with the intent of using "charity to avoid recognizing the problem and finding a solution for it. [Charity] appeases our consciences."[7] NGO expert Linda Polman takes an even more radical stance regarding philanthropic work as she claims that humanitarian aid actually finances war. Polman's research determines that some nonprofits ineffectually manage funds that eventually trickle through various sub-organizations and often end up in the pockets of corrupt warlords.[8] Ultimately, although being especially adept at gathering a

[5] Beth Kanter and Allison Fine, *The Networked Nonprofit* (San Francisco: Jossey-Bass, 2010), 11.

[6] Bill Drayton and Valeria Budinich, "A New Alliance for Global Change," *Harvard Business Review*, (2010): 5.

[7] Muhammad Yunus, *Banker to the Poor: Micro-lending and the Battle Against World Poverty* (New York: Public Affairs, 1999), 249.

[8] Marc Winkelmann, "They are poor, not stupid," *Enorm*, (2010): 46-49.

plethora of passionate volunteers working together for human progress, many of the nonprofits that exist across the world are often inefficient and understaffed.[9]

The limitations of the public sector and the increased social awareness of the private sector are giving rise to a new form of business—one that fuses both commercial and philanthropic structures. Various hybrid companies—formally known as social enterprises—have emerged in recent decades and offer the possibility of obtaining the advantages from both corporations and philanthropic institutions: "businesses offer scale, expertise in manufacturing and operations, and financing [while] organizations contribute lower costs, strong social networks, and deep insights into customer and communities."[10] Overall, social entrepreneurs first measure their companies' impact on people or the environment and, secondly, the amount of profit obtained in a given period. In terms of funding, social enterprises differentiate themselves from nonprofits in that they derive part of their revenue through product sales. They do, however, also employ the traditional public sector's financial strategies of receiving donations, grants, contracts, corporate sponsorships, and sponsoring auctions, special events, and workshops. In such cause-driven businesses, owners can gradually recover the money invested but cannot receive additional dividends, while investors seek social returns rather than monetary gains.

Social businesses have been particularly successful when accounting for the often disregarded low-income customer. Dissolving the once rigid boundaries of philanthropy and enterprise, social entrepreneurs look for innovative ways of applying market-based strategies to achieve the triple bottom line of social, environmental and

[9] Ibid.

[10] Drayton and Budinich, 1-2.

financial advancement. This powerful combination has the possibility of mending market imperfections that neither the private nor public sectors are able to address. An estimated four billion people, for example, are not yet included in the world's formal economy.[11] This staggering figure is largely a consequence of for-profits' preconception that serving the low-income consumer is not a cost-effective strategy. Innovative companies that have taken the initiative to integrate low-income consumers into their business models have reaped the benefits of accessing the more than six trillion dollars contained at the bottom of the world's economic pyramid.[12]

Such social enterprises are able to transform under-developed or non-existent markets into lucrative businesses opportunities, especially because of the first mover advantages that they obtain.[13] The Grameen Bank, for example, a microfinance company extending loans to poor Bangladeshi citizens, is one of the most prominent social enterprises and one of the first of its kind to attain financial sustainability. Although Muhammad Yunus, Grameen Bank's founder, did not initially intend it, the organization became self-sustaining because Yunus wanted to improve the bank's access to the capital market and avoid the policy prescriptions of donors.[14] Today, the company sustains itself through interest payments from customers as well as donations.

Meanwhile, Colcerámica, one of the largest building-materials retailers in South America, partnered with Kairos, a nonprofit committed to helping citizens who are displaced by armed conflict, to start a social enterprise called Viste Tu Casa (Dress your

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[11] Ibid.

[12] Drayton and Budinich, 4.

[13] Winkelmann, 45.

[14] Muhammad Yunus and A. Jolis, *Banker to the Poor—The Autobiography of Muhammad Yunus, Founder of the Grameen Bank* (London: Aurum, 1998), 169.

Home). Selling low-cost ceramics and home products, the initiative seeks to improve living conditions for the one billion people around the world who live in slums and squatter towns and are consequently excluded from the formal housing market. Viste Tu Casa's strength arises from its hybrid value chain, which draws from Colcerámica's business expertise such as sales and marketing and Kairos' knowledge about local communities.

Moreover, the social business Newman's Own, founded by actor Paul Newman in 1982, receives a majority of its profits from product sales such as salad dressing and donates 100% of the proceeds, after taxes, to various educational, religious and ecological causes.[15] The organization has provided over $300 million to charity. Another highly influential social business, Bead for Life, eradicates extreme poverty in Africa by assisting Ugandan women in turning colorful recycled paper into beautiful jewelry that is sold all over the world. Unlike traditional charities, Bead for Life empowers impoverished people to start their own companies and gain economic independence rather than relying on recurring donations.

While until recently many of these exemplary social businesses were conceived without the assistance of formal institutions, social entrepreneurs are now beginning to unite brilliant people, original ideas, philanthropic organizations, and for-profit corporations to galvanize larger, bolder initiatives. For the past two years, for example, the Global Social Business Summit (GSBS) has provided an annual, interactive forum for participants to elaborate on new undertakings ranging from microcredit, nutrition, and access to water to post-crisis rebuilding, empowerment of women, and healthcare. The efforts at GSBS culminated in several new social ventures:

[15] *Newman's Own* (2011): available online at http://www.newmansown.com.

> We have started to solve various problems. We've created an eyecare hospital, a nursing college, a joint venture with Danone in which we produce a specifically designed yogurt for undernourished children. We've also created a joint venture with Viola to bring clean water to villages. BASF produces mosquito nets, Adidas is designing a shoe for people who have never worn a shoe before. [16]

In addition to the efforts of GSBS, Ashoka, a leading cause-driven venture, has worked to build sector infrastructure to support the growth of the field by providing "seed financing and capital, bridges to the business and academic sectors, and strategic partnerships that deliver social and financial value."[17] These examples demonstrate that entrepreneurs, organizations, and companies from all walks of life are displaying interest in socially responsible business conducts.

Governments have also legitimized the sector as countries such as the United States, Belgium, Italy, and the United Kingdom, have enacted appropriate legislation to allow for the formation of new social purpose organizations. In the United States, Robert Lang, a New York-based CEO created the concept of a low-profit, limited-liability company (L3C), which is described as "the for-profit with a nonprofit soul."[18] In the United Kingdom, the Social Enterprise Coalition, founded in 2002, functions as an umbrella association that spawns social businesses.[19]

While the potential of social business is uncontested, the field is still in its relative infancy, and various gaps in the research still remain. Currently, the academic world primarily describes successful initiatives, legitimizes the field, provides a framework through which an abundance of intellectual questions motivate further

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[16] Thomas Friemel, "The seed is planted," *Enorm*, (2010): 14-17.

[17] Ashoka: Innovators for the Public, *Build Sector Infrastructure* (2011): available online at http://www.ashoka.org/build.

[18] Erin Shaver, "L3C: Beyond Greenwashing," *Denver Magazine* (2010): available online at http://www.denvermagazine.com/December-2010/L3C/

[19] Julia Grosse, "Working for Change," *Enorm*, (2010): 32.

exploration, and unifies conceptual fragments that prepare this area of study for holistic theoretical encapsulation. Most studies, however, center on community development in the U.S., Canada and the U.K[20] instead of focusing on impoverished countries that presumably need the most help. In addition, perhaps the greatest shortcoming is that, beyond microfinance, few large-scale success stories of enterprising social innovations exist.[21] This is partly explained by the fact that social businesses often lack a commercial perspective and are often characterized by conflicting priorities.[22]

Overview

To address the issue of sustainability in the social enterprise field, this thesis isolates various determinants of financial success. Specifically, this research empirically tests for the relationship between financial health (Y) of various social enterprises with international operations and access to leverage (X_1), use of a market-based strategy (X_2), board size (X_3), inclusion of women on the board (X_4), and business background of board members (X_5). The author contends that organizations that include a large number of board members with business backgrounds, employ a greater commercial component such as debt to scale operations, and trade goods or services to generate revenues obtain greater economic returns. In addition, the inclusion of women on the board is hypothesized to increase financial success, while larger boards are believed to negatively affect the dependent variable. Moreover, in a

[20] Johanna Mair and Ignasi Marti, "Social Entrepreneurship Research: A Source of Explanation, Prediction, and Delight," *Journal of Business,* (2006): 36-44.

[21] J. Dees and Beth Anderson, "Framing a Theory of Social Entrepreneurship: Building on Two Schools of Practice and Thought," ARNOVA Occasional Paper Series, Vol 1, No. 3 (2006): 39-66.

[22] Elizabeth Chell, "Social Enterprise and Entrepreneurship: Towards a Convergent Theory of the Entrepreneurial Process," *International Small Business Journal*, Vol 25, No. 1 (2007): 12.

pragmatic case-study, this thesis demonstrates how social businesses can strategically provide value to pertinent stakeholders to develop a competitive advantage. Finally, interviews with prominent social entrepreneurs provide insights into additional variables that such organizations can incorporate to develop initiatives that are both high-impact and sustainable.

The theory chapter illustrates the frameworks that scholars have devised to conceptualize the social enterprise field. Many of these theories demonstrate the various arrangements that cause-driven businesses encompass, ranging from quasi-charitable to nearly commercial structures. Research provides few guidelines, however, regarding the optimal balance between both extremes. The chapter also underscores stakeholder theory of governance as an essential element for organizational sustainability, because it provides social entrepreneurs a potential source of competitive advantage.

The literature review (Chapter III) provides a discourse on the concepts of social enterprise and sustainability. The chapter presents relevant research regarding the manner in which hybrid businesses achieve financial independence based on the advantages their unique status imparts. The author also analyzes studies that determine the effects of board constitution on the economic health of companies as well as additional variables that scholars attribute to social entrepreneurial success.

Furthermore, the data and methodology chapter elucidates the empirical protocol that this thesis utilizes. The chapter describes the individual variables, the target population, and data collection, and justifies the use of a mixed methodology that draws from both quantitative and qualitative analyses. The quantitative portion employs a regression analysis to determine the correlation between the dependent and independent variables, while the qualitative section utilizes interviews with social entrepreneurs to illustrate the significance of stakeholder theory to the field. The disclosure of the data collection and analysis processes intends not only to validate the findings of this study, but also allow future research to elaborate on the results of this thesis.

Lastly, the results and analysis chapter presents the findings of the ordinary least squares regression and the consequent implications. The author also provides a pragmatic example of how a particular social enterprise, the Abraham Path Initiative, is in the process of developing a competitive advantage by strategically accounting for stakeholders. The example illustrates how other hybrid businesses can become financially sustainable in a cost-effective manner. The chapter ends with a discourse on additional variables that further studies can test empirically.

CHAPTER II

THEORY

Social entrepreneurship has attracted a considerable amount of scholarly attention and is now acknowledged as an important field of economic research.[1] A significant point of contention in the literature is that social entrepreneurship is an important catalytic phenomenon that is essential in creating new forms of activity in all parts of the economy.[2] While researchers have taken considerable steps in legitimizing social enterprise, the field is still young and requires further empirical testing and theoretical encapsulation. Scholars have applied different theoretical strands to diverse social entrepreneurial manifestations but, currently, the field as a whole can only be comprehended in a piecemeal fashion. This chapter takes a closer look at the general social sector and positions social enterprises in the context of other types of social organizations. Next, this section analyzes tentative social enterprise frameworks and examines various relevant governance theories that support the contention that the successful enterprising of social businesses is contingent on particular attributes of their boards of directors and the utilization of specific funding strategies.

[1] Paul Light, "Searching for Social Entrepreneurs: Who They Might Be, Where They Might Be Found, What They Do," ARNOVA Occasional Paper Series, Vol 1, No. 3 (2006): 13-37.

[2] J. Dees and Beth Anderson, "Framing a Theory of Social Entrepreneurship: Building on Two Schools of Practice and Thought," ARNOVA Occasional Paper Series, Vol 1, No. 3 (2006): 39-66.

The Optimal Positioning of Social Enterprises

The inherent complexity and vastness of the social sector makes it essential for managers and directors to understand thoroughly their organization's unique position and structure in relation to other institutions. Unlike the private sector where leaders tend to situate firms in more concrete industries and seek to maximize profits accordingly, social organizations have inherently broader factors to consider and must devise appropriate methods through which financial sustainability can be achieved. Acclaimed author Jim Collins's Economic Engine in the Social Sectors table allows for a comparative analysis of different social organizations and their various financial positioning strategies:

TABLE 2.1: Economic Engine in the Social Sectors

High *Depend Upon Charitable Donations & Private Grants*	American Cancer Society Special Olympics **II** Small Local Church Nature Conservancy Teach for America	**III** Mega Church Girl Scouts Local Council NYC Opera Share our Strength Harvard College Private
Low	Boys & Girls Clubs **I** Charter Schools K-12 Public Schools NASA EPA NYPD	**IV** Schools Mayo Clinic Red Cross Goodwill Industries Northwestern Memorial Hospital UC Berkeley
	Low *Depend Upon Business Revenues*	*High*

The first and second quadrants of Table 2.1[3] illustrate organizations that are typically associated with the traditional non-profit sector. The first quadrant is comprised of institutions that predominantly rely on governmental funding such as NASA and charter schools because they are unable to generate different forms of revenue. In this case, sustainability depends on the ability to obtain the support of public and political institutions. The second quadrant is composed of local churches and the American Cancer Society, for example, which fund themselves primarily through charitable donations from private individuals. These require excellent personal relationships and fundraising expertise. The third and most economically optimal quadrant is characterized by social enterprises that obtain funds both through charitable support and market-based strategies such as through the sale of Girl Scout cookies or opera tickets. These social ventures require extreme business and fundraising prudence. Finally, the fourth quadrant most closely resembles for-profit businesses because of the low reliance on charitable donations and the ability to raise revenue through the provision of products (i.e., Goodwill Industries' use of thrift stores), services (i.e., nonprofit hospitals), tuition (i.e., private schools) and so forth. The large scope of the social organizations encompassed in the table demonstrates the diverse nature of the social sector and underscores the development of a coherent governance and sustainability strategy that accounts for the enterprise's unique position vis-à-vis competitors.

