PROJECT ON PHILANTHROPY, POLICY, AND TECHNOLOGY

September 2013

Good Fences: The Importance of Institutional Boundaries in the New Social Economy

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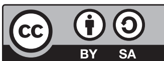

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I. Introduction

New modes of funding and an ever-increasing focus on measurable outcomes have fundamentally changed the way in which nonprofits and social enterprises finance the production and distribution of social goods, both at the national and international level. Major legal changes in campaign finance (especially those emerging from the 2010 Supreme Court decision *Citizens United v. Federal Election Commission)* have transformed the roles that nonprofit organizations play in political campaigns and political advocacy in the United States. The rise of hybrid organizational forms such as flexible purpose corporations and benefit corporations ideally provides promising venues for the production and distribution of social goods with the potential to combine the efficiency and flexibility of commercial enterprises with the accountability and transparency of public actors, and the discipline of the market with the social mission of a public actor. Digital and mobile communications have expanded the ways in which we communicate, organize, network, and transact, which in turn has had profound effects on public, nonprofit, and commercial organizations, including the mechanisms for domestic and transnational fundraising (mobile phone donations, crowdfunding platforms, etc.) and coordination of nonprofit activity (Ushahidi, Google disaster organizing, flu tracking, etc.). Together, these changes add up to a new social economy—a dynamic and diverse set of enterprises that deploy private resources for the creation and sustenance of public goods and that shape the way these goods are distributed across society.

The emergence of this new social economy is an exciting development, full of potential to improve the financing, production, and distribution of public goods. Yet important questions surround this emerging economy and the changing structure of the nonprofit sector within it. What is, and what should be, the relationship between new sharing enterprises and more traditional nonprofit organizations? Have recent changes in the sphere of campaign finance—changes accelerated by the Supreme Court's judgment in *Citizens United*—modified the balance between political and nonpolitical (e.g., charitable or welfare-based) activities within the nonprofit sector as a whole? Is the pressure on nonprofits to become more transparent and accountable as a consequence

of their increasing political role compromising distinctive features of this sector, such as the traditional norms of anonymity that have long protected philanthropic donors? What is the future of impact investing and its relationship to more traditional forms of charitable giving and philanthropy? How is digital technology changing the production and provision of social goods and the structure of civil society, especially concerning our freedom to speak and associate and expectations of privacy when doing so? Is it feasible and desirable to crowdfund public goods or civic enterprises?

All these questions are joined together by the widespread awareness that the traditional separation between three sectors—the public, the private and the nonprofit or associational sector—is progressively eroding in the new social economy. Today, social goods are provided through a variety of financial mechanisms and organizational structures that mix together public, private, and nonprofit features, as well as digital and non-digital dimensions. In addition, the traditional functions of the three sectors are blurring: market mechanisms are used to support nonprofit enterprises; nonprofit enterprises are used to fund political activity; publicly funded goods are provided by privately-owned companies, and so on. As a consequence of this, the traditional ways of accounting for the actions of the three sectors are blurring as well: quantitative metrics and outcome-based forms of measurement, more traditionally used in the business sector, are increasingly applied to nonprofit organizations and social enterprises. Norms of transparency and procedural fairness, traditionally limited to state action, are being progressively extended to private actors, and so on.

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The common awareness that the institutional boundaries between sectors are blurring naturally raises the concern that the policy framework developed for the old tri-partite social economy is not up to the task of structuring and

regulating the new social economy. The old rules are not adequate for the new tools. Yet it is impossible to propose, or even conceive of, appropriate policies unless one has an idea of where the boundaries, if any, between institutional mechanisms and organizational forms should be drawn in the first place. Simply announcing that one should draw lines between sectors in a way that "best solves problems" or "drives efficient results" is to beg the question. What work are we trying to accomplish, what problems are we trying to solve, through different enterprise forms and funding structures? How ought one decide how to structure and regulate the new social economy?

In order to answer this fundamental question, we must first ask whether one should only care about the production of outcomes (the social good or "impact"), regardless of the sector that produces it, or whether one should instead also care about how the division of roles and responsibility for producing social goods is allocated across sectors. In brief, do social outcomes alone matter or do the organizational structures or institutional mechanisms through which social outcomes are pursued matter as well? We cannot simply be guided by the question, "what works, and what works most efficiently?" We need also to ask and answer some questions about values. This is the subject of concern in this short essay.

