Changing Environment: New forms, actors, and instruments

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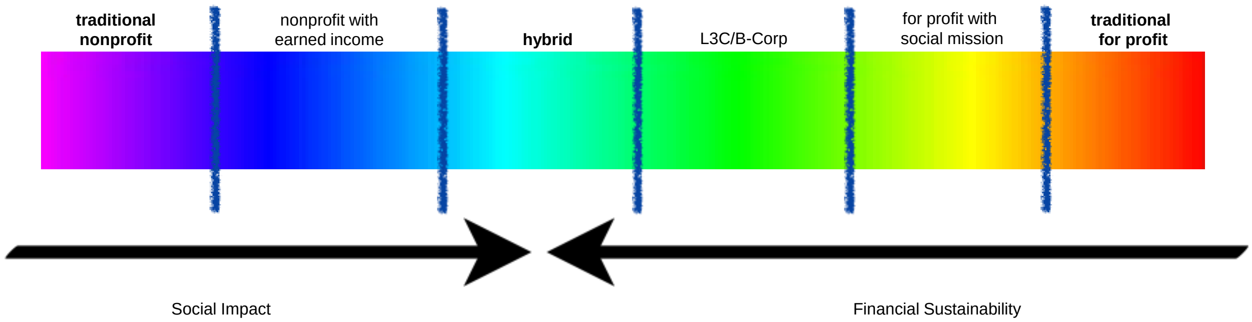
Over time, the range of possible forms in the "social sector" has expanded and the line between business and nonprofit has been blurred. A spectrum of forms ranging from purely charitable to entirely commercial has emerged with a new middle between traditional nonprofit and for-profit forms. This middle is populated by nonprofits that have gravitated toward a financial model driven by earned income (related and unrelated to mission), to hybrid forms like L3C and B Corps, and for-profit firms that have a social purpose.

The idea of a social enterprise spectrum represented a major breakthrough in descriptive work about the sectors, in that it advanced the traditional understanding of sectoral division into a more flexible continuum of organizational types. The social enterprise spectrum runs from organizations that are entirely commercial, for-profit, and market driven to those that are entirely charitable, donative, and voluntary.[1] By arguing for a continuum leading from purely philanthropic to entirely commercial – and with a middle ground full of hybrid forms – the spectrum usefully defeated the idea that precise and immutable boundaries separated the world of organizational forms. Cultural entrepreneurs can and do choose from a variety of positions along this spectrum. The larger question of the "right" organizational form is up for grabs, as the default charitable form can no longer be taken for granted. Organizations now populate the

[1] See J. Gregory Dees, *The Social Enterprise Spectrum: Philanthropy to Commerce*, Case #9-396-343, (Boston: Harvard Business School Press, 1996) and J. Gregory Dees, "Enterprising Nonprofits," in *Harvard Business Review on Nonprofits* (Boston: Harvard Business School Publishing, 1999), pp. 135-166.

landscape ranging across an entire spectrum that includes now an ever larger and more complex hybrid center.



While some may feel that arts and culture are now and will always be a nonprofit enterprise, there is reason to resist this conclusion, especially given the breadth and diversity of the field. Instead of accepting the nonprofit form as the default and immutable answer to the question of institutional auspice, it is wiser to ask: How can a cultural leader or entrepreneur start to think about the implications of the forms that are emerging? There are really three key assessments that are comprehensive and conclusive in determining what form is appropriate, specifically: the nature of the value to be created, the market in which the organization will operate, and the priorities and motives of the leadership team or entrepreneur who is standing on the precipice of a new venture or a major reinvention.

Deciding on form

A first step in the sorting of options across the social enterprise spectrum relates to the idea or value proposition. In trying to assess the best organization form through which to pursue value creation, a critical judgment needs to be made about the kind of equity that will be built. Specifically, this assessment asks: "On what type of equity model is this idea based?" There are three possible answers: social equity, private equity, or a mixed case. In the social equity model, value accrued is distributed broadly, to many individuals, and benefits a whole community. Ideas based on a social equity model are publicly oriented. They usually depend on a public perception of impartiality or substantial contributions of volunteer support for their realization and often what is created is actually a public good, such as artistic excellence or connoisseurship. Furthermore, organizations based in a social equity model are usually more dependent on trust or the amount of goodwill and commitment that is needed to make the product or service attractive to clients or customers. Trust is essential when dealing with vulnerable populations or when the product is controversial and untested.