Social enterprises, as illustrated in Table 2.1, require especially complex structures because of their unique characteristic of blending commercial and charitable

[3] Jim Collins, *Good to Great and the Social Sectors* (Boulder: Jim Collins, 2005), 21.

aspects. Table 2.2[4] provides a general overview of these hybrid organizations relative to purely charitable and commercial ventures. The table also illustrates that today's economy increasingly blurs the dichotomy between charity and commerce as the private sector seeks to include corporate social responsibility and public services utilize market-based strategies in their operations.[5]

TABLE 2.2: Social Enterprise Spectrum

	PURELY CHARITABLE		**PURELY COMMERCIAL**
Motives, Methods & Goals	Appeal to goodwill; mission-driven; Social value creation	Mixed motives; Balance of mission+market; social+economic value	Appeal to self-interest; market-driven; economic value creation
Key Stakeholders			
Targeted Customers	Pay nothing	Subsidized rates, and/or mix of full payers and those who pay nothing	Pay full market rates
Capital Providers	Donations and grants	Below-market capital and/or mix of donations and market rates capital	Market rate capital
Work Force	Volunteers	Below-market wages and/or mix of volunteers and fully paid staff	Market rate compensation
Suppliers	Make in-kind donations	Special discounts and/or mix of in-kind and full price	Charge full market price

This spectrum depicts the full business model range that entrepreneurs can select, ranging from the mostly altruistic and affiliative motives of philanthropy to the self-

[4] J. Gregory Dees, "Enterprising Nonprofits," *Harvard Business Review*, Vol 76, No. 1 (1998): 55-66.

[5] J. Gregory Dees and Jaan Elias, "The Challenges of Combining Social and Commercial Enterprise," *Business Ethics Quarterly*, Vol 8, (1998): 165-178, 167.

interested and wealth maximizing objectives of for-profits. On the left are purely charitable organizations that seek to better society and rely on donations for capital and operating expenses, use volunteers as a source of labor, and give away products. On the right are purely commercial enterprises that look to generate economic wealth, buy and sell goods in established markets and hire employees through labor markets. The idea is not to view businesses as a dichotomy of two types, but rather as a continuum. While most public and private companies function somewhere inside this continuum, social enterprises are unique in the sense that their mixed structure is comprised of sub-units that rest at different points on the spectrum.[6]

Balancing social and business structures into the organization's profile is a considerable challenge. While Table 2.2 captures the essence of social entrepreneurship, it does not offer guidelines whereby the optimal convergence point is found. The research of Mair and Marti suggests that set-up choice is contingent on the nature of the social needs addressed, the amount of resources needed, the scope for capturing value, and the ability to raise capital.[7] Hudson proposes that social entrepreneurs create more business-like ventures and utilize established markets to scale their endeavors.[8] At the same time, Weisbrod suggests that social enterprises also face the danger of becoming too commercial.[9] One implication is the possibility of incurring

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[6] Dees and Elias, 176.

[7] Johanna Mair and Ignasi Marti, "Social Entrepreneurship Research: A Source of Explanation, Prediction, and Delight," *Journal of Business* (2006) 36-44.

[8] Ray Hudson, "Life on the edge: navigating the competitive tensions between the 'social' and the 'economic' in the social economy and in its relations to the mainstream," *Journal of Economic Geography*, Vol. 9 (2009): 501.

[9] Burton Weisbrod, "The Pitfalls of Profits," *Stanford Social Innovation Review* (2004): 40-47.

a "mission-drift" whereby the emphasis of commercialized non-profits on revenue accrual undermines the original social mission.[10]

Scholars regard the optimal positioning and equilibrium of social enterprises as an important topic of academic research. In a tentative unification of the field, Young[11] applies a supply and demand framework as an explanation of the social enterprise "market." The demand for social enterprise includes individual consumers who prefer to endorse socially oriented organizations, governmental institutions looking for more efficient ways of addressing public goals, and for-profit corporations that seek to obtain competitive advantages through philanthropic associations. Meanwhile, the supply side is comprised of entrepreneurs who look to make a good living while also contributing to society, paid and pro bono volunteers who are motivated at least in part by nonmaterial motives (i.e., satisfaction of improving society, recognition, altruism, on-the-job training and so forth), and capital providers seeking to invest in socially responsible endeavors. One of the implications of the supply and demand framework of social enterprise is that there are two distinct routes towards the emergence of social ventures. In Europe, social enterprise appears to be demand-driven because initiatives often start through governmental incentives, which in turn creates new opportunities for the private sector. In contrast, social enterprise in the U.S. appears to be galvanized by the supply side since social economic innovations tend to start through private efforts.[12]

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[10] Burton Weisbrod, ed., *To Profit or Not to Profit* (New York: Cambridge University Press, 1998), 271-285.

[11] Dennis Young, "A Unified Theory of Social Enterprise," Georgia State University Nonprofit Studies Program (2007): 1-23.

[12] Young, 12.

Governance Theories Applied to Social Enterprises

Although scholars have applied many tentative frameworks to the field of social enterprise, most are primarily descriptive and often lack pragmatism. The study of social entrepreneurial governance, on the other hand, provides key insights through the analysis of different managerial strategies in relation to overall firm performance. The unique characteristics of social enterprises require managers and directors to consider an array of factors. Scholars have applied the comprehensive body of governance theory specifically to social enterprises in an attempt to devise optimal managing approaches. When referring to for-profits, corporate governance is defined as a "set of relationships between a company's management, its Board, its shareholders and other stakeholders […] also providing the structure through which the objectives of the company are set, and the means of attaining those objectives."[13] While this generic description also applies to social enterprise, governance becomes more complex because instead of merely maximizing returns to shareholders, social enterprises must often accomplish the triple bottom line of social, environmental and financial success. Social entrepreneurial governance is further complicated by the fact that managers and directors require both commercial and non-profit experience, donors expect concrete evidence of socio-environmental impact, investors anticipate economic and/or social returns on investment, and a broader group of stakeholders must frequently be considered and managed.

One relevant managerial framework is the stakeholder theory of governance. This theory asserts that high firm performance can be achieved through the strategic allocation of value to a broad network of stakeholders. This concept counters the short-

[13] *OECD Principles of Corporate Governance* (Paris: OECD Publications, 2004), 1-66.

term approach of solely looking to maximize profit for the company and returns to shareholders. Encompassing a greater network of individuals and organizations, stakeholders are "any identifiable group or individual who can affect the achievement of an organization's objectives, or who is affected by the achievement of an organization's objectives."[14] Although this common definition has been severely criticized for its ambiguity,[15] it underscores the importance of allocating greater value to a broader constituency than the minimum required simply to maintain the willful participation of stakeholders. Firms that engage in such a strategy do so because of economic advantages incurred, altruistic or moral motives to build strong relationships, or both.[16]

Meanwhile, Garvare and Johansson propose a more specific definition by denominating primary stakeholders as "actors that: (i) provide essential means of support required by an organization; and (ii) could withdraw their support if their wants or expectations are not met, thus causing the organization to fail, or inflicting unacceptable levels of damage."[17] This narrowed approach distinguishes between primary and secondary stakeholders to whom businesses can distribute value correspondingly and diminishes the possibility of over-allocating goods, time and money. A pragmatic example of a company that takes this theory into account is a coffee house chain that decides to pay for additional worker benefits and above-market

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[14] R. Freeman and D. Reed, "Stockholders and stakeholders: a new perspective on corporate governance," *California Management Review*, Vol 25 (1983): 91.

[15] Chris Mason, James Kirkbride and David Bryde, "From stakeholders to institutions: the changing face of social enterprise governance theory," *Management Decision*, Vol 45, No. 2 (2007): 288.

[16] Jeffrey Harrison, Douglas Bosse and Robert Phillips, "Managing for Stakeholders, Stakeholder Utility Functions, and Competitive Advantage," *Strategic Management Journal*, Vol 31 (2009): 61.

[17] Rickard Garvare and Peter Johansson, "Management for sustainability—A stakeholder theory," *Total Quality Management*, Vol 21, No. 7 (2010): 741.

purchasing prices from suppliers because they are "intentional in their efforts to optimize the value of their relationships with stakeholders. In contrast, 'satisficers' may attempt to offer jobs that are barely sufficient to retain employees or offer products that are just good enough… such firms are missing opportunities for value creation.[18]

The theory foresees an organization at the core of a network comprised of various stakeholder groups and envisions the business acting as the predominant agent in an exchange system of goods, services, information, technology, talent, influence, money, and other resources.[19] Since social enterprises inherently attract diverse stakeholders, this constellation of important constituents must be identified. While primary stakeholders in commercial ventures, for example, include employees, managers, customers, suppliers and the firm's owners,[20] social enterprises must take different constituents into account as well because of their complex structure. Thus, it is common for social enterprises to include partner organizations, donors, volunteers, government agencies and so forth in their stakeholder network. Since the stakeholder ladder tends to be larger in social enterprises, the inclusion and administration of stakeholders must be clear and intentional. Mason et al.[21] recommend that board members recognize the extent of each stockholder's provision of value to the company as a common operational procedure.

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[18] Ibid.

[19] R. Freeman and W. Evan, "Corporate governance: a stakeholder interpretation," *Journal of Behavioral Economics,* Vol 19 (1990): 337: 359.

[20] Harrison et al., 60.

[21] Mason et al., 289.

Stakeholder theory has been criticized in many fronts and particularly in its application to commercial institutions. Many critiques center on the decrease in shareholder returns due to the yielding of resources and benefits to a larger group of stakeholders.[22] This argument is attenuated in the context of social enterprises since traditional shareholders seeking mere financial returns do not fund such businesses.[23] Instead, stakeholder theory may be essential for the success of social enterprises because it encourages managers and boards of directors to pursue a strategic direction that takes into consideration broader factors and key players that account for the institution's survival.[24] Stakeholder theory also supports greater communication among the organization's constituents and allows for greater operational participation of stakeholders, which is indispensable given that these hybrid organizations tend to rely heavily on local knowledge and feedback. Harrison et al.[25] contend that firms that allocate greater resources to specific stakeholders than the minimum required to maintain satisfactory participation often develop trusting relationships through which competitive advantages arise. More specifically, establishing mutual trust with stakeholders allows organizations to acquire nuanced information about consumer utility functions. The disclosure of personal customer preferences allows firms to operate with greater efficiency, innovate according to specific consumer needs and

[22] J.R. Boatright, "Contractors as stakeholders: reconciling stakeholder theory with the nexus-of-contracts firm," *Journal of Banking and Finance*, Vol 26 (2002): 1849.

[23] C. Low, "A framework for the governance of social enterprise," *International Journal of Social Economics*, Vol 33 (2006): 381.

[24] Mason et al., 289.

[25] Harrison et al., 58.

become more resilient when facing unexpected events.[26] The establishment of meaningful interactions with consumers is especially important for social enterprises that compete directly with for-profits.

While stakeholder theory's emphasis on networking and establishing vital relationships is congruent with the underlying culture of social enterprises, agency theory underscores different responsibilities of the board. The framework addresses the implications of the separation between ownership and management.[27] The theory suggests that managers (agents) often act in their own self-interest when administering firms in an attempt to maximize their own power and wealth at the expense of the owners (principals). These selfish motives lead to "agency costs," or management inefficiencies, due to agents' inability to act in the best interest of the enterprise. From the viewpoint of agency theory, the board of directors is incorporated in an organization's governance structure to protect shareholder interests, provide corporate supervision and offer a long-term vision. Although the theory is typically applied to large for-profits as a countermeasure to financial scandals, research suggests that the separation of management and ownership is also advisable in smaller enterprises and galvanizes firm growth.[28]

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[26] Harrison et al., 65-67.

[27] Matthew Lynall, Brian Golden and Amy Hillman, "Board Composition from Adolescence to Maturity: A Multitheoretic View," *Academy of Management Review*, Vol 28, No. 3 (2003): 417.

[28] Jaana Lappalainen and Mervi Niskanen, "Does Board Composition and Ownership Structure Affect Firm Growth? Evidence from Finnish SMEs," *Research in Economics and Business: Central and Eastern Europe*, Vol 127, No. 1 (2009): 74.

Stewardship theory has also been proposed as an adequate basis for social enterprise governance.[29] The theory contends that companies that encourage an atmosphere of trust between the primary stakeholders and managers develop governance systems in which managers and directors look to promote the overall progress of an organization and maximize the objectives of various stakeholders. The stewardship framework counters agency theory's more pessimistic undertone because it presumes that managers and directors are primarily "pro-organization"[30] and are motivated less by the self-interested desire for personal wealth and power. While agency theory seems to be a more suitable explanation of the incentives often found in for-profits—especially in high-profile accounting scandals—stewardship theory is more congruent with the motivations of social entrepreneurs because it "aligns with the ethos of social enterprise and psychological and social profile of its managers […the focus is on] prioritizing, safeguarding and balancing interests."[31] Given the eleemosynary nature of social enterprises, the stewardship framework emphasizes the altruistic impulses of managers and directors and consequently confers greater liberty to social entrepreneurial governance agents. This view counters agency theory's emphasis on the role of board of trustees in safeguarding the larger interests of the company and contrasts with the "stakeholder governance model [in the sense] that board members

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[29] C. Low, "A framework for the governance of social enterprise," *International Journal of Social Economics*, Vol 33 (2006): 376-385.

[30] J. Davis, F. Schoorman and L. Donaldson, "Towards a stewardship theory of management," *The Academy of Management Review*, Vol 22 (1997): 20-47.

[31] Mason et al., 290.

should be sufficiently free and able to deliver increased productivity"[32] with less concern about allocating value to stakeholders.

Finally, resource dependency theory, which has been offered as a viable approach to studies concerning board diversity and composition—especially in empirical research conducted in for-profits—purports that the board of directors will reflect the environment of the firm and is responsible for disseminating key resources and information throughout the company.[33] Directors are also responsible for providing vital resources to organizations such as counsel, direction and legitimacy.[34] Meanwhile, the theory depicts the institution as an open entity operating in an interconnected system in which it interacts with external factors such as other organizations and environmental stimuli.[35] The board of directors is responsible for ensuring healthy, efficient relations with shareholders and other firms to keep the enterprise sufficiently independent and to reduce transaction costs.[36] Although necessitating empirical testing, resource dependency theory is congruent with many characteristics of social enterprise. In particular, the framework underscores the board's function to establish sound relations with other organizations and provide vital skills and resources. Moreover, the theory suggests that the board can inexpensively affiliate the firm with suppliers of critical

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[32] Ibid.

[33] A. Hillman, A. Cannella and R. Paetzold, "The resource dependence role of corporate directors: Strategic adaptation of board composition in response to environmental change," *Journal of Management Studies*, Vol 37 (2000): 235-254.

[34] A. Hillman and T. Dalziel, "Boards of Directors and Firm Performance: Integrating Agency and Resource Dependence Perspectives," *Academy of Management Review*, Vol 37 (2003): 383-396.

[35] J. Pfeffer, "Size and composition of corporate boards of directors," *Administrative Science Quarterly*, Vol 21 (1972): 218-228.

[36] O. Williamson, "Corporate governance," *Yale Law Journal*, Vol 93 (1984): 1197-1229.

resources by embedding trust and reciprocity in their governance structure.[37] Unlike for-profits, philanthropic institutions have the possibility of utilizing their local knowledge and community participation to create a network without the full costs that a corporation might incur. This is particularly important for social enterprises because they are often resource-deprived in their initial stages of development.