II. Sector Agnosticism and the Importance of Measurable Outcomes

It is tempting to believe that outcomes matter more than institutional mechanisms. At the end, the argument goes, institutional mechanisms or "sectors" are nothing more than artificial and conventional means of achieving certain ends. What matters are the ends, not the means. As long as the blurring of the boundaries between sectors appears to be a necessary, or even merely more efficient, way of achieving greater social impact, understood as the achievement of measurable social goals, it should be welcomed.

To illustrate, consider the case of the so-called "sharing economy," in which nonprofits, for-profits, and peer-to-peer models are all providing sharing services, such as car-sharing, bike-sharing, couch-sharing, and so on. Many would argue that the organizational structure matters when it comes to raising capital but does not determine whether genuine public benefits are produced. Given the way commercial and nonprofit capital markets work, many see scaling as easier to do in commercial structures. Indeed, both sharing enterprises and nonprofits seem to be looking to market structures for opportunities to scale up their activities, more so than to the public sector. Since some public benefits obviously increase with scale—more car-sharing equals more emission reductions, for example—if we focus on measurable outcomes, the use of market mechanisms by nonprofits should be welcomed.

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From this *outcomes-based perspective,* what matters then is to try and find a common quantifiable and clearly defined measure of public benefit. The important question is, therefore, what kind of measurable outcomes the sharing economy is best suited to produce. In this respect, it could be argued that the sharing economy contributes to three kinds of public goods in the near term: *environmental benefits, financial benefits, and community or quality of life benefits*. In the longer term, the role of trust may actually set the stage for a fourth

benefit: civic engagement. This last benefit is problematic from the perspective of measureable outcomes, because it is especially difficult to quantify, difficult for sophisticated social scientists, still more difficult for employees at sharing enterprises. Leaving, for the moment, this problematic good aside, to the extent that a reliable measure of public benefit can be found, then from the outcomes-based perspective, what kind of organizational structure produces results becomes irrelevant. According to this view, we should think about policies that reward public benefit on the back end (as an activity or outcome) rather than on the front end (through organizational form, nonprofit tax exemptions, commercial tax credits and incentives, etc.).

A similar point could be made in relation to another emerging part of the new social economy: impact investing. Impact investors look to the market as the key mechanism for bringing innovations to scale. Microfinance offers a clear example of this phenomenon. If traditional banks can demonstrate that they can make a margin of profit from microfinance, then large banks across the world will get into the microfinance business. In this way, microfinance becomes available at much larger scale than any single, traditional philanthropic mechanism could achieve.

Traditionally, philanthropy has sought to bring successful ideas to scale, but the mechanism for doing so has most frequently been state or public financing, not the market. One conventional take on the role of philanthropy in a democracy is that philanthropic assets represent society's risk capital: let philanthropists, rather than state budgets and politicians, experiment with innovative social programs, evaluate them, and then bring the best to scale by having them taken over by the state. Carnegie's libraries, Head Start programs, the 911 emergency number, and traffic safety lines are all examples of this dynamic. Yet, as philanthropy and impact investing continue their co-evolution, we now have to choose between two possible scaling mechanisms: markets and public sector finance. On what basis (and when) will we determine whether the appropriate scaling mechanism should be a market (private finance) or a government (public finance)?

We must now ask, again, whether it is the good itself, the outcome, that has public value or if that value is at least in part conferred by its financing mechanism. Given the array of enterprises and capital working on social problems, there is a strong temptation to incentivize desirable social outcomes in an organizationally neutral or "sector agnostic" way, focusing more on what is accomplished than on the type of organization that accomplishes it. This partly explains the increasing, perhaps obsessive, focus on measurable outcomes and social impact and the nearly universal approbation attached to that fuzziest of labels, the "social entrepreneur."

III. The Dangers of Sector Agnosticism

Despite the widespread optimism that has greeted social entrepreneurship and social innovation, focusing on immediate, measurable social outcomes may not be all that matters. Attention to the distinctive nature and role of each organizational structure and institutional mechanism can matter, too. This is because treating different organizational forms and financial mechanisms as fully interchangeable may have dangerous consequences. These dangers can be categorized as follows:
(1) neglecting low-return outcomes;
(2) confusing different regulatory regimes; and
(3) neglecting non-measurable outcomes.
As we will see, many of these dangers persist even if measurable outcomes can be better achieved by mixing different institutional structures. Taking these dangers seriously may push us to reconsider the claim that we should always incentivize social outcomes in a "sector agnostic" way and rather be more sensitive to the distinctive contributions and limitations of each and every sector.