In contrast, ideas based in a private equity model are privately oriented. In the private equity model, value accrues to one or more private entities and usually depends on a clearly articulated and defendable asset, such as an intellectual property or patent. Value is usually concentrated, more easily quantifiable and convertible into monetary terms. In the cultural context, a new film technology or a marketable child experience that emphasizes immediate consumer satisfaction will likely fit the private equity model. There are in fact many ideas in the arts and culture that have revenue creating potential for investors. From themed parks for children to IMAX theaters, the potential for creating substantial equity can in some cases be considerable.

Within this key assessment, ideas that are based on a social equity model are best served with a non-profit organization. Likewise, ideas based on a private equity model are best served with a for-profit organization, thus yielding a "for-profit" result. If the leader cannot definitively affirm either equity model, then this assessment is ruled a "mixed" case and further questions must be answered to determine the enterprise's form.

The second driver of sector selection relates to the presence or absence of paying customers. Fairly assessing who if anyone will pay for the product or service being proposed is a critical step toward appropriate sector selection. In cases where a prospective patron or ticket buyer will likely not be able to afford the full cost of the product being produced, a focus on philanthropic inputs may drive the selection of the nonprofit form. This of course pushes one to assess as well whether there are sufficient philanthropic investors available willing to pay the additional cost. In instances where a large group of customers are ready and able to pay for an experience, the leader may well be advised to consider a for-profit firm or subsidiary. And of course there will be mixed cases where some customers will be ready and able to pay while others will not.

This part of the decision tree thus presents three possible answers: a direct payer model, a third-party payer model, or a mixed case. In the direct payer model, there are customers available who are not only willing but also able to pay for the cultural experience. As a result, there is a direct flow of funds from the customers to the organization. In the third-party payer model, there either are not customers, or the customers that the organization wishes to serve are not able to pay for the program or service. In this case, a third-party payer is required to subsidize or fund the product or service provided by the organization. The third-party payer model is also one that often relies on large numbers of unpaid partners or volunteers for the viability of its financial model.

Direct payer models are best served with a for-profit organization, and if the market context relies on a direct payer model, then the resulting answer for this assessment is "for-profit." In contrast, third-party payer models are best served by a non-profit organization and would thus yield a "non-profit" result. If there is neither clearly a direct payer nor a third-party payer model, then the result would be the "mixed" case, which may lead to the selection of a hybrid model. To effectively answer the questions related to this complex assessment, leaders must understand explicitly the type of pricing model they will deploy, which is usually dependent on a keen understanding of the competitive landscape, including the types of clients or customers, their ability to pay, and what other organizations are charging for similar products, services or programs.

There are a number of other suggestive factors related to this market context. They can be utilized in a secondary process for refinement of position along the social enterprise spectrum. For example, one set of suggestive factors relates to the amount and type of start-up capital required. If the entrepreneur is in pursuit of an idea that requires large volumes of highly flexible capital, he is most likely best served by a for-profit organization that benefits from a greater variety and accessibility of capital than non-profit organizations.