Conclusion

The theories examined in this chapter provide an overview of the tentative frameworks that scholars employ to depict the social enterprise field and suggest methods through which such organizations can continue to flourish. Further empirical testing, however, is required. Meanwhile, the governance theories analyzed provide insight regarding the roles of directors and managers. Resource dependence and stakeholder theories underscore the importance of embedding trust in the company's culture and expanding the enterprise's networks to reap the benefits of strategic partnerships, which are particularly promising for social organizations that often lack financial resources. Although likely to require different governance strategies depending on the social need being addressed, size of the venture, and industry in which they operate, social enterprises possess a greater possibility of attaining financial success by intentionally accounting for stakeholders and providing a unique product. While this section applies various theoretical frameworks to social enterprises, the next chapter analyzes pertinent scholarly research in the social enterprise field and identifies the gaps in the literature that propel this thesis.

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[37] A. Larson, "Network dyads in entrepreneurial settings: A study of the governance of exchange relationships," *Administrative Science Quarterly*, Vol 37 (1992): 76-104.

CHAPTER III

LITERATURE REVIEW

To investigate the hypothesis that social enterprises attain financial independence through the inclusion of specific characteristics in their boards of directors and the utilization of a market-based strategy as a source of funding, this thesis first examines the current research in this area. While the previous chapter explores the theoretical underpinnings of this thesis, this literature review analyzes the characteristics of financially successful social enterprises. This section investigates the concept of sustainability in the social enterprise field, and proceeds to look at specific factors that contribute to high levels of operational performance.

The Interplay of Organizational and Global Sustainability

Sustainability is inherently interconnected with social enterprise because these hybrid organizations seek to preserve the environment and improve societal welfare through an enduring business model. While developed with the intention of providing global sustenance social enterprises, ironically, face the challenge of first becoming sustainable themselves. As Mason et al. note, the significance of sustainability cannot be emphasized enough, as it is "the ultimate aim for the social enterprise."[1] This topic requires further analysis because, ultimately, social enterprises only fulfill their

[1] Chris Mason, James Kirkbride and David Bryde, "From stakeholders to institutions: the changing face of social enterprise governance theory," *Management Decision*, Vol 45, No. 2 (2007): 295.

praiseworthy missions once they themselves become financially independent and functional in the long-term.

The awareness that businesses possess in relation to the urgent need for global sustainability is an increasingly pressing matter as humanity faces a progressively more limited supply of resources. Although a vast topic, a general description of sustainability entails the prolonged existence of an entity, which is capable of thriving amidst different forms of pressure and harmoniously coexisting with other entities. Global sustainability, for example, implies a healthy interplay between humans and nature where individuals not only live decently and preserve the environment, but also guarantee the same conditions for future generations.[2] The stark reality, however, is that the world and its economic element appear to be heading in the contrary direction:

> Free-market capitalism, celebrating individualism, consumerism and excessive insatiable acquisitiveness, not only creates a yawning gap between the rich and poor but it also threatens ecological sustainability and human well-being, greatly increasing the risks to both economy and environment and indeed human life on the planet as we know it.[3]

The struggle to promote ecological sustenance and social well-being across the globe presents the opportunity for change on numerous fronts, including current economic systems. Definitions of organizational sustainability, for example, typically do not take into account corporations' coexistence with the environment and larger global system. In the same vein, definitions of entrepreneurship tend to focus on the achievement of economic aggregation, capital accretion or wealth creation. Social enterprise, on the other hand, seeks to instigate socio-environmental amelioration by considering the

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[2] Rickard Garvare and Peter Johansson, "Management for sustainability—A stakeholder theory," *Total Quality Management*, Vol 21, No. 7 (2010): 737.

[3] Ray Hudson, "Life on the edge: navigating the competitive tensions between the 'social' and the 'economic' in the social economy and in its relations to the mainstream," *Journal of Economic Geography*, Vol. 9 (2009): 494.

frequently neglected benefits of entrepreneurship such as "work, employment, belongingness, community, friendship, self-respect, social standing and development of one's capability."[4] Some tout the field as the way of the future and as a necessary transition away from the current economic *modus operandi*. In academia, these hybrid companies have spawned a new burgeoning scholarly field that seeks to develop further these organizations' eclectic potential for political, economic, environmental and social amelioration.

Characteristics of the Social Enterprise Field

Before understanding how social enterprises can first operate independently and then be used as a vehicle for global improvement, one must understand their unique characteristics. Scholars describe social entrepreneurship as a "business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profit for shareholders and owners."[5] Dissolving the once rigid boundaries of philanthropy and commerce, social enterprises empower local communities, address market imperfections where both public welfare and mainstream companies fail to protect the environment, and provide goods and services to underprivileged persons and so forth. Many of these market failures arise both when commercial firms do not foresee financial returns and governments lack political incentives to address particular societal needs. Unlike traditional non-profits, social entrepreneurs look for innovative ways of applying market-based strategies to achieve the triple bottom line of social,

[4] Elizabeth Chell, "Social Enterprise and Entrepreneurship: Towards a Convergent Theory of the Entrepreneurial Process," *International Small Business Journal*, Vol 25, No. 1 (2007): 17.

[5] Chell, 8.

environmental and economic advancement. In short, social enterprises "blur boundaries between nonprofit and for-profit [...] they enact hybrid nonprofit and for-profit activities."[6] Although driven by varied objectives, all social enterprises endeavor to improve society in some way and are motivated primarily by their mission rather than profit generation.[7]

Although the laudable undertakings of social enterprises are not novel, their approach is unique in the sense that they not only promote healthy change around the world but also, ironically, address imperfections precisely for the traditional agent of socio-environmental change: the non-profit sector. Conventional social organizations are often thwarted from accomplishing their missions because of their unhealthy reliance on governmental subsidies, grants and donations.[8] In contrast, social enterprises seek to grow organically by trading products and services through a sustainable process. Like for-profits, social enterprises can either reinvest net earnings or redistribute funds to stakeholders, which allows for greater flexibility and long-term planning vis-à-vis traditional non-profits.

Utilizing social entrepreneurship as a remedy for the world's most severe problems has drawn the attention of many scholars, but the field still requires further empirical testing. Most of the literature focuses on academic formalities such as legitimizing the field and formulating theoretical contexts, but many of these are

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[6] R. Dart, "The legitimacy of social enterprise," *Nonprofit Management & Leadership,* Vol. 14 (2004): 415.

[7] J. Dees and Jaan Elias, "The Challenges of Combining Social and Commercial Enterprise," *Business Ethics Quarterly*, Vol 8, No. 1 (1998): 166.

[8] Mason et al., 286.

generalized assertions that often lack support with practical evidence.[9] Concomitantly, a number of studies center on community development in affluent countries such as the United States, Canada and United Kingdom. These industrialized countries, however, presumably require the least provision of alternative forms of social aid.[10] In addition, although some success stories exist, Dees and Anderson[11] note that only a handful of social enterprises have been successfully scaled, especially in third-world countries. This is partly explained by the fact that the private sector facilitates the development of social enterprises by providing aggregate support. Hudson notes that in de-industrialized regions of the world, "the 'economy' of the mainstream and the 'social' objectives of social economy organizations are dis-articulated and simply do not connect."[12] In other words, since the social economy still depends on the private sector, scholarly research still requires further insights as to how social enterprises can expand and flourish in developing nations.

Financial Sustainability of Social Enterprises

Having understood some of the characteristics, potential, and challenges of the field, the key question remains: How can social enterprises become sustainable? Sustainability remains an important scholarly subject and a considerable challenge for organizations in general given that in the United States only 39% of small businesses

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[9] Hudson, 498.

[10] Johanna Mair and Marti Ignasi, "Social Entrepreneurship Research: A Source of Explanation, Prediction, and Delight," *Journal of Business*, (2006): 36-44.

[11] J. Gregory Dees and Beth Anderson, "Framing a Theory of Social Entrepreneurship: Building on Two Schools of Practice and Thought," REDF Publications (2006): 39-66.

[12] Hudson, 501.

are profitable and 50% fail within five years.[13] Sustainability is an even greater challenge for social enterprises due to their disagreeing priorities, frequent lack of a business outlook,[14] and operations in demanding conditions. Hudson identifies that, to move to a state of financial liberty, such institutions must transform from financially dependent *social economic organizations* into sustainable *social enterprises*.[15] The necessity of this transition stems from the recognition that, as important as philanthropic leverage may be—especially at the onset—grants and donations are inevitably time-limited. For this maturing progression to occur, however, there is "no simple or straightforward process [but rather it requires] an experimental trial-and-error process of learning-by-doing, an open-ended process with no pre-defined end point."[16]

Although no concrete method exists for attaining sustainability, social enterprises must inevitably hone the advantages that their unique status provides. Unlike for-profit companies, hybrid organizations are eligible for federal, state, county, and city tax exemptions. They also attract voluntary sources of labor, receive public and private donations (contributors receive tax exemption advantages), and form a competitive advantage based on their unique social mission.[17] Social entrepreneurs also have the potential to build a customer base through "an attraction that is of little monetary value but of considerable social value."[18] While customers are important in

[13] Chell, 12.

[14] Ibid.

[15] Hudson, 504.

[16] Hudson, 502.

[17] Chell, 12.

[18] Chell, 17.

creating financial independence, the funding strategy of a social enterprise is likely to be comprised of a mixed source of revenue—especially in the early years—that consists of a commercial aspect, charitable contributions, and voluntary and in-kind contributions.[19] Hudson contends that social enterprises must seek to expand into the space of more extensive mainstream markets by utilizing their socially driven mission as a unique selling point to scale the scope of their operations and trade more extensively.[20] Meanwhile, even if social entrepreneurs do not possess a large monetary resource-base, they often have adept networking skills and considerable potential for building social capital, the ability to connect with people.[21] In addition, internal resources such as "social, personal, intangible ones, which include tacit knowledge, emotional intelligence and so on, and may be mobilized subconsciously"[22] can be used as potential sources of competitive advantage. Similarly, Harrison et al. purport that enterprises can also create a competitive advantage by embedding a managing-for-stakeholders concept in their culture whereby resources are strategically allocated to key stakeholders.[23] Firms can employ this approach to generate a unique reputation "not only by creating and sharing value with stakeholders, but by *becoming known* as a firm that does so."[24] By creating strong alliances with stakeholders, social enterprises

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[19] Chell, 14.

[20] Hudson, 501.

[21] Elizabeth Chell and S. Baines, "Networking, Entrepreneurship and Micro-business Behaviour," *Entrepreneurship and Regional Development,* Vol 12, No. 3 (2000): 195-205.

[22] Chell, 13.

[23] Jeffrey Harrison, Douglas Bosse and Robert Phillips, "Managing for Stakeholders, Stakeholder Utility Functions, and Competitive Advantage," *Strategic Management Journal,* Vol 31 (2009): 67.

[24] Ibid.

can acquire crucial information about consumer preferences where for-profits typically spend exorbitant amounts in employing consultants and research firms.[25]

Although the process of reaching financial sustainability is complex and relies on various different factors, this paper seeks to isolate some aspects such as governance structures that may help explain the discrepancy between successful and mediocre social enterprises. The subject of strategic governance is especially important in the context of social enterprises because leaders must encompass the "local, often unique mission of each organization."[26] Specifically, the board of directors plays a crucial role in providing skills and resources that can help organizations reach financial independence. Research suggests that firms with higher quality boards tend to outperform companies with lower quality boards.[27] Mainly, the board of directors provides "(1) advice and counsel, (2) legitimacy, (3) channels for communicating information between the firm and external organizations, and (4) assistance in obtaining resources of commitments from important elements outside the firm.[28] Consensus also exists in regards to board members' significant role to provide advice and guidance to

[25] Harrison et al., 68.

[26] Mason et al., 295.

[27] Jaana Lappalainen and Mervi Niskanen, "Does Board Composition and Ownership Structure Affect Firm Growth? Evidence from Finnish SMEs," *Research in Economics and Business: Central and Eastern Europe*, Vol 127, No. 1 (2009): 69.

[28] A. Hillman, A. Cannella, and R. Paetzold, "The resource dependence role of corporate directors: Strategic adaptation of board composition in response to environmental change," *Journal of Management Studies*, Vol 37 (2000): 235-254.

management,[29] enhance the reputation and legitimacy of the enterprise[30] and acquire vital resources for the firm.[31]

While the acumen of board members is imperative, the connection between specific board characteristics and financial performance has spawned an abundance of scholarly research that isolates specific variables that contribute to overall organizational success. Most, however, center on large, mature commercial ventures with results that cannot be extrapolated to encompass smaller, social organizations.[32] Although few studies correlate success of social enterprises with board characteristics, scholarly work involving smaller commercial ventures does provide some insight and direction for the evolution of the social enterprise field. A study of small and medium sized for-profit firms, for example, demonstrates that the importance of the board's composition is inversely correlated with firm size.[33] The fact that social enterprises tend to be smaller than commercial businesses further underscores the importance of identifying board characteristics that affect financial results and social impact. Specifically, institutions with boards comprised of more than seven or eight members are prone to ineffective leadership,[34] which is partially explained by larger boards'

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[29] J. Westphal, "Collaboration in the boardroom: Behavioral and performance consequences of CEO-board social ties," *Academy of Management Journal*, Vol 42 (1999): 7-25.

[30] C. Daily and C. Schwenk, "Chief executive officers, top management teams and boards of directors: Congruent or countervailing forces?" *Journal of Management*, Vol 22 (1996): 185-202.

[31] M. Mizruchi and L. Stearns, "A longitudinal study of borrowing by large American corporations," *Administrative Science Quarterly*, Vol 39 (1994): 118-140.

[32] "Board Composition from Adolescence to Maturity: A Multitheoretic View," *Academy of Management Review*, Vol 28, No. 3 (2003): 416.

[33] Lappalainen and Niskanen, 66.

[34] M. Jensen, "The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems," *The Journal of Finance*, Vol 48 (1993): 831-880.

propensity towards utilizing assets inefficiently.[35] Concomitantly, Bozec contends that large boards tend to be more susceptible to incurring agency problems[36] because of directors' ineffective oversight of managers. Others find that larger boards are negatively correlated with firm value[37] and do not enhance financial returns.[38]

Other board characteristics correlated with performance of the enterprise include ownership structure and board independence. Boards that are comprised primarily of outside directors who are financially independent of their respective organizations and do not share family or social ties with the CEO promote more efficiently managed and monitored businesses.[39] The rationale is that directors who are unaffiliated with management roles are more capable of providing sustainable strategic direction, resources, and support because short-term financial motives are less likely to influence them. Studies also show that board members with low ownership levels are willing to take larger risks and aim for higher growth rates.[40] Additional research contends that the board is an essential link between managers and shareholders,[41] especially if board members are unbiased outside representatives.

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[35] Lappalainen and Niskanen, 69.

[36] R. Bozec, "Boards of Directors, Market Discipline and Firm Performance," *Journal of Finance and Accounting*, Vol 32 (2005): 1921-1960.

