

Hybrid Organizations: More Than Just a New Fuel— An Interview with Steve Dubb

by the editors

Nonprofit Quarterly: What's the definition of a nonprofit hybrid business?

Steve Dubb: I understand a nonprofit hybrid to be an organization that has some kind of earned income and therefore mixes facets of the traditional business world with the nonprofit world of seeking grants, foundation funding, and individual donations.

NPQ: What are the characteristics of this category, and what kinds of organizations fall into it?

SD: I tend to think of the majority of nonprofits as hybrid nonprofits. Universities and hospitals, for example, have always received a large percentage of their income from business revenue, whether it's tuition for universities or bill payment for hospitals.

But when people think of the hybrid nonprofits, they're thinking of these new primarily social service-type nonprofits that raise revenue while serving a social-service mission. One good example is Pioneer Human Services in Seattle, Washington. It is able to provide drug- and alcohol-free housing, employment, and job training. And it has about eight different businesses that employ these participants, thereby raising nearly its entire

budget, about \$60 million, from its business income. One of its businesses involves manufacturing parts for Boeing; it also runs a couple of restaurants. Now, it gets some government revenue that tends to get underplayed in all this in the form of contracts from the government. But that's an example of nonprofit business. You wouldn't normally think of reintegrating those ex-addict populations as a way they would be able to self-generate a lot of the profit, and yet it's been a very successful model for over 40 years.

In San Francisco, there is New Door Ventures, which operates a print shop and a bicycle repair shop. Again, it's serving the people who are being employed: at-risk, using young adults. So that part of the social service is actually the business itself. So I think when people think of hybrid nonprofits, they are thinking more in terms of this new type of social enterprise rather than merely earning income, which, actually, most nonprofits do. In both of those cases, the businesses are integral to the nonprofit corporation. In the case of others, for example, the Greyston Bakery, I believe, it is a for-profit business subsidiary; so they're legally separate entities: the business and the nonprofit. It can work either way.

NPQ: We've heard a lot about various organizational forms—such as B corpo-

rations, L3Cs, and others—that are trying to sort of straddle and create either for-profit or minimal-profit corporate structures that encourage civic benefit. Where do these organizations fit in the equation?

SD: There are two different tendencies. I described the tendency coming from the nonprofit direction. There is this other tendency coming from the business world—socially responsible business, in essence. Some of these new forms—the B corporation, and you could even add the fair-trade label—are all attempts to create a niche or a brand, where people are willing to pay more for services in which part of the product is the social value that the business provides (for instance, fair wages in Latin America for coffee farmers).

The L3C is a new specific legal form, enacted by the state of Vermont in 2008, that allows businesses that are willing to accept a lower rate of profit, which obviously can reduce their ability to attract investors who are seeking solely an economic return, to raise capital from foundation program-related investors.

NPQ: How do these new forms fit into the social-entrepreneurship conversation? You described one stream coming up through the nonprofit world and

expanding and another that's coming from the for-profit world that's interested in changing business models to adapt to social needs. Between these two sides, what kinds of tensions do you see, if any? What are the driving features of each side?

SD: I don't think anybody goes into business saying, "I want to run a hybrid for-profit" (or a nonprofit). Maybe some people do. But I think the driving force is trying to meet a need that hasn't been met in society. Clearly we have a situation where traditional solutions haven't worked as well as we would have liked.

If you're a nonprofit doing social-service delivery, and government funding is being cut, then how are you going to meet your mission of social-service delivery? One way is to organize politically for advocacy. But another way is to try to adjust your funding stream model so that you are less dependent on government financing.

In the corporate world, the problems are different. But I think there are a lot of small business owners who are discouraged with the direction of American business. We have a lot of corporations that picked up stakes and left. There are rampant problems with greed and speculation that—if they weren't obvious before—have become obvious with the collapse of the financial sector both in the United States and internationally. There have been problems with corporate accountability that led to—finally—a policy response in the form of the Sarbanes-Oxley law of a few years ago.

The old-style corporate model seems to be faltering. Some of the government's ability to fund social services seems to be faltering. To deal with these forces, there's some experimentation going on, and some of these experiments, but not all, lead in the direction that we could call hybrid nonprofits, or social enterprises. Or

maybe just call them hybrid organizations.

NPQ: *What else will fill this space? What about the space between government and nonprofits?*

SD: One sector that doesn't usually get mentioned at all and is quite large is employee ownership. There are now 11.2 million employee-owners in the United States, who work for companies owned in whole or part by employee stock ownership plans, or ESOPs. Prior to the financial meltdown, the value of the shares of these owners was over \$900 billion. That's a pretty significant portion of the economy. That's a greater number of workers than there are workers in unionized jobs in the private sector. Nearly 10 percent of employment in the private sector is ESOP. That's large. And if you look at areas like manufacturing, it's larger than that.

How did this happen? It wasn't a liberal idea or a conservative idea, per se. It started with a tax benefit that came out of the 1974 pension legislation, known as ERISA [the Employment Retirement Income Security Act] that allows an exiting owner to roll over the capital gain. Say you're a family business, and there's nobody in the family who can carry on that business. Prior to the existence of ESOP, you would either shut down or sell to a competitor. The ESOP section of the ERISA law gives the chance to turn over the ownership to the employees and keep the business in the community. That's been attractive. More than half of all employee-owned businesses have been started in this manner: a retiring business owner gradually shifting ownership to the employees, financed through their pension contributions. That's a hybrid form of business that's now very common, and I have never seen it described as a social enterprise or a hybrid.