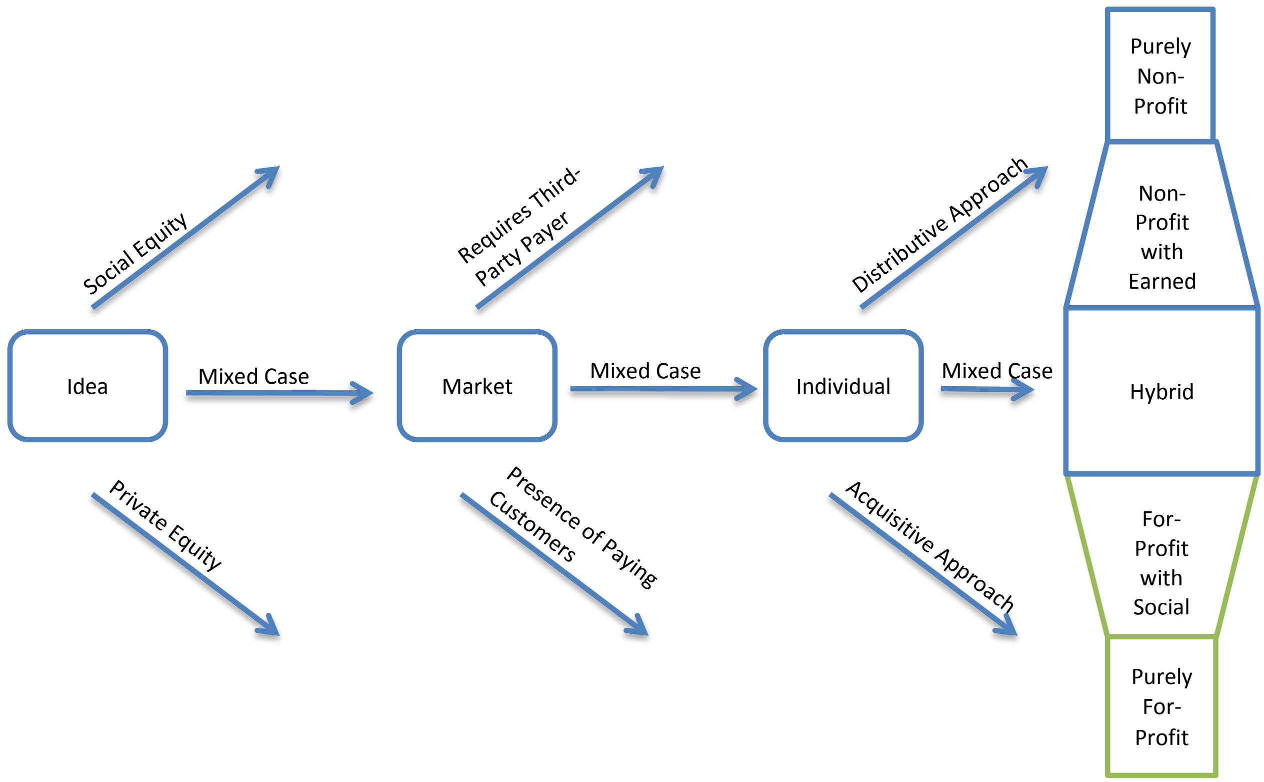
A final driver of form comes down to the personal traits of leadership teams or entrepreneurs setting out to pursue or reengineer their creative visions, and how the leaders' personal qualities will interact with the chosen form. A key trait that needs to be evaluated is the inclination toward acquisition versus distribution. In the distributive approach, value, power and wealth are shared among a large number of stakeholders. In the acquisitive approach, value, power and wealth are centralized among a smaller number of private individuals. The preference for one approach over the other has substantial consequences for ownership, decision-making, and personal ambition. For example, in the distributive model, ownership is diffuse and as a result, decision-making frequently is too. In the distributive model, there is often very limited opportunity for personal wealth accumulation by the leader. In contrast, under an acquisitive model, ownership and decision-making authority are retained along with the possibility of personal wealth accumulation should the venture take off and hit a real market need. Different leaders may find that their particular personalities and styles are more appropriate to one of these forms. Since these leaders will be doing the bulk of the work, the question of their personal orientation and values is an important one.

To successfully evaluate this question, leaders must be clear about how they believe they can maximize value creation through their organization. A fundamental personal orientation toward self is different from one that is other-oriented and committed to redistribution. There are indeed many leaders who are deeply self-absorbed with their own cultural visions, and not particularly open to input and "interference" from others. For these leaders, the whole organization is a reflection of their own vision and values. In other organizations, the community needs and interests take center stage. In such cases, value creation is more a function of using resources to meet the demand and interests of those around the organization. From arts education organizations to museums that focus on the history of particular populations, the world of arts and culture is populated by many people who are oriented outward, toward the community and its needs. In these more community focused organizations, local residents may play a central role in governance and agenda setting.

The bottom line is simple: leaders who are motivated by the distributive model will be best served in a non-profit organization. Those who are driven by an acquisitive model will be best served in a for-profit form. And, those for whom neither of those choices is the perfect fit will fall into the "mixed" case.

Taken together, these three assessments of the nature of the social value proposition, the conditions in the competitive environment and the traits of the leader constitute the foundation of a normative and contingent theory of sector selection for both organization and programmatic auspices.