[37] T. Eisenberg, S. Sundgren and M. Wells, "Larger board size and decreasing firm value in small firms," *Journal of Financial Economics*, Vol 48 (1998): 35-54.

[38] A. Dehaene, V. De Vuyst and H. Ooghe, "Corporate Performance and Board Structure in Belgian Companies," *Long Range Planning*, Vol 34 (2001): 383-398.

[39] Lynall et al., 418.

[40] J. McConnell and H. Servaes, "Additional Evidence on Equity Ownership and Corporate Value," *Journal of Financial Economics*, Vol 27 (1990): 595-612.

[41] F. Adjaoud, D. Zeghal and S. Andaleeb, "The Effect of Board's Quality on Performance: a study of Canadian firms," *Corporate Governance*, Vol 15 (2007): 623-635.

Studies also suggest that success of an enterprise is contingent on gender diversification of the board of directors. Bear et al.[42] find a positive correlation between female inclusion in boards and strength ratings for corporate social responsibility (CSR) in for-profits. This phenomenon is partly explained by female board members' ability to create social capital through a heightened awareness and sensitivity to CSR.[43] The implications are important for the developing social enterprise field because, since funding frequently stems from charitable donors looking to support organizations that produce maximum social impact, boards that contain women may be more likely to have pronounced benefits to society and thus attract additional investors. This is congruent with the fact that Williams finds that boards with higher proportions of women tend to attract greater charitable donations.[44] This finding can be partially explained by the fact that, since female board members tend to be more supportive and influential in communities,[45] mixed boards are able to engender superior relationships with stakeholders and thus facilitate fundraising, networking and cooperation with individuals and organizations. In addition, women tend to utilize more participative decision-making approaches,[46] which can allow the board of directors to address important decisions through broader perspectives and more open communication.

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[42] Stephen Bear, Noushi Rahmen and Corinne Post, "The Impact of Board Diversity and Gender Composition on Corporate Social Responsibility and Firm Reputation," *Journal of Business Ethics*, Vol 97 (2010): 217.

[43] R. Williams, "Women on Corporate Boards of Directors and Their Influence on Corporate Philanthropy," *Journal of Business Ethics*, Vol 42 (2003): 1-10.

[44] Ibid.

[45] A. Hillman, A Cannella and I. Harris, "Women and Racial Minorities in the Boardroom: How Do Directors Differ?" *Journal of Management*, Vol 28 (2002): 747-763.

[46] A. Konrad, V. Kramer and S. Erkut, "Critical Mass: The Impact of Three or More Women on Corporate Boards," *Organizational Dynamics*, Vol 37, No. 2 (2008): 145-164.

Meanwhile, although few studies exist regarding board characteristics specifically in the context of social enterprises, preliminary research advocates the extensive use of established metrics and accounting methods. Mason et al.,[47] for example, suggest that governance attributes such as transparency and accountability can provide social enterprises greater legitimacy and sustained performance. Governance and organizational clarity can be established through the use of social auditing and financial accounting methods. Scholars advise social enterprises to incorporate accountability methods in their day-to-day operations as a form of developing a formal process through which financial, social and/or environmental performance can be consistently measured and compared. This type of routine accountability legitimizes organizations and advances the social enterprise field as a whole. This remains a considerable challenge, however, because fewer auditing and disclosure regulations exist in the social sector and social enterprises must, optimally, measure both economic and social returns. Currently, the inability of many social enterprises to evaluate social impact in a concrete and comparable manner across the field undermines overall transparency and remains a major obstacle.

In addition to organizational transparency, the social experience and business skills that board members bring to their respective organizations may be essential determinants of successful performance. Mason et al. discuss the importance of developing a board that is both representative and brings the necessary expertise to maximize impact.[48] Bringing the right personnel is essential since social organizations are often comprised of an abundance of workers with social experience but sometimes

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[47] Mason et al., 294.

[48] Mason et al., 290.

lack the business sense to promote financial sustainability. In the same vein, Hudson notes that many aspiring social enterprises "fail because of a lack of a clear sense of mission, an inability to reconcile their ethical and social objectives with market realities, and for that reason fail to align processes with aims.[49] Therefore, a common predicament for social entrepreneurs is finding ways to ground their often idealistic visions. Dees observes that to move the business concept forward while maintaining the original mission, social entrepreneurs must utilize high emotional intelligence in selecting key personnel.[50] Regarding the board of directors, this assumption is likely to translate into social enterprises backed by members with considerable business savvy. Corroborating this logic, Chell notes that many non-profits that are "commercially successful often have a business-led Board, recruit key managers from business and have a strong business culture."[51] Therefore, social entrepreneurial board members with an educational or experiential background in business may provide the necessary strategic vision for the organization, while directors who are familiar with the non-profit sector may be crucial in grounding the mission at a local level.

In addition, financial structure is another variable that may dictate the successful development of social enterprises. The fact that funding constraints are one of the greatest barriers to growth in the private sector suggests that the same is likely to be true in the public sector. More specifically, small firms often face considerable challenges in obtaining external leverage.[52] Becchetti and Trovato find that companies that are

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[49] Hudson, 505.

[50] Gregory Dees, "Enterprising Nonprofits," *Harvard Busines Review*, Vol 76 (1998): 55-67.

[51] Chell, 12.

[52] Lappalainen and Niskanen, 73.

credit rationed by their financial institutions typically possess lower growth rates,[53] and Hall et al. claim that firm growth is positively correlated with short-term debt.[54] As an extension, a social enterprise's rate of growth may also be contingent on the entrepreneur's access to financial leverage, especially at the onset.

Conclusion

Social enterprises hold great potential in bridging the gap between businesses and socio-environmental needs, and creating a more sustainable future for the world. Many obstacles, however, still remain because these hybrid organizations often operate in locations of the world that are not optimal, and more research concerning the element of financial sustenance of such enterprises must be conducted. This literature review analyzes some of the progress that has already taken place in the field and posits that the board of directors is an essential component for the successful scaling of social enterprises. Specifically, this chapter expounds on why social enterprises with smaller boards that include greater heterogeneity in terms of gender diversification and include directors with an extensive business background perform at higher levels than other comparable organizations. While this section explains some of the potential underpinnings that promote the successful scaling of social enterprises, the next chapter portrays the specific methodology that this thesis employs to determine the effects of individual variables on financial performance of social businesses.

[53] L. Becchetti and G. Trovato, "The determinants of growth of small and medium sized firms. The role of the availability of external finance," *Small Business Economics*, Vol 19 (2002): 291-306.

[54] G. Hall, P. Hutchinson and N. Michaels, "Industry Effects on the Determinants of Unquoted SMEs' Capital Structure," *International Journal of the Economics of Business*, Vol 7 (2000): 297-312.

CHAPTER IV

DATA AND METHODOLOGY

While the last chapter examines the current scholarly research in the social enterprise field, this section specifies the hypotheses of this thesis and determines the research protocol used in this study. Although numerous factors contribute to the success of organizations, this research intends to isolate particular determinants of the overall performance of social enterprises. Specifically, this thesis contends that the sustainability of social enterprises is contingent on various board characteristics, choice of funding strategy, and the ability to produce a competitive advantage through the allocation of value to stakeholders. This study utilizes a mixed methodology that draws upon the advantages of both quantitative and qualitative analysis. This hybrid approach stems from the highly regarded research of Eisenhardt,[1] who outlines a pragmatic process for gathering data in case studies. Eisenhardt discusses the various advantages of using a mixed method, such as greater validity associated with a synergistic approach[2] and an increased likelihood of generating novel theory.[3]

The quantitative portion of this thesis tests for the correlation between financial performance of social enterprises (Y) and access to leverage (X_1), use of a market-based

[1] Kathleen Eisenhardt, "Building Theories from Case Study Research," *Academy of Management Review*, Vol 14, No. 4 (1989): 532-550.

[2] Eisenhardt, 533.

[3] Eisenhardt, 546-547.

strategy (X_2), board size (X_3), inclusion of women on the board (X_4), and business background of board members (X_5). Meanwhile, the qualitative part of this research is comprised of a case study of the Abraham Path Initiative (API). The effects of the characteristics of API's board of directors on financial performance are analyzed through interviews with various API stakeholders. This section intends to unearth additional factors that may be associated with the sustainability of nonprofits, analyzes the extent to which API is able to allocate value to its constituents, and demonstrates how these hybrid organizations can employ stakeholder theory to develop a competitive advantage.

Quantitative Section Data

Variables

The effects of five independent variables are tested against return-on-assets (ROA), the dependent variable. The independent variables were chosen specifically because of their applicability to the field of social enterprise. Philanthropic companies must adopt the most efficient structure for the board of directors and utilize an optimal funding strategy to scale operations. Below are detailed descriptions regarding the metrics used for each variable as well as the impetus for their inclusion.

Dependent Variable

Financial Performance. This study uses return-on-assets as a measure of financial performance. Measuring a company's ability to generate income per dollar invested in total assets,[4] ROA is often used as a measure of financial health and efficiency. Many scholars recommend ROA as an optimal metric of financial performance such as Hagel et al.,[5] Pandya and Rao,[6] and Klapper and Love.[7] The problems associated with the use of ROA as an indicator of financial health are well known. In particular, the possibility of using misleading accounting tactics such as the reduction of the asset base to boost ROA is attenuated in this study because of the eleemosynary nature of social organizations. Moreover, using ROA as a measure of financial performance is especially suitable in the often resource-depleted public sector because it underscores the need for exceptional efficiency in generating funds. In addition, other commonly accepted profitability ratios such as return on equity (ROE) are incompatible with the structure of social organizations because shareholders do not fund nonprofits.

Independent Variables

Access to Leverage. Financial constraints have been found to be one of the greatest barriers to the successful scaling of companies.[8] In the for-profit sector,

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[4] Judy Laux, "Topics in Finance Part II—Financial Analysis," *American Journal of Business Education*, Vol 3, No. 3 (2010): 82.

[5] John Hagel, John Brown and Lang Davison, "The Best Way to Measure Company Performance," *Harvard Business Review*. Available online at http://blogs.hbr.org/bigshift/2010/03/the-best-way-to-measure-compan.html.

[6] Anil Pandya and Narendar Rao, "Diversification and Firm Performance: An Empirical Evaluation," *Journal of Financial and Strategic Decisions*, Vol 11, No. 2 (1998): 71.

[7] Leora Klapper and Invessa Love, "Corporate Governance, Investor Protection, and Performance in Emerging Markets," *Journal of Corporate Finance*, Vol 10, No. 5 (2004).

[8] D. Storey, *Understanding the Small Business Sector* (Cengage Learning, 1994).

especially small companies often have difficulty in obtaining outside funding.[9] This is a hindrance for companies because firm growth is often positively related to short-term debt.[10] The smaller nature of social organizations suggests that they also struggle to find access to leverage, which stifles the possibility of using debt to scale operations. This research uses debt-to-assets ratio as a measure of access to leverage, which is the same metric used in a similar study that correlates firm growth and leverage.[11] This thesis expects a positive relationship between access to leverage and financial performance.

This study also tests whether larger social enterprises (measured in total assets) have a greater ability to acquire leverage to scale operations. The underlying logic is that organizations with a larger asset base can more easily cover internal expenses while also repaying debt. In addition, larger companies often possess a more reliable reputation, which allows for the withdrawal of more sizeable loans. Therefore a positive correlation is expected between debt-to-assets ratio and total assets.

Use of a Market-Based Strategy. Social organizations often depend unhealthily and unsustainably on philanthropic donations. Therefore, experts on the field of social entrepreneurship highly emphasize the importance of adding a commercial component

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[9] L. Becchetti and G. Trovato, "The determinants of growth of small and medium sized firms. The role of the availability of external finance," *Small Business Economics*, Vol 19 (2002): 291-306.

[10] G. Hall, P. Hutchinson and N. Michaelas, "Industry Effects on the Determinants of Unquoted SMEs' Capital Structure," *International Journal of the Economics of Business,* Vol 7 (2000): 297-312.

[11] Jaana Lappalainen and Mervi Niskanen, "Does Board Composition and Ownership Structure Affect Firm Growth? Evidence from Finnish SMEs," *Research in Economics and Business: Central and Eastern Europe*, Vol 127, No. 1 (2009): 69.

to generate revenue and move the social mission forward.[12] This thesis contends that social enterprises that incorporate a market-based funding strategy have a greater possibility of prospering. The measurement of the commercial component of social enterprises is determined by calculating the proportion of overall revenue derived from investment income and sale of assets, products and services.

Board Size. The board of directors is responsible for overseeing the activities of companies. In social enterprises, directors often prioritize the development of organizational sustainability through the implementation of a coherent financial strategy and the appropriate allocation of resources. A sizeable board, however, can become inefficient and detrimental to the company. Findings show that larger boards become more prone to ineffective leadership[13] and agency problems.[14] Since boards need to be especially efficient in managing limited funds in the often resource-deprived nonprofit sector, this study expects a negative relationship between board size and financial performance.

Inclusion of Women on the Board. This study advocates the addition of female directors as a possible contributor to organizational success. Bear et al. find that the inclusion of women in boards has positive effects in Fortune 500 companies due to the tendency of female directors to enhance corporate social responsibility ratings and

[12] Gregory Dees, "Enterprising Nonprofits," *Harvard Business Review*, Vol 76 (1998): 55-67.

[13] M. Jensen, "The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems," *The Journal of Finance*, Vol 48 (1993): 831-880.

[14] R. Bozec, "Boards of Directors, Market Discipline and Firm Performance,*" Journal of Finance and Accounting*, Vol 32 (2005): 1921-1960.

critical board processes.[15] Although these findings apply to large firms, Bear et al. recommend that future research expand to examine smaller businesses.[16] Concomitantly, Williams finds that boards with higher proportions of women tend to attract greater charitable donations.[17] Since the survival of social organizations often depends on philanthropic contributions, perceived reputation of the company, and the business's ability to promote social and/or environmental change, the inclusion of women on the board of directors is expected to positively affect financial performance of social enterprises.

Business Background of Board Members. Studies analyzing the construct of social organizations find that people who run philanthropic entities often have the necessary passion and willingness to make a positive difference, but sometimes lack the commercial pragmatism to develop a sustainable business model.[18] [19] This thesis purports that social enterprises containing a board of directors with an extensive educational and professional background in business will promote a healthier financial direction for the organization. This study measures the relationship between the proportion of board members with a commercial history and ROA of organizations.

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[15] Stephen Bear, Noushi Rahman and Corinne Post, "The Impact of Board Diversity and Gender Composition on Corporate Social Responsibility and Firm Reputation," *Journal of Business Ethics*, Vol 97 (2010): 217.

[16] Bear et al., 218.

[17] R. Williams, "Women on Corporate Boards of Directors and Their Influence on Corporate Philanthropy," *Journal of Business Ethics*, Vol 42 (2003): 1-10.