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A. Neglecting low-return outcomes

Certain dangers that follow from completely ignoring differences and boundaries between institutional and finance mechanisms can themselves be grasped by the language of outcomes. Consider again the case of microfinance. At first blush, it seems desirable to allow, even encourage, large banks across the world to take over for traditional philanthropic mechanisms. Encouraging investors seeking market returns to flood into the space will quickly create capital and broaden the scale, and, therefore, the overall impact of microfinance. Yet, the risk of doing so is that only certain outcomes will be maximized while others, perhaps equally or more important, will be neglected. For example, while market investors may be willing to support enterprises that can promise

high financial and social returns, money is less available for enterprises that serve the most desperately poor. In brief, different financial mechanisms and organizational structures are able to bear different risks and provide different benefits. Their desirability strongly depends upon the nature of the targeted market: market scaling through impact investing may be appropriate to support enterprises that already possess disposable income, whereas more traditional forms of grants may be still necessary to support enterprises that serve the very poor.[1]

In addition, we might worry that introducing forthrightly commercial, profit-seeking enterprises into the delivery of small loans cuts against a particular and important ethos of microfinance. None other than the father of microfinance, Nobel prize-winning economist Muhammad Yunus, founder of the Grameen Bank, expressed outrage in 2011 when commercial, for-profit firms began offering microcredit. "The kind of empathy," Yunus wrote, "that had once been shown toward borrowers when the lenders were nonprofits disappeared. . . . Poverty should be eradicated, not seen as a money-making opportunity."[2] Should public policy be indifferent to whether microlenders are for-profits or nonprofits, worrying only about what creates the "most impact"?

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B. Regulatory confusion

Other dangers that come with the blurring of boundaries between sectors have, instead, to do with the *confusion between regulatory regimes* and the consequent absence of clarity regarding mechanisms of accountability and the division of responsibilities between actors. This problem clearly emerges in the case of impact investing. The intertwined paths of impact investing and philanthropy have created a "regulatory mosh pit," where rules of different domains are overlaid confusingly atop one another, jostling for position.[3] One example can be seen in the different reporting requirements for benefit corporations—corporate entities required to have a "general public benefit" and to take into

account stakeholders' interests in their operations—and nonprofit 501(c)(3) corporations. Somewhat ironically, the former must file an annual statement of socially productive activities, whereas the latter need only file annual financial statements. Similarly, the governance mechanisms for public accountability, the different transparency and reporting standards, and the definitions of fiduciary responsibility for philanthropists and investors do not align so much as stand in stark contrast to one another.

Similar problems of confusion among regulatory systems also arise when the boundaries between nonprofit and political organizations, rather than nonprofit and market organizations, are at stake. In this respect, reflection on the role of nonprofits in the post-*Citizens United* era is illuminating. *Citizens United* has blurred boundaries between nonprofits and political organizations by allowing 501(c)(4) and (c)(6) nonprofit organizations to play an important role in electioneering expenditures. Compared to other organizational forms such as political action committees, political parties, and Super PACS, 501(c)(4) and (c)(6) nonprofits offer donors a distinctive loophole (or, perhaps, advantage) in conducting political campaigns: these nonprofits do not need publicly to disclose donors' identities. By opening opportunities for nonprofit organizations in campaign finance and political spending that didn't exist in the past, Citizens United has generated regulatory confusion. Two distinct regulatory regimes—the transparency and donor disclosure that has long been at the heart of campaign finance (overseen by the Federal Election Commission) and the permission for anonymity in donations to nonprofits that has long been at the heart of financing risky or controversial not-for-profit activity (overseen by the IRS and the Charitable Offices of state Attorneys General)—are now tripping over each other's toes. We find little reason for optimism about their ability or motivation to clear up the muddle.

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Also, the new landscape creates confusion about which organizations should count as nonprofits for legal purposes and thus be entitled to tax exemptions. It is an established principle of the United States tax code that organizations cannot finance the campaigns of actual political candidates while also benefiting from tax subsidies and retaining the traditional degree of donor anonymity. By becoming unabashed political actors, welfare organizations should, according to this principle, therefore lose their nonprofit tax-privileged status and have to abide by the norms of transparency that characterize political organizations. In this respect, some suggest that the tax code should be reformed so as to differentiate more clearly among different classes of organizations. Organizations involved in elections should be clearly separated from those that are not and made subject to different tax treatment and disclosure requirements.