The cumulative answers to the set of three assessments will indicate which of the five possible organizational types is best suited for a particular venture. There are two "pure" types (pure non-profit and pure for-profit), two "dominant" types (non-profit with earned income and for-profit with social mission), and two "inconclusive" results (the pure hybrid form and a generic inconclusive result). A visual representation of each of the three assessments and the social enterprise spectrum is presented below:



Understanding the new actors and instruments

Beyond the choice of form, cultural leaders must also confront changes in the nature of the actors that shape the revenue stream of the sector. The funding scene has shifted over time to the point where impact investor, not longstanding foundation donors or individual givers, are key trend setters. These new impact investors in the sector have made strong demands for results and proof of impact, which have challenged charities and arts and culture organizations in particular. Compared to some human service nonprofits that have a long tradition of tracking outputs and outcomes, many arts and culture organizations struggle to engage in the performance measurement challenge. Many groups are caught between two equally unappealing options for dealing with the demand for metrics from the donor community. The first is to simply get very good at counting outputs (number of tickets sold, number of free tickets given away, number of education programs carried out, number of schools reached through outreach efforts, etc.) and thus avoid the more complex topics of outcomes (how did the programs actually change the people who took part), or the even thornier question of artistic quality. The second approach is to focus more on financial performance and use a range of metrics as proxy measures for social value creation. Of course, neither move is particularly satisfying and neither responds head on to the challenge of measuring performance for the increasingly demanding donor community.

In the area of fundraising methods, a series of major changes have swept across the field in recent years. Cultural organizations have experimented with new ways to tap into growing possibilities of social media fundraising online, using networks and new technology to attract new support from donors who would otherwise not be accessible. While it is easy to ask others to follow one's organization on Twitter, actively managing and maximizing these new modes of engagement requires real effort and attention. One of the implications for social media fundraising is that the model of cultivating donors has changed from one in which a small number of high stakes contacts is replaced by an approach that instead emphasizes a much larger number of more informal contacts. By enabling a relationship built on regular contact around content that is of interest to subscribers and supporters, social media has changed the way arts and culture organizations and their stakeholders interact.

At the same time, giving circles and donor advised funds within mutual funds and community foundations have emerged as important but sometimes difficult to access sources of funding. These aggregations of individual donors pose a new challenge to fundraisers since neither philanthropic form is as easy to identify and access as traditional philanthropic foundations that are listed in directories, have staffs who respond to inquiries, and are generally oriented toward interacting with nonprofit organizations. Giving circles and donor advised funds are far more private, more introspective and less open to approaches from grantseekers.

This all has implications for the way fund raising is now done and will need to be done in the future.

New instruments are being used to finance social impact across the nonprofit sector and in the process create new ways to finance organizational growth. Nonprofit organizations need to appreciate that there are signs of a shift away from grants to quasi-equity investments, which allow investors in nonprofits to participate in the financial upside—and downside—of programs financed with their funds. When the program proves successful at creating a return, part of this return is shared with the investor. There have also been efforts to launch social stock exchanges that permit investments in businesses that have a social purpose, and allow these firms to raise capital more efficiently than would otherwise be possible. And there are many new ideas about debt instruments for the nonprofit sector, some of which would be pertinent to larger arts and culture organizations seeking to mobilize funds for capital and other projects. And as a result of the cultural building boom of the past two decades, more and more organizations are willing to take on debt – and sometimes very substantial debt – to finance their projects. In this sense, the mainstream nonprofit arts and culture organizations have become far more "corporate" in the way they think about borrowing and finance.

This new financial landscape must be appreciated and understood, with new forms, actors, and instruments all considered together and placed in the broader context of change and increased competition in the sector. Leaders must now be prepared to ask complex question about when it may make sense to look beyond the nonprofit form, when to use new organization forms like B Corporations and L3Cs, how to interact with new funders and financiers, and how to think in a fresh way about the all the new options that the changing environment presents. For some organizations, the for-profit form may be appealing for what it signals about market responsiveness. But the B Corp and L3C forms promise to preserve the trust element that creates confidence by opening these companies to external scrutiny of their environmental and human resource policies.

Taken as a whole, the world around arts and culture organizations looks different than it did 10 years ago. Not only have new forms appeared, but the financial landscape around the cultural sector has been altered by the appearance of new actors and tools.