[18] Chris Mason, James Kirkbride and David Bryde, "From stakeholders to institutions: the changing face of social enterprise governance theory," *Management Decision*, Vol 45, No. 2 (2007): 290.

[19] Ray Hudson, "Life on the edge: navigating the competitive tensions between the 'social' and the 'economic' in the social economy and in its relations to the mainstream," *Journal of Economic Geography*, Vol. 9 (2009): 505.

Sample Population

The target population for this study includes all social enterprises with international operations. Although definitions for social enterprise vary, this research draws from a population of nonprofit organizations with 501(c)(3) standing and also incorporate commercial aspects in their funding strategy. A commercial component as seen on the company's 990 form may include revenue sources such as program service revenue and investment income. Nonprofits that attain revenue solely from contributions and grants, on the other hand, are considered to be purely social organizations and are not used in this study. A sample of social enterprises was chosen with the intention of including diverse companies characterized by variation in size, industry of focus, funding strategy and board composition. Moreover, for the purposes of this study, only companies that include biographies of each director on their websites were used. The sample population (n=34) includes the following organizations:

- Abraham Path Initiative
- Acumen Fund
- Amnesty International
- Ashoka
- Bead for Life
- Charity: Water
- Childhelp Inc.
- Fair Labor Association
- Focus on the Family
- Foundation Center
- Friendship Bridge
- Girl Scouts
- Global Exchange
- The Global Fund
- Global Fund for Women
- Global Giving Foundation
- Global Greengrants Fund
- Goodwill Industries International
- Grameen Foundation
- Greater Good
- Habitat for Humanity International
- Heifer International
- Housing Works
- International Development Enterprises
- Livestrong
- Mercy Corps
- Nature Conservancy
- Newman's Own Foundation
- Rainforest Alliance
- Root Capital
- Save the Children Federation
- Smile Train
- Women's Bean Project
- Young Life

Data

This study employs data regarding revenue sources, ROA and debt-to-assets ratio found in 990 forms on the Foundation Center's 990 Finder,[20] which reveals the yearly revenues, expenses, assets and liabilities of nonprofit organizations. Occasionally, the financial information for social enterprises in the sample population was unavailable on the Foundation Center website, in which case 990 forms were accessed through the companies' website. This thesis utilizes standard accounting methods to calculate statistics. ROA, for example, was found by dividing net income by total assets and debt-to-assets ratio by dividing total liabilities by total assets. The author computes data regarding the use of a market-based strategy by dividing the sum of all revenue generated commercially by the total revenue. This research employs data from the three most recent years available on the Foundation Center's 990 Finder website. Although not all statistics encompass the same three consecutive years, this study only uses financial information disclosed between 2004 and 2009.

Moreover, data on board size, proportion of women on the board of directors, and background of board members were gathered from the individual websites of the various social enterprises included in this study by accessing the link that discusses the biographies of each board member. In addition to observing the number of total board members in each social enterprise, the statistic concerning the inclusion of women in the board was calculated by dividing the number of female directors by the total size of the board. Next, the biographical profile of all board members was used to classify each person as possessing an educational and professional background that is primarily

[20] *Foundation Center 990 Finder* (2006): available online at http://dynamodata.fdncenter.org/990s/990search/esearch.php.

characterized as social, business, mixed, or neither. The following examples gathered from several of the social enterprises included in this study demonstrate the selection process.

The first biographical summary illustrates a board member with a business background:[21]

> C. Hunter Boll is a former managing director of Thomas H. Lee Partners, one of the largest private equity firms in the world. He joined the firm in 1986. In 2005, he co-founded Source Audio LLC, a start-up venture focused on providing consumers with next generation accessories for the musical instrument market. Mr. Boll is Chief Operating Officer for Source Audio LLC. From 1984 to 1986, Mr. Boll was with the Boston Consulting Group, a corporate strategy consulting firm. He previously served as an Assistant Vice President, Energy and Mineral Division of Chemical Bank. Mr. Boll is a director of Metrics Companies, Inc., TransWestern Publishing and Source Audio LLC. Mr. Boll received a BA in Economics from Middlebury College and an MBA from the Stanford Graduate School of Business.

Mr. Boll has an extensive and diverse career, but the fact that he received an undergraduate degree in economics and an MBA in business emphasizes his compatibility with the "business" category.

Below is an example of a board member with a primarily social background:[22]

> Sakena Yacoobi is the founder and executive director of the Afghan Institute of Learning, one of the largest non-profit organizations in Afghanistan. She is vice president of the board of Creating Hope International. She is the recipient of the 2005 National Endowment for Democracy Award and the 2004 Peter Gruber Foundation - Women's Rights Prize. In 2006, she received the Citizen Leader Award from the University of the Pacific in Stockton, CA and the Skoll Award for Social Entrepreneurship. In 2007, she received an honorary doctorate from the University of the Pacific for her human rights work.

Although Ms. Yacoobi is involved in various different leadership roles, she has experience working in nonprofits, received a doctorate in human rights education, is a board member of the social venture Creating Hope International, and was awarded various philanthropically-oriented prizes.

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[21] *Acumen Fund Board of Directors* (2011): available online at http://www.acumenfund.org/about-us/board-of-directors.html.

[22] *Global Fund for Women Board of Directors* (2010): available online at http://www.globalfundforwomen.org/who-we-are/board-of-directors.

Meanwhile, the biography below demonstrates how an educational and professional career falls under the "mixed" category:[23]

> Jim Greenberg brings to Grameen Foundation a passion for microfinance, defeating poverty on a massive scale and a focus on India and the Middle East/North Africa. He currently serves on Grameen Foundation's Board of Directors, is the founding Chairman of Grameen Capital India, is on the Board of Directors of Grameen Jameel Pan-Arab Microfinance Ltd., and is the Co-Chairman of the Grameen Foundation Investment Committee. Not only has Grameen Foundation benefited from Jim's valuable knowledge, seasoned insight and strategic direction, but he and his wife also helped to launch the India Initiative. Jim has a rich executive and management background in international business. In 1995 he became the founding partner of DevCorp International B.S.C. (c), a Bahrain-based venture development and investment company with active projects spanning shrimp farming, petrochemicals, light manufacturing, and telecomm/IT. Jim is currently Chairman and CEO of the company.

Although Mr. Greenberg is involved in the private sector and has experience in international business, he is also highly involved in microfinance projects that serve underprivileged populations around the world, which places him in the "mixed" classification.

Occasionally, board members contain a professional and academic history that is neither social nor business oriented. As demonstrated below, persons with backgrounds in law and pharmaceuticals, for example, were placed in the "neither" category:[24]

> Pietro, who is from Italy, is an elementary particle physicist working in Bologna as researcher for the Italian Institute for Nuclear Physics. During the 1990s he joined the Amnesty International Italy board, where he served as vice-chair. At the international level, he was a member from 2001 to 2003 of the Standing Committee on Research and Action and in 2004 joined the board of the Amnesty International European Union Association, which he became chair of in 2006. He was elected to the IEC in August 2007.

Although Mr. Antonioli clearly expresses an interest for social amelioration by joining Amnesty International, his area of focus primarily involves nuclear physics research.

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[23] *Grameen Foundation Board of Directors* (2010): available online at http://www.grameen foundation.org/who-we-are/people/board-of-directors#James%20L.%20Greenberg.

[24] *Amnesty International: Pietro Antonioli* (2010): available online at *http*://www.amnesty.org/en/who-we-are/our-people/international-executive-committee/pietro-antonioli.

There is no immediate evidence that he has previous academic or experiential familiarity with business or the public sector.

Overall, this thesis contends that board members falling under either the "business" or "mixed" classifications contribute some economic insight to the social enterprise. The "business background of board members" variable is found by dividing the number of directors who fall under the "business" or "mixed" categories by the total amount of members on the board. This proportion is correlated with the ROA of the particular social enterprise.

Quantitative Section Methodology

Hypotheses

Based on the above description of variables, this thesis tests for five hypotheses that isolate specific variables expected to be related to the financial performance of social enterprises:

- *Hypothesis 1**a***: Social enterprises with greater access to leverage experience improved financial success.
- *Hypothesis 1**b***: There is a positive relationship between debt-to-equity ratio and total assets of companies.
- *Hypothesis 2*: Financial performance of social enterprises is positively correlated with the use of market-based funding strategy.
- *Hypothesis 3*: Board size of social enterprises is inversely correlated with financial performance.
- *Hypothesis 4*: Financial performance of social enterprises is positively correlated with the proportion of women on the board of directors.
- *Hypothesis 5*: Financial performance is positively related to the proportion of total board members who have an educational and professional background in business.

Research Methodology

This study uses the EViews statistical software to generate least squares linear regressions between the five independent variables (debt-to-equity ratio, number of board members, proportion of female directors, proportion of directors with business backgrounds, proportion of revenues generated commercially) and the dependent variable (ROA). The author tests for multicolinearity, heteroskedasticity and normality in the regressions.

Qualitative Section Data

While the previous section analyzes the effects of board composition and commercial structure on financial performance, numerous other factors affect the overall success of a social enterprise. The second portion of this research examines interviews with four social enterprise leaders and analyzes a case study of the Abraham Path Initiative (API). This thesis uses a case study because it is a "research strategy which focuses on understanding the dynamics present within single settings."[25] The data collected further elucidate the effect of the characteristics of the board on financial performance and expound on additional variables and new hypotheses for further research regarding the sustainability of social enterprises. These include the effects of using internal metrics, the ability to provide value to stakeholders, the organizational structure, the transparency of the company's vision, and incorporation of a strategic marketing campaign.

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[25] Eisenhardt, 534.

Choice of Social Enterprise for Case Study Analysis

As a young organization (founded in 2007) that has lagged financially (a shrinking budget and a negative average return-on-assets between 2007 and 2009), API constitutes an appropriate company for the study of financial sustainability. While philanthropic donations initially funded the operational costs of the organization, API must find new sources of revenue as it matures. Like many other philanthropic ventures, API has a praiseworthy mission and vision but lacks an adequate sustainability model. Understanding how to move away from philanthropic dependency is a common theme for social organizations. In addition, since API's board of directors has undergone various changes since the company's inception, interviews can elucidate the optimal construct of a social entrepreneurial board.

Variables

Use of Metrics. Although social entities must disclose 990 forms each year, there are few requirements enforcing the use of internal performance metrics. Unlike for-profits, philanthropic organizations must account for both financial performance and social impact. Studies show that nonprofits that use rigorous accounting methods are perceived as being more legitimate.[26] Increased legitimacy and a respectable reputation connote trust to consumers and donors, which can lead to greater philanthropic donations and access to leverage.

Transparency and Tangibility of Vision. This thesis contends that transparency of vision is an important element in the development of organizational sustainability.

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[26] Mason et al., 295.

Social enterprises rooted in a tangible and emotive vision that immediately draws outsiders to the company's mission are likely to create a competitive advantage.

Strategic Marketing Campaign/Brand Development. Given the challenge of functioning with limited resources, social organizations must develop their brand reputation and market their campaign creatively. Unlike for-profits that often spend exorbitant amounts on advertising, social enterprises must be promoted inexpensively yet still attract customers and publicity.

Organizational Structure. For-profits are usually characterized by a hierarchical organizational structure, while nonprofits tend to be much more decentralized. The hierarchical model is operationally adequate for expansive firms but often undermines the cohesiveness of the company's mission. Employees are likely to feel less empowered and have different motivations for working at the particular firm. The decentralized configuration, on the other hand, assumes a more egalitarian approach towards the role of stakeholders—who often share strong passions for the social cause of the organization—but may also lead to operational inefficiency if the roles and objectives of employees are unclear. Social enterprises, fusing aspects of both for-profits and nonprofits, face the challenge of implementing an optimal structure that allows for both functional efficiency and preservation of the social mission.

Distribution of Value to Stakeholders. The extent to which social ventures provide value to their constituents is an important factor because it can assist in the development of social capital.[27] As discussed in the literature review, social capital and the managing-for-stakeholders concept create a competitive advantage and provide

[27] Elizabeth Chell and S. Baines, "Networking, Entrepreneurship and Micro-business Behaviour," *Entrepreneurship and Regional Development*, Vol 12, No. 3 (2000): 195-205.

organizations with important information about consumer preferences, both without high cost.[28] This thesis determines the way in which API accounts for stakeholders and focuses especially on the appropriation of value to donors. Donors are particularly important because they are often responsible for funding operations in the early stages of social enterprises. Unlike investors in the private sector who expect financial gains, donors in the public sector anticipate social returns.

Sample population

The sample population for the API case study includes twelve individuals chosen as representatives of the organization's stakeholder ladder. These include interviews with the API founder, the executive director, four consumers, one employee, two hosts, one board member, one country director and one individual from a partner organization.

In addition, the author interviewed the leaders of three additional social enterprises: Acumen Fund, Global Greengrants Fund (GGF), and Bead for Life. Acumen Fund is a non-governmental organization that utilizes entrepreneurial approaches to solve the problems of global poverty. Specifically, Acumen Fund invests in seed companies in India, Pakistan, and Eastern Africa that work on a variety of issues such as health, housing, energy, water, and agriculture. Meanwhile, GGF provides small grants to grassroots groups focusing on social justice and environmental sustainability. Moreover, Bead for Life, empowers Ugandan women through the production and sale of handmade bead jewelry and shea butter products.

[28] Jeffrey Harrison, Douglas Bosse and Robert Phillips, "Managing for Stakeholders, Stakeholder Utility Functions, and Competitive Advantage," *Strategic Management Journal*, Vol 31 (2009): 67-68.

Data

After receiving the consent of the Colorado College Institutional Review Board, which tests for ethical and safe conduct for interview-based research, the author conducted twelve interviews in November 2010 during an API-led walk through Palestine. Interviews were recorded electronically and later transcribed.

Interview Questions for API Consumers and Hosts

- How did you hear about API? How do you benefit from this project? Why did you become involved?
- In your own words, what is the vision of this organization? How tangible is this? Do you connect with it?
- How do you think API can reach financial independence? What are the main challenges?

Interview Questions for API Executive Director, Founder, Employees, Board Members, Country Directors, Members of Partnering Organizations, and Acumen Fund, GGF, and Bead for Life Leaders

- What is the company's sustainability model?
- How does the social enterprise create value for various stakeholders?
- Does the company use internal metrics and benchmarking to track progress?
- What is the vision? How transparent and tangible do you think it is? How congruent has the organization been in upholding its vision?
- What type of marketing campaign does the organization use? How is the brand developed?
- What is the organizational structure? Is it mostly hierarchical or decentralized? Why is this particular structure used?

Qualitative Section Methodology

After providing a brief summary of API, data regarding the changes in the characteristics of its board of directors will be analyzed in conjunction with its financial performance. In addition, a chart containing the opinions of different stakeholders regarding the previously discussed variables will be constructed and assessed for any incongruities, as well as highlighting the strengths and weaknesses of the organization. The analytical approach of this thesis will benefit the social enterprise field by providing an empirical and comprehensive methodology for stakeholder research.