And yet this solution is unpromising. The problem created by Citizens United is deeper than a confusion in the tax code. It is about a confusion of social spheres and institutional organizations. By blurring the boundaries between the political sphere and the nonprofit sector, Citizens United ultimately threatens both. It threatens the political sphere by undermining the transparency appropriately at the heart of democratic politics and by giving disproportionate political influence to the wealthy. But it also threatens the nonprofit sector. Citizens United may undermine trust in the nonprofit sector if it becomes clear that many nonprofits operate as secretive means for the exercise of political influence rather than as genuine social welfare organizations. At the same time, applying strict disclosure norms to nonprofits would threaten the traditional norm of anonymity that has long served the purpose—essential to a flourishing democracy—of protecting donors who wish to support controversial causes.

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C. Neglecting non-measurable outcomes

As the case of *Citizens United* illustrates, confusion among regulatory systems

and standards of accountability is not the only problem that arises in the new social economy. Other, less visible and less measurable, dangers arise when the lines between institutional mechanisms blur. These dangers have to do with the *loss of the distinctive function* and expressive values of each and every mechanism or sector. Even if we assume that the blurring of institutional boundaries makes the achievement of certain, measurable outcomes more efficient, it may have costs in terms of less measurable outcomes like civic engagement, trust, and social capital.

For example, what is lost, if anything, if the market is seen as the most likely or preferred "exit strategy" or scaling mechanism for ventures started philanthropically in the sharing economy? Although it may be true that, as argued above, market scaling mechanisms could improve overall social measurable outcomes, one possible concern is that reliance upon the market will threaten the ability of these ventures to act as sources of civic engagement and to be perceived in this way by society. This parallels the concern, famously expressed by sociologist Richard Titmuss and others, that giving economic incentives to donors (and, we may add, to philanthropic organizations) can crowd out intrinsic motivations by diminishing donors' (and philanthropic organizations') sense of civic duty or by creating doubts about the true motives for which these donors and organizations operate.[4] Concerns about "mission creep" have come to the forefront as microfinance, once largely the province of nonprofit lenders, has grown and attracted commercial activity.

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Similar considerations arise with regard to impact investing. Here philanthropy emerges only as a starting point in a trajectory that ultimately leads to complete

market adoption. No distinctive role would be left for philanthropy. Yet if that were the case, something would be missing. Impact investors are willing to balance social good against diminished financial returns, but how could we then ensure that causes and goods that have no immediate or direct economic return—assistance to the very poor, provision of soup kitchens, etc.—that have traditionally been provided through charitable and philanthropic means, will not be neglected? Need every social enterprise generate a revenue stream from its services? Is not a system of philanthropy necessary to keep certain motivations and social virtues, such as altruism and benevolence, alive?

IV. Conclusion

Reflection on the importance of measurable outcomes, as well as on the vices and virtues of sector agnosticism, leads us to conclude that the answer to our initial question, "Do outcomes matter more than the organizational structure through which they are achieved?" should be that it depends on what kind of outcomes we have in mind. The distinction between organizational structures may be irrelevant if all we are trying to achieve is certain outcomes defined by a simple quantitative measure. Yet, if by outcomes we have in mind a more complex idea of societal values and social bonds, a clear division of labor between organizational structures and financial mechanisms may still have an important role to play in contemporary society. Good fences between the nonprofit, commercial, and public sectors may after all make for happier neighbors, greater trust, and more flourishing societies.

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[1] Kevin Starr, “The Trouble With Impact Investing: P1.” Stanford Social Innovation Review. Jan. 24, 2012. http://www.ssireview.org/blog/entry/the_trouble_with_impact_investing_part_1

[2] Muhammad Yunus, “Sacrificing Microcredit for Megaprofits,” New York Times, January 14, 2011.

[3] Lucy Bernholz, Rob Reich & Chiara Cordelli, “ReCoding Good: Part 6. Impact Investing.” Stanford Social Innovation Review. 1 June 19, 2012. http://www.ssireview.org/blog/entry/recoding_good_part_6

[4] Titmuss, R.M., 1971: The Gift Relationship, London: Allen and Unwin. See also Bénabou, R. and Tirole, J., 2006. Incentives and Prosocial Behavior. American Economic Review 96(5): 1652-1678.