Next, the author proposes additional variables related to organizational success based on the interviews with leaders of API, GGF, Bead for Life, and Acumen Fund.

Hypotheses

- *Hypothesis 1*: By strategically allocating value to stakeholders, API will develop a competitive advantage, gain nuanced information on customer utility functions, and attract more donors, customers, joint ventures, and media coverage.

- *Hypothesis 2*: Success of social enterprises is contingent on the ability to blend hierarchical and decentralized structures, convey the emotiveness and tangibility of the vision, identify and distribute value to relevant stakeholders, effectively develop the brand, and use adequate internal metrics.

Conclusion

This chapter presents the specific hypotheses that motivate this study and isolates testable variables within the general topic of social enterprise sustainability. Overall, this thesis draws from the advantages of both quantitative and qualitative methods. The detailed descriptions of the research protocol intend to legitimize the findings of this study and allow scholars to build on this dissertation in the future. The next chapter examines the results of the numerical portion, provides a case study of API with a special emphasis on stakeholder research, and prepares the field for further research.

CHAPTER V

RESULTS AND ANALYSIS

This chapter presents the results produced by the numerical analysis outlined in the previous chapter, a brief case study of the social enterprise the Abraham Path Initiative (API), and interviews with leaders of different philanthropic organizations. The first section displays and elaborates on the empirical results of the ordinary least squares (OLS) regression used to reveal the determinants of the financial performance of social businesses. The second portion demonstrates how API and other philanthropic organizations can use stakeholder theory to develop competitive advantages. The final part of this chapter analyzes an array of interviews with nonprofit leaders and presents additional variables related to social enterprise sustainability that future studies can explore further.

Quantitative Section Results

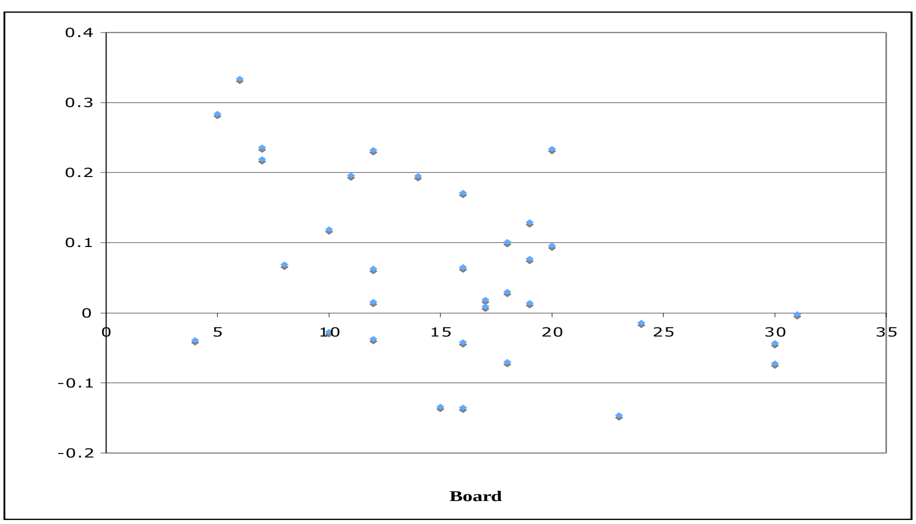
This thesis tests for the relationship between financial health (return on assets) of 34 social enterprises and five independent variables: size of the board of directors, representation of women on the board, proportion of board members with a business background, proportion of total revenue derived commercially, and access to leverage. As Table 5.1 displays, of the five independent variables tested, only size of the board is significantly correlated ($p=.034$) with financial health of companies at a 95% confidence interval. All other variables are not significantly correlated with return on assets (ROA), and there is no convincing relationship between total assets and access to leverage as previously hypothesized.

TABLE 5.1 Significance of Variables in the OLS Regression (n=34)

Variable	Coefficient	Standard Error	T-statistic	Probability
Size of Board	-.007	.003	-2.23	.034
Proportion of Women on Board	-.003	.106	-.025	.981
Proportion of Directors with Business Background	.094	.098	.962	.344
Proportion of Revenue Derived Commercially	-.002	.077	-.024	.981
Access to Leverage	-.009	.102	-.086	.932

The OLS regression produces a coefficient of -.007 for size of the board, which reveals an inverse relationship between return on assets and number of total board members. Graph 5.1 shows a scatter plot of all the data points from the sample population with board size on the x-axis and ROA on the y-axis. The pattern of the data points

GRAPH 5.1 Scatter Plot of Return on Assets vs. Board Size



illustrates the inverse relationship between the two variables. The results demonstrate that, holding all else constant, for every additional member included in the board of directors, ROA of a company decreases by .007.

Moreover, the data collected for the OLS regression passed the normality, multicolinearity and heteroskedasticity tests, which implies that the sample population is a good representation of the target population of social enterprises with international operations. The R-squared value for the OLS regression is .255, suggesting that 25.5% of the variation in ROA is explained by size of the board, while the remaining 74.5% is contingent on other factors. Additional variables that may affect ROA are explored in the last section of this chapter.

Meanwhile, in terms of data analysis regarding the sample population, Table 5.2 illustrates certain characteristics of the social businesses used in this research. Specifically, the table shows the average, range and standard deviation for each variable collected from the 34 social enterprises used in this study. Table 5.2 demonstrates that,

TABLE 5.2 Analysis of Variables

Variable	Average	Range	Standard Deviation
Return on Assets	.063	-.146 – .334	.126
Size of Board (number of directors)	15.6	4 – 31	6.87
Proportion of Women on Board	.404	0 – 1	.242
Proportion of Directors with Business Background	.597	.1 – 1	.253
Proportion of Revenue Derived Commercially	.301	-.173 – .96	.309
Access to Leverage	.277	.001 – .879	.217

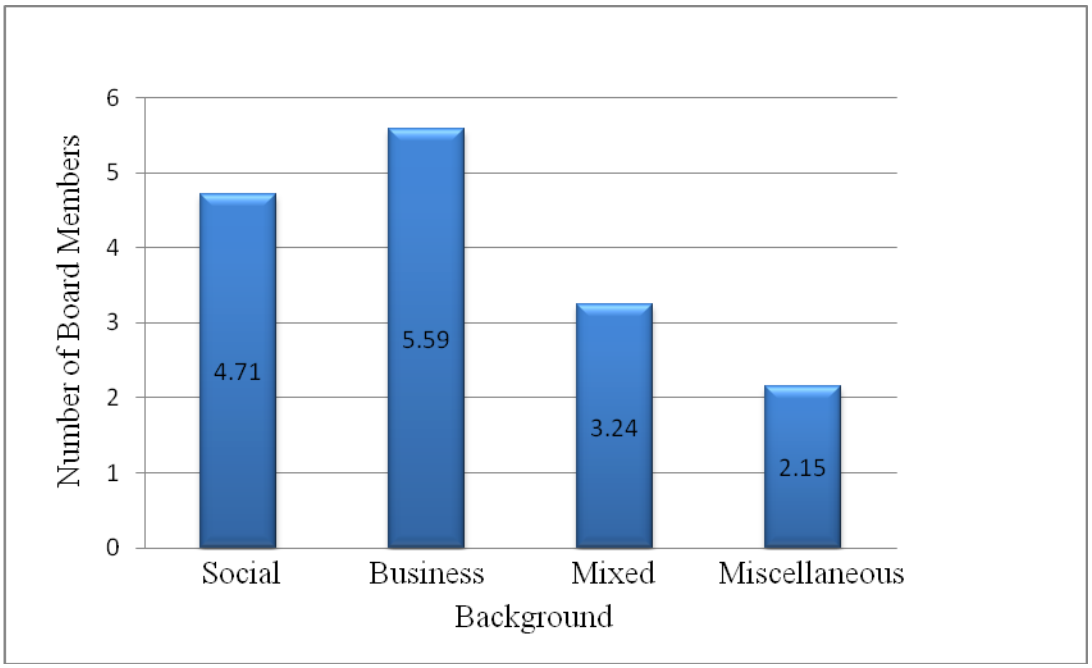
on average, the companies used in this study produce $.063 of income for every $1 in total assets. Habitat for Humanity International has the lowest ROA of -.146, while Bead for Life has the highest ROA of .334.

Regarding companies' board characteristics, the sample population has an average of 15.6 directors, with Greater Good, Global Giving Foundation, and Bead for Life containing the smallest boards, and Save the Children Federation, Girl Scouts, and Goodwill Industries International possessing the largest boards. In terms of female representation, boards are comprised of a mean proportion of .404 women. Livestrong and Young Life, however, have no female board members, while the Global Fund for Women is run entirely by female directors. There is also great variation in the proportion of directors with a business background. While the average proportion of total board members with business backgrounds is .597, Global Greengrants Fund, for example, only has one member out of ten total directors with business experience.

In terms of funding strategy, the 34 social enterprises derive 30.1% of their revenue, on average, through the use of a market-based strategy. Companies such as Acumen Fund and Save the Children Federation, however, actually had negative revenues from business initiatives, in part because of unprofitable investments. On the other hand, Bead for Life and Girl Scouts are predominantly funded through the sale of products (96% and 90%, respectively, of sales derived commercially). Lastly, companies possess a mean $.217 worth of liabilities per $1 in total assets. Greater Good has an extremely low debt-to-assets ratio at .001, while International Development Enterprises possesses the greatest debt-to-assets ratio at .879.

Moreover, a portion of this research involves grouping board members into distinct academic and professional categories. Graph 5.2 shows the background of board members in the sample population. On average, the social enterprises incorporated in this study contain 4.71 board members with a primarily social background, 5.59 directors with a business background, 3.24 members with a mixed social and business background, and 2.15 directors with miscellaneous experience. Naturally, the background of board members tends to be contingent on the mission of

GRAPH 5.2 Background of Board Members



the company. Social enterprises that contain a specifically socio-economic mission such as Acumen Fund, Grameen Foundation, and Root Capital are comprised almost entirely of board members with business backgrounds (92%, 93%, and 100%, respectively), while more socially or environmentally oriented firms such as Global Greengrants Fund contain low percentages (10%).

Quantitative Section Analysis

The empirical finding that board size is inversely correlated with financial performance holds numerous implications for the social enterprise field. Although no studies have tested for the relationship between ROA and board size specifically in the context of the social enterprise field, the negative correlation between the two variables found in this research is congruent with the work of various academic scholars. As discussed in the literature review, Jensen[1] finds that for-profit firms containing boards with more than seven or eight members are susceptible to ineffective leadership. Similarly, Lappalainen and Niskanen[2] establish that companies with large boards often squander valuable assets, and Dehaene et al.[3] claim that larger boards do not increase financial returns.

Although many viable explanations exist for the inverse relationship between financial health and board size, social enterprises with larger boards such as Save the Children Federation (30 directors), Goodwill Industries International (31 directors), and Girl Scouts (31 directors) are likely to encounter inefficiencies in board operations and asset utilization. Larger boards are also inclined to contain directors with different objectives, which is likely to undermine the overall cohesiveness of the board. This is congruent with Bozec's claim that agency problems often plague for-profit firms with

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[1] M. Jensen, "The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems," *The Journal of Finance,* Vol 48 (1993): 831-880.

[2] Jaana Lappalainen and Mervi Niskanen, "Does Board Composition and Ownership Structure Affect Firm Growth? Evidence from Finnish SMEs," *Research in Economics and Business: Central and Eastern Europe,* Vol 127, No. 1 (2009): 69.

[3] A. Dehaene, V. De Vuyst and H. Ooghe, "Corporate Performance and Board Structure in Belgian Companies," *Long Range Planning*, Vol 34 (2001): 383-398.

large boards.[4] On the other hand, companies with small boards and high ROAs such as Bead for Life (six directors, ROA=.334) and Newman's Own Foundation (seven directors, ROA=.219) are likely to avoid many agency problems by ensuring that board members share the same goals, mission and vision.

Moreover, the economic prudence with which company leaders execute board meetings can mirror the larger financial underpinnings of organizations. Typically costly, board meetings can deplete companies' budgets in the purchase of flights, accommodations, and other expenses. Larger boards inevitably increase the propensity for high expenditures. Overall, there appears to be a close link between board size and companies' ability to generate income efficiently.

While this thesis find a significant link between board size and financial health, the results do not reveal a correlation between ROA and business background of board members, proportion of revenue derived commercially, or access to leverage. The lack of relationship demonstrates that, although the concept of social business has gained momentum in the last decade, a definite dichotomy still exists between commerce and philanthropy, and the private and public sectors. The largest, most successful nonprofits, for example, are still primarily funded through donations rather than commercial instruments. The Nature Conservancy, for instance, with its tremendous success and mammoth size ($5,558,898,735 total assets), obtained more than $868.9 million from donations and received much less revenue from its program service

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[4] R. Bozec, "Boards of Directors, Market Discipline and Firm Performance," *Journal of Finance and Accounting*, Vol 32 (2005): 1921-1960.

($376.6 million) and investment income ($143.4 million) in 2009.[5] The same paradigm is true for the other sizeable social enterprises included in this research such as Heifer International (2.9% of revenue acquired through market-based strategy) and Smile Train (3.1% of funds acquired commercially). Smaller, younger companies that are funded primarily through the sale of products and services such as Bead for Life (96% of revenue acquired commercially) are still anomalies and have not been scaled as extensively as some of the largest and most renowned nonprofits. Overall, the lack of a relationship between the use of business strategies and financial health of social organizations illustrates that, although the distinctions between the private and public sectors are becoming less pronounced, nonprofits still predominantly use philanthropic sources of revenue such as grants, donations and fundraising to finance operations.

Lastly, the fact that the proportion of female directors is not correlated with financial health of organizations also has many repercussions for the social enterprise field. The hypothesis that the increased participation of women on the board increases ROA is rooted in studies that demonstrate that female directors tend to attract greater donations,[6] participate extensively in local communities,[7] and increase corporate social responsibility (CSR) in the private sector.[8] The lack of significance found in this study

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[5] *Foundation Center 990 Finder* (2006): available online at http://dynamodata.fdncenter.org/990s/990search/esearch.php.

[6] R. Williams, "Women on Corporate Boards of Directors and Their Influence on Corporate Philanthropy," *Journal of Business Ethics*, Vol 42 (2003): 1-10.

[7] A. Hillman, A Cannella and I. Harris, "Women and Racial Minorities in the Boardroom: How Do Directors Differ?" *Journal of Management*, Vol 28 (2002): 747-763.

[8] Stephen Bear, Noushi Rahmen and Corinne Post, "The Impact of Board Diversity and Gender Composition on Corporate Social Responsibility and Firm Reputation," *Journal of Business Ethics*, Vol 97 (2010): 217.

implies that the various strengths that female directors bring to organizations may have a greater impact in corporations than in philanthropic ventures. By their very nature, nonprofits already have a positive ethos and socio-environmental respect, which implies that they have less to gain from improvements in CSR. Moreover, the ability of women to attract greater donations, as purported by Williams,[9] is not necessarily captured by the measure of ROA, since the social enterprises included in this study fund themselves through various sources of revenue.

While the first portion of this chapter explores specific attributes of successful social enterprises through a numerical analysis, the next section investigates additional variables through a case study and various interviews.

Qualitative Section Analysis

The qualitative portion of this thesis demonstrates how organizations can employ stakeholder theory to develop competitive advantages through a pragmatic example in the context of the Abraham Path Initiative (API). The last part of this section discusses various interviews with leaders of four social enterprises: API, Bead for Life, Global Greengrants Fund (GGF), and Acumen Fund. This section unearths additional variables associated with organizational success that prepare the academic field for further research.

Strategic Allocation of Value to Stakeholders

Although non-governmental organizations (NGOs) often have fewer resources and a smaller asset-base than many commercial ventures, they often have to compete

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[9] R. Williams, 1-10.

for the same customers in similar markets. This thesis argues that nonprofits have the potential to hone their grassroots nature and decentralized organizational structures to develop strong links with stakeholders. As discussed preliminarily in the theory chapter, companies that are particularly adept at allocating resources to stakeholders gain loyalty from constituents, establish trusting relationships, and develop competitive advantages.[10] The close proximity of organizations' internal and external stakeholders promotes meaningful interactions through which companies acquire crucial information about stakeholder preferences. Accordingly, this communication expedites and facilitates the calibration of companies' operations, strategies, and overall resilience.

While directors are required to identify, prioritize and manage certain stakeholder groups, minimal scholarly work exists regarding the best approach at selecting and maintaining prominent stakeholder ties.[11] Social enterprises must strive not only to identify primary stakeholders but must also find the optimal allocation of value to these groups. Graph 5.3 conceptually demonstrates the general dilemma that social enterprises (and other organizations) face in addressing stakeholders.

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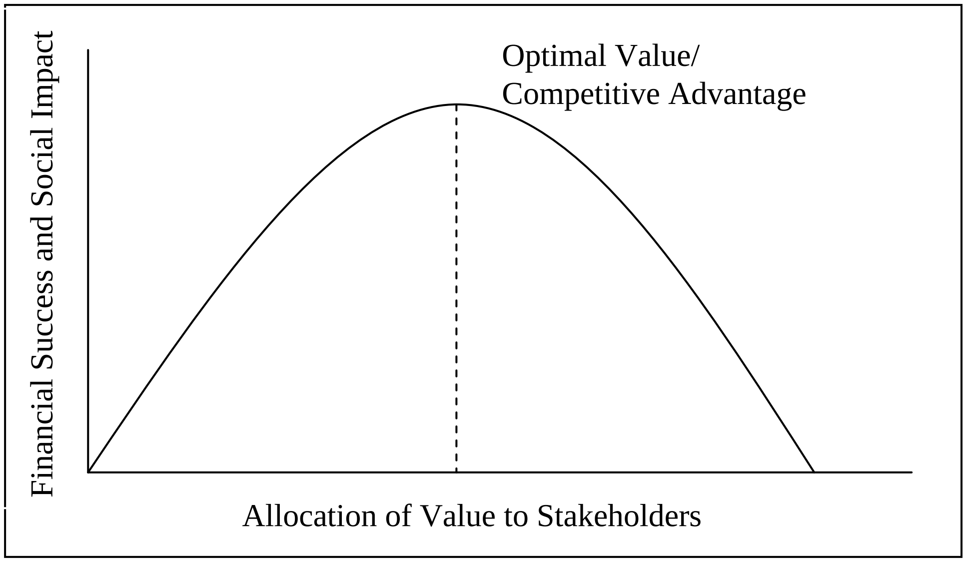
[10] Jeffrey Harrison, Douglas Bosse and Robert Phillips, "Managing for Stakeholders, Stakeholder Utility Functions, and Competitive Advantage," *Strategic Management Journal*, Vol 31 (2009): 61.

[11] Chris Mason, James Kirkbride and David Bryde, "From stakeholders to institutions: the changing face of social enterprise governance theory," *Management Decision*, Vol 45, No. 2 (2007): 296.

GRAPH 5.3 Optimal Allocation of Value to Stakeholders



The x-axis represents the distribution of resources and time spent managing relationships, while the y-axis demonstrates the firm's financial success and the extent of social impact. The apex of the graph denotes an organization's optimal and most balanced allotment of value to stakeholders. At this point, a company creates a competitive advantage, obtains the greatest financial returns, and provides the highest social impact. To the left of the peak, the organization does not build enough close connections with other organizations or provide exclusive benefits to maintain key stakeholders. Meanwhile, a company's positioning to the right of the apex entails an over-allocation of value whereby the costs of managing for stakeholders surpass the benefits received. Such an eventuality may be the result of a firm's allocation of too many resources towards acquiring information on customer utility functions or an inefficiency in selecting and distributing value to key stakeholders.[12]

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[12] Harrison et al., 69-70.

Allocation of Value in Social Enterprises: A Pragmatic Example

An analysis of API's strategic allocation of value to its stakeholders illustrates the importance of understanding precisely the motivators that entice people to participate in the activities of an organization. A company can be seen as an intermediary, facilitating nexus through which various stakeholders achieve their particular objectives. While donors and employees, for example, have different goals than the executive director and governmental agencies, the business is responsible for connecting stakeholders with dissimilar objectives. The organization catalyzes change, promotes experiences, provides goods and services, and brings value to individuals, companies, and political entities. A business that is unable to meet the requirements of its constituents risks losing valuable relationships and customers.

William Ury, the founder of API, finds that his philanthropic venture must provide benefits to numerous stakeholders even with an extremely limited amount of resources:

> API has so many stakeholders and yet, comparatively, so few staff members that we were forced to move away from the idea of viewing API as an organization and, rather, developed a more flattened structure with a strong emphasis on networks. This year we are starting an annual gathering at Harvard where a community of the "Friends of the Path" can independently form a supportive community. We also started using social media to bring different people with similar interests together without having them go through API first.[13]

In addition to expanding networks in an efficient and creative manner, Mr. Ury explains that the organization must also decide which donors to include. Currently, a handful of high net worth individuals fund API rather than an abundance of smaller contributors: "We would be unable to cultivate a large donor-base at this point because we can only

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[13] William Ury. Interview by Thomas Modern, 18 November 2010. iPhone Recording. *Sustainability of Social Enterprises*. Boulder, Colorado.

allot a certain amount of strategic time to fundraising."[14] While in the past API leaders unsuccessfully attempted to take into consideration the requests of too many stakeholders—placing API to the right of the apex of Graph 5.3—over time they have learned to account efficiently for the needs of different individuals and organizations.

Merging the operations of a business with the needs and expectations of stakeholders requires a thorough understanding of the impetus that drives the company's constituents. This entails objectively identifying the stakeholders that constitute an organization and intentionally determining the value that each stakeholder expects from the particular company. Table 5.3 illustrates API's stakeholder ladder and the basic motivations that attract different people, organizations, and entities. Other social enterprises can use a similar approach in developing a strategic plan to move the mission forward while also reaching financial independence.

TABLE 5.3 Allocation of Value to API Stakeholders

API Stakeholders	Expected Value
Executive director	*Fulfill the dream of creating peace in Middle East and the world *Profitability of the Path through sustainable tourism *Create hope, educate world about the Middle Eastern strife *Compensation
Founder	*Realize the vision *Create peace and mutual understanding between persons from all walks of life in Middle East as well as between West and global Muslim community
Country directors	*Benefit specific constituency of particular country that they represent *Want locals to view them as figure of trust *Compensation
Employees	*Fulfill passion for social amelioration in Middle East through specific talents and resources brought to the organization *Compensation
	(Table continues on the following page.)

[14] Ibid.

Hosts	*Gain respect, be seen by the world, disseminate their stories, challenge stereotypes *Uphold cultural norm of hospitality *Compensation
Local Communities	*Cultural respect *Interact with foreigners *Share customers
Board members	*Uphold API ideals and realize the dream of the company *Connect with others on the Board and people with similar passion for social change
Partner organizations	*Share customers (for-profits) *Educate people about specific social issues (nonprofits) *Fulfill own agenda
Tourism Operators	*Revenue from shared customers *New product to sell
Customers/ Walkers	*Cultural knowledge *Authentic experiences *Social impact
Donors	*Tangible social impact (returns) *Prestige through association with API, renowned philanthropists and Harvard University *Improved commercial relationships with other philanthropists
Local political entities	*API is a vehicle for the execution of political agenda (i.e., economic development, diplomatic relationships)
International government agencies	*Support social change abroad, worldwide peace *Sustainable economic development
Media	*Attain publicity through dissemination of emotive stories *Raise awareness and positive social impact
Corporations	*Cost-effective advertising *Improve public image and develop brand through cause marketing and social responsibility *Tax write-offs *Facilitate operational expansion through knowledge about Middle East and association with trusted organizations
Universities	*Educate students *Advance research

Table 5.3 illustrates that, unlike the private sector where profit maximization is overwhelmingly the norm, social enterprises must manage the varied objectives of their constituents. In the case of API, the underlying impetus ranges from universities looking to advance research and customers seeking to undergo a genuine experience to tourism operators expecting financial returns and local political entities whose agenda is

economic development. API's allocation of value ladder also suggests that the further the positioning of stakeholders from the organization's core, the greater the likelihood for motivations to vary. The founder, the executive director, and the staff, for example, are primarily fueled by the passion to pacify one of the most turbulent regions in the world. External stakeholders, on the other hand, such as corporations often support nonprofits to receive tax deductions through philanthropic contributions and to improve their public image through cause marketing, which is advertising through the cooperative efforts of for-profits and charitable institutions. Meanwhile, an entity such as the international media possesses different goals that vary from the need to attain publicity through the dissemination of emotive stories to raising social awareness in different countries. Ultimately, companies such as API must adapt and operate in accordance with the motivations of constituents. The identification of stakeholders' expected value is imperative in the nonprofit sector where the ability to attract donors, corporations, political entities, and partner organizations often determines the NGO's survival.

While API leaders have learned to manage different stakeholders and allocate value efficiently, they have also observed the necessity to prioritize constituents. When asked about the most significant stakeholders, Mr. Ury underscores the importance of donors and explains that, similar to investors in the private sector, philanthropists fund social projects with the expectation of encountering tangible social returns:

> Donors feel like they become ambassadors of the Path. They feel like they are doing something that is contributing to the situation in the Middle East and start to feel less heavy about it. There is also the aspect of prestige whereby donors are associated with other philanthropists such as the Rockefeller family and a Saudi prince as well as Harvard University, which is where API was founded. They are also able to tell their friends and family about the whole thing.[15]

[15] Ibid.

In addition to the social impact and the acquired prestige, Mr. Ury has discovered that philanthropists' contributions often help their own business interests. One prominent donor, for example, who is Jewish, often donates to API with his friend, who is of Arab descent. The act of mutual giving enhances their friendship and commercial relationship and, on a larger scale, provides hope for the Palestinian-Israeli conflict.

Understanding that the organization cannot rely merely on charitable contributions, API is also working to establish joint ventures with specific corporations. BASF, one of the world's leading chemical companies, for example, has expressed its interest in working with API as it expands into the Middle East. If negotiations follow through successfully, BASF will provide revenue to API in exchange for knowledge about the complex political, social, and economical underpinnings of the Middle East. BASF will also gain the trust of local entities through its association with a reliable regional organization. API's development of a positive reputation through its strategic allocation of value to pertinent Middle Eastern citizens, political parties, and social institutions not only benefits API, but also appeals to large foreign companies such as BASF. Unlike traditional nonprofits that unhealthily rely on charity, social enterprises such as API have the opportunity to devise business models with concrete competitive advantages that promote financial independence and the fulfillment of their social missions.

A similar acquisition of stakeholder preferences helped API scale its operations in some of the most politically disparate regions of the Middle East. Mr. Ury explains:

> Understanding what each stakeholder looks for improves organizational success. One of the main lessons for API in the last five years arose from the fact that we started off with the vision of trying to contribute to the peace in the region. But then we found that peace was not the immediate agenda of local hosts and governments, but rather it was

> the economic development of the area. Now we have to frame API not only as a peace-building endeavor, but also as an economic undertaking. Countries disagree on just about everything, except for the desire for many tourists. And there is a synergy: if tourists go to Palestine, they also travel to Israel, and vice versa. The same is true with Jordan. 70% of the tourists are Christians who want to go to all the sites. So all these countries end up benefiting.[16]

At first, API staff failed to attract the support of local citizens and political entities because framing the social enterprise as a peace-building effort raised too much skepticism. Gradually, API employees overcame their preconceptions as they discovered that economic development is the unifying objective of a majority of Middle Eastern stakeholders.

Overall, API leaders have learned to improve the success of the organization by understanding the intricate motivations that drive pertinent individuals, entities, and organizations. When discussing the project with different stakeholders, API leaders are able to cater to the needs of specific individuals and organizations by framing the Path in the most suitable manner. These examples demonstrate how acute knowledge of stakeholder preferences can lead to increased support, donations and, ultimately, a competitive advantage.

In addition to attracting loyal philanthropists and developing a strategic plan that accounts for the different needs of stakeholders, organizations like API can acquire crucial information about customer preferences that allow the company to calibrate operations accordingly. Table 5.4 demonstrates how the development of trusting relationships with consumers enhances the disclosure of personal customer preferences.

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[16] Ibid.

TABLE 5.4 Disclosure of Personal Customer Preferences

Stakeholder	Information Shared
Customer #1	*Recommends publication and sale of illustrated book with descriptions of the Path as souvenir for walkers and people who have never walked the Path
Customer #2	*Invite Muslims who have never been to the Middle East to walk the Path to experience non-extremism and religious tolerance in the face of adversity
Customer #3	*Establish long-term connections between walkers and hosts by initiating a system of communication (i.e., exchange of letters, electronic mail, small gifts, contributions, etc.)

API has struggled with the issue of financial sustainability because the partnering tourism agency receives the internally generated revenue from walkers on the Path. To scale operations, API must find a source of profitability in which funds can recycle through the larger company. Being aware of the organization's financial difficulties, one of the customers suggests that API sponsor the publication of an illustrated book of the Path that can be sold as a souvenir both to walkers of the Path and to those who have not yet had a chance to experience it. Such a complementary product would help generate funds to attenuate API's reliance on donations and would activate latent demand in customer groups who are unable to travel the Path.

Additional Variables for Further Research

This thesis unearths some of the possible factors that contribute to the sustainability of social enterprises. Specifically, the quantitative section tests for the impact of funding strategy, business characteristics and board attributes on financial health of companies. Naturally, the success of organizations is contingent on many other variables as well. Drawing from interviews with the leaders of four social enterprises, this section proposes additional variables for further research in the field. As shown in Table 5.5, these elements include internal use of metrics, tangibility of the vision, funding strategy, organizational structure, and brand development.

TABLE 5.5 Additional Variables Potentially Related to Financial Success

	Abraham Path Initiative	Global Greengrants Fund	Acumen Fund	Bead for Life
Competitive Advantage	*One of most recognized cultural tourism enterprises in Middle East *Audacious vision *Harvard-based program *One of only cross-border cultural initiatives	*Ability to mobilize 100s of volunteers *200 high-net worth consistent donors *Integrity and trustworthiness of company	*Pioneer in the field *Progressive, undtraditional *Large asset-base *Business experience of company leaders	*Financially independent *Affordable product with story behind it *Ability to inspire and connect people
Internal Use of Metrics (Social and Financial)	*Few internal metrics—especially regarding social change	*Little use of benchmarking *Provide donors with honest feedback starting on the premise that they do not know how social change happens	*Stringent use *Require seed companies to benchmark financial/social impact	*Precise information on revenue sources and expense allocation *Social impact statistics (i.e., # of people who built a home and started a business)
Tangibility of Vision	*Varied interpretations *Must be adapted based on audience *Potentially difficult to grasp	*Vision is tangible to locals and volunteers who see palpable, regional environmental change	*As an incubator organization for social enterprises, vision can be diluted by quantity of issues addressed	*Tangible vision bolstered through stories, videos, house parties, sale of jewelry
Funding Strategy	*Funded primarily by high-net worth individuals *Small revenue from customers-- must travel to Middle East to walk the Path	*Stock Market *Only receive large donations from network of high net worth individuals	*Initially funded by Rockefeller Foundation *Include smaller donors and receive greater return in invested capital	*97% of revenues from sale of African-made jewelry
Organizational Structure	*Experimentation with different models *Currently semi-hierarchical	*Flattened, “distributive” structure *Empower regional advisory board to obtain local knowledge	*Mixed approach: flattened to empower employees; hierarchical to promote business ethic	*Decentralized *Numerous partner-organizations *“Bead Circle” connects bead-makers and supporters
Brand Development	*Word of mouth *Media articles (i.e., U.K.’s *The Guardian*) *YouTube, TED talks *Social media	*House parties *Integrity of advisors builds reputation; shared “David and Goliath” story	*Online presence, promotional videos, and social networking. *Creative competitions	*“Bead Parties” raise awareness and funds *Retelling company story in schools and media

The four companies included in this research vary considerably in terms of use of metrics. Bead for Life and Acumen Fund underscore the importance of benchmarking progress, while API and GGF possess few tangible performance indicators. GGF founder Chet Tchozewski explains:

> We understand that sociologist economists don't have a plausible theory for how change happens. We look to challenge the notion of metrics and, instead of providing misleading numbers on metrics and overall progress, we hone on the ability to be honest. We are realistic in letting investors know that change takes time and we give them meaningful feedback starting on the premise that we don't know how social change happens.[17]

While GGF distinguishes itself from other nonprofits and gains the trust of investors through a contra strategy that avoids using metrics, Acumen Fund builds its legitimacy through the stringent use of a unique benchmarking instrument called BACO, or "best available charitable option," which is used to assess the social impact and cost-effectiveness of investments.

Overall, the use of metrics is a considerable challenge for nonprofits and social enterprises because such organizations must track both financial returns and social impact. Although the fact that 501(c)(3)s must complete detailed financial reports each year helps legitimize the public sector,[18] only 43 percent of nonprofits post their annual reports on their websites.[19] This lack of transparency is even more conspicuous in regards to social metrics because organizations' missions differ tremendously and

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[17] Chet Tchozewski. Interview by Thomas Modern, 18 October 2010. iPhone Recording. *Sustainability of Social Enterprises*. Boulder, Colorado.

[18] Chris Mason, James Kirkbride and David Bryde, "From stakeholders to institutions: the changing face of social enterprise governance theory," *Management Decision*, Vol 45, No. 2 (2007): 295.

[19] Beth Kanter and Allison Fine, *The Networked Nonprofit* (San Francisco: Jossey-Bass, 2010), 76.

cannot always be quantified. Author Jim Collins underscores this challenge in his monograph *Good to Great and the Social Sectors*:

> For a business, financial returns are a perfectly legitimate measure of performance. For a social sector organization, however, performance must be assessed relative to mission, not financial returns. In the social sectors, the critical question is not "How much money do we make per dollar of invested capital?" but "How effectively do we deliver on our mission and make a distinctive impact, relative to our resources? [20]

Not only are social metrics difficult to measure, but organizations must continuously balance two extremes: on the one hand social enterprises risk causing a mission drift if profit maximization becomes the focus and, on the other hand, an overemphasis on the social commitment can lead to an unsustainable model.

Meanwhile, tangibility of vision is another variable that future studies can empirically test as an indicator of organizational success. At API, for example, maintaining the congruency of the company's vision is a challenge because the differing political views in API's operational sphere often call for varied interpretations of the company's overall mission. Framing API as an instrument for economic development, for example, attracts new participants, but sometimes jeopardizes the greater peace-promoting effort of the organization. Bead for Life, on the other hand, has honed its ability to unify a comparatively less controversial vision with its unique Ugandan jewelry and shea butter products. The social business has efficiently made its vision more palpable by connecting Western customers with the cultural characteristics of Uganda. An example is the concept of Americans hosting "bead parties" that are dedicated to raising awareness about third world countries through an evocative evening of cultural appreciation. Bead for Life founder Torkin Wakefield explains,

> The story is as important as the beads. We have developed a "bead circle" that connects Ugandan "beaders" and Americans who now feel empowered because they

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[20] Jim Collins, *Good to Great and the Social Sectors* (Boulder: Jim Collins, 2005), 5.

> are helping others. Recently, one American host went through a profound experience where she was touching the beads imagining the woman who made them, and she started crying and praying. It's a highly evocative experience, an engine of power and hope. Developed countries help Africans become empowered and financially independent, while Africans help us by providing connection and meaning to our lives.[21]

Ultimately, it is the powerful story and the tangibility of the vision behind the Ugandan products that draw customers to Bead for Life.

Additionally, the interviews with the four company leaders reveal that the organizational structure of social enterprises is an important factor and requires a delicate balance between hierarchy and decentralization. API, for example, experimented with different corporate arrangements and eventually found its way to a semi-hierarchical model. Before discovering the optimal local candidate to manage API operations in Palestine, the company attempted to appoint an executive with various respected credentials as country director. Eventually, API executives observed that the person's Western academic and experiential knowledge was not suited for the unique challenges of the Middle East. Although the current Palestinian director has less formal training, he does provide insightful knowledge about the region and possesses strong links with key figures. The example demonstrates that API's initial hierarchical approach was not optimal. Similarly, GGF has established itself as an extremely flattened company:

> We promote regional advisory boards to maintain GGF's competitive advantage of being a grassroots campaign that draws from local knowledge. We are a distributive organizational structure in the sense that we give real power to people in Brazil, Ghana and China, for example.[22]

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[21] Torkin Wakefield. Interview by Thomas Modern, 15 October 2010. iPhone Recording. *Sustainability of Social Enterprises*. Boulder, Colorado.

[22] Chet Tchozewski. Interview by Thomas Modern, 18 October 2010. iPhone Recording. *Sustainability of Social Enterprises*. Boulder, Colorado.

In the same way that donors provide revenue to GGF with few inquires about fund usage, the organization supports local environmental campaigns abroad without imposing specific mandates. On the other hand, unlike API's and GGF's decentralized model, Acumen Fund resembles a commercial enterprise to promote business ethics within the company and in the commercial initiatives that it sponsors.

Another variable that future studies can investigate is brand development of social enterprises. Unlike for-profits that often spend exorbitant amounts on advertising, social enterprises must often employ creative strategies. Like Bead for Life's encouragement of "bead parties," GGF supports participative gatherings to promote the company's cause: "We incentivize house parties to raise environmental awareness. Our branding strategy draws from the high integrity of our advisors and, most importantly, the shared David and Goliath story."[23] Both Bead for Life and GGF masterfully kindle people's passion for social amelioration. Meanwhile, believing that social media has the potential to reach a larger audience, Acumen Fund takes a different route. Acumen Fund founder Jacqueline Novogratz explains:

> We have a strong online presence, and use aggressive online campaigns such as Google ads, videos and social networking. We also build the brand by running competitions such as "Search for the Obvious." The idea is that the most successful businesses often fill the most obvious gaps. So we engage engineers, entrepreneurs, physicians, and designers to come up with innovative ways of addressing key basic elements such as sanitation.[24]

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[23] Ibid.

[24] Jacqueline Novogratz. Interview by Thomas Modern, 20 October 2010. iPhone Recording. *Sustainability of Social Enterprises*. Boulder, Colorado.

Unlike Acumen Fund's active marketing campaign, API has taken a more passive stance but has still attracted the attention of international media including United Kingdom's *The Guardian, The Times,* and *The Independent,* U.S.-based *National Public Radio* and the *Christian Science Monitor*, and Brazil-based *Veja* magazine and *Globo TV*, and TED online talks. Overall, these companies juxtapose brand development approaches ranging from traditional house parties to elaborate online efforts.

In addition, preliminary writings focusing specifically on the topic of brand development through social media demonstrate that cause-driven organizations have the opportunity to embrace the interconnectivity of the 21st century and transform into "networked nonprofits." As described in *The Networked Nonprofit*, such companies efficiently create networks and produce participative social cultures:[25]

> They are easy for outsiders to get in […] They engage people in shaping and sharing their work in order to raise awareness of social issues, organize communities to provide services [… They] are comfortable using the new social media tool set—digital tools such as e-mail, blogs, and Facebook that encourage two-way conversations between people, and between people and organizations, to enlarge their efforts quickly, easily, and inexpensively [… On the other hand,] organizations without social cultures fade because the oxygen needed for them to thrive—authentic conversations—requires leadership's attention and appreciation to exist.

Given that social enterprises must inexpensively build their reputation and attract customers, subsequent research can advance the field by focusing specifically on advertising through the use of online resources.

In addition to brand development, future studies can also analyze the effects of different funding methods on the overall success of social enterprises. This thesis isolates a specific component of companies' financial model by studying the correlation between return on assets of organizations and commercially derived revenue. Since a

[25] Kanter and Fine, 3.

company's source of revenue is likely to change over time, successive research can determine whether thriving social businesses follow a certain optimal funding progression that other hybrid firms can replicate. In addition, given that seventy-five of the largest nonprofits in the country derived only seven percent of total donations online, [26] future studies can explore the potential of online funding strategies so that organizations can receive a greater share of revenue through the internet. Moreover, the lack of significance between the use of a market-based strategy and financial performance in the sample population of this thesis suggests that nonprofits still heavily rely on philanthropic contributions. Future studies can explore both the strategy that the largest organizations employ to attract donors and the ideal approach to building a charitable base (i.e., do the most successful social enterprises rely on a handful of high net worth individuals or do they receive smaller contributions from a large donor base?).

Research Limitations

While this thesis has sought to contribute to the social enterprise field in numerous ways, the author encountered several limitations. For example, the author tests for the effects of specific factors on financial performance of organizations. However, since profit maximization is not the primary objective of nonprofits investigated in this study, a more accurate dependent variable would also include social impact. Future studies can also employ multiple measures of financial health since return on assets only accounts for a portion of companies' economic success. Moreover, systematic assessment of board members' background inevitably contains

[26] Kanter and Fine, 138

some subjectivity because online biographies only provide a snapshot of directors' academic experience and professional history. In addition, due to the brevity of the allotted research period, the author collected a relatively small sample size. A more accurate study can follow similar procedures and include hundreds of social enterprises with international operations. Such a procedure would also allow for cross-industry comparisons that may highlight different optimal approaches towards organizational sustainability depending on the particular operational sector. Lastly, this thesis draws from a relatively broad sample population that includes young and mature social enterprises alike. Like any for-profit, social businesses are likely to require considerable donations and/or leverage at their inception. These initial sources of funding, however, are not always representative of companies' long-term strategies and can skew the debt-to-assets ratio and use of a market-based strategy variable. Ideally, this study would have differentiated between recent start-ups and older companies that are more likely to operate consistently each year.

Conclusion

The quantitative results portion of this chapter determines that out of the five variables tested, only board size is significantly correlated (in an inverse relationship) with financial health of social enterprises. The quantitative analysis section examines the implications of these findings and underscores the importance of board efficiency in managing resources. The qualitative investigation emphasizes social businesses' identification of pertinent stakeholders and the strategic allocation of value to constituents. The author also presents new variables that further research can empirically test in the field of social enterprise sustainability. Lastly, this chapter analyzes the limitations of this project such as the small sample size and the inability to measure social impact in addition to financial health of companies. The next chapter briefly summarizes the content of this thesis and discusses its contributions to the academic literature and the social business field.

CHAPTER VI

CONCLUSION

This thesis has sought to demonstrate the potential of the social enterprise field in addressing an array of global issues ranging from the Middle Eastern strife, common pathologies, and poverty to water contamination, deforestation and pollution. Unlike traditional charity, hybrid companies utilize market-based strategies such as the sale of products to promote a social or environmental mission. To date, however, relatively few social enterprises have successfully transitioned from the early phase of financial dependence to a mature stage characterized by true organizational sustainability. Although complex in nature, this shortcoming is partly a consequence of the difficulty to position enterprises optimally so that they include an adequate balance of commercial and charitable aspects. In addition, social enterprises often operate in destitute regions of the world that lack formal economies and adequate business infrastructure.

To address the matter of financial sustainability, this research isolates specific variables such as access to leverage, use of a market-based strategy, board size, inclusion of women on the board, and business background of board members and tests for their effects on the financial health of social businesses. The empirical results based on a sample of international organizations that derive part of their revenue from the sale of goods and services demonstrate that an inverse relationship exists between financial success and the size of the board of directors. Moreover, this thesis explores additional factors related to sustainability such as the use of internal metrics, tangibility of vision, funding strategy, organizational structure, and brand development. Employing a pragmatic case study, this dissertation also demonstrates how social enterprises can inexpensively develop a competitive advantage by strategically allocating value to stakeholders.

Overall this thesis contributes to the social enterprise academic literature by further legitimizing the field, applying pertinent governance theories, and building on seminal research regarding the sustainability of social businesses. In addition, the interviews with prominent social entrepreneurs and the case study on the Abraham Path Initiative demonstrate how leaders of hybrid companies tackle organizational challenges and develop their initiatives into healthy and effective organizations. Although a considerable amount of research remains for scholars to conduct, this dissertation has intended to advance the field of social enterprise and provide significant insights for social entrepreneurs.

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