It's not your traditional stock corporation; it's not your traditional family business. And it does have social benefit. It keeps jobs in the community, and it spreads the wealth in a time of increasing wealth inequality, especially since we are now at 1928–1929 levels of wealth inequality in the United States. It's not too surprising that we have a financial crisis when you look at how concentrated wealth has become in this country. And ESOPs are one mechanism that could ameliorate that and, to some extent, do, though not sufficiently to change those numbers.

NPQ: *There is an ongoing two-way conversation between the social entrepreneurs and the traditional nonprofit community organizers, but is it the right discussion?*

SD: At some level, we are asking the wrong question. I see these as two different trends that happen to be occurring at the same time. One is of nonprofits that are trying to fill needs that are growing because of the withdrawal of government support or the shifting of the type of government support provided. The other is the drive for socially responsible businesses. They're serving different purposes and happening for different reasons. Community development corporations [CDCs] and community development financial institutions [CDFIs] are very prevalent hybrid nonprofits. They do housing development or, in the case of CDFIs, loans to support housing or business development, so that's earned income as well as providing a social benefit. The latest survey, in 2005, found 4,600 community development corporations; 40 years ago there were close to zero. You can't find too many cities that don't have community development corporations. It's changed the landscape. And it's happened because of the

privatization of government functions. Government doesn't build very much housing anymore—not directly. It's offloaded that function onto nonprofits. There's also been a lot of movement on the nonprofit side to get in that area. And in some ways, it's been an effective solution.

NPQ: *Do any of these trends have distinct advantages or disadvantages over another?*

SD: I think employee ownership and other forms of socially responsible businesses may have an advantage perhaps, in the sense that they are completely self-sustaining—and certainly with employee ownership, this is true. The other advantage of employee ownership in particular is that, while most of the decision-making authority of employee-owned companies involves management making decisions, there are some decisions that fall to the employees under current law—such as whether to shut down your home plant. So that provides a level of anchoring of capital.

When you look at employee ownership, also the traditional nonprofits—universities, hospitals—these “anchor institutions” can't move too easily. In a global economy, where more businesses are subject to being moved, it's important to have a percentage of the economy anchored. You need a certain level of rooted capital in order to have an environment where you can make productive investment decisions or you can have a new-energy economy emerge—or whatever is going to be the next basis of a stable economy that builds middle-class jobs and middle-class wages. I think these kinds of institutions will play an important role in providing the necessary base level to make a new period of economic growth possible.

NPQ: *Do the community development and social-service fields illustrate the*

best example, or have other fields experienced an infusion of hybrids?

SD: This may still be in the community development field, but community land trusts are going to be increasingly important. It's sometimes referred to as shared-equity housing. Typically, you think of the decision of housing as a choice between whether you rent or own. With land trusts, you do both, or a little bit of each. One of the largest ones is Champlain Housing Trust, based in Burlington, Vermont. It has about 2,000 households as members in the Greater Burlington area. The equity split is 25 percent and 75 percent. Seventy-five percent stays with the nonprofit to provide permanently affordable housing. Twenty-five percent goes to a family, which can go toward making a down payment when it moves out of that land trust.

NPQ: *In this trend toward hybridization, there are some true believers; have they in any way distorted the conversation? What is empty rhetoric? And have promising avenues opened up?*

SD: The problems with the rhetoric often have to do with the idea that government doesn't have a role in social-service delivery—because “Nonprofits can do it all on their own!” Or having earned income is a goal in itself. Earned income is a means to an end; if it helps to achieve your mission, then it's a positive. I like the work of Andrew Wolk of Root Cause. He explains that if there's no market, then you have a nonprofit; but if there's some market, then some kind of hybrid solution works.

But there are going to be plenty of areas where you're going to need government support and even 100 percent government funding and support. I don't think you're going to see too many hybrid food banks, for instance (although a hybrid nonprofit could operate a food bank alongside other income-producing activities). Ex-offender

programs may in some cases be able to generate income; and if they can, that's great. But in many cases, that won't work. So is hybridization a good thing? Sure, if it solves problems. But I don't think it's going to solve all of our problems. There are going to be some cases where the traditional models, in fact, do work best.

NPQ: *If the trend is that earned income becomes the objective of all businesses, what's the impact of this development?*

SD: To the extent that it encourages nonprofits to be more financially cognizant or savvy, that's a positive. The risk is that earned income will be valorized to the degree where foundations tend only to support nonprofits that also generate earned income—because, after all, that's a higher leverage ratio, right? The tendency is to fail to meet the hardest cases. That's the easiest way to increase your percentage of earned income.

So if you look at housing, public housing serves people who make 30 percent of area median income (AMI) or below. Most CDCs serve people who earn between 50 percent and 80 percent of AMI. Well, if the people you're housing make twice the income of folks in public housing, guess what? They can pay more. You don't need as much subsidy; it's easier to make ends meet as a hybrid nonprofit. So the *most* needy get the *most* neglected, and there is a huge shortage of housing for people who have very low income. And that's a real risk: if hybridization becomes an imperative rather than a tactic that makes sense in some cases but doesn't in others, that's a problem.

NPQ: *In addition to the opportunities and dangers and the trajectory of growth for hybrid nonprofits, are there other points that are worth making?*

SD: I should probably at least mention,

because it is a growing sector and it's a growing role for hybrids, the emerging and growing green economy. For instance, deconstruction. In Cleveland I think there are about 7,000 to 8,000 empty houses that need to be taken down as part of the foreclosure crisis and, from before that, the economic decline of that city. So you can either just demolish the house entirely, or you can try to take some of the more valuable pieces of it and try to recycle it. This isn't very profitable, but there is some income in it.

And there are a number of reuse centers—Habitat for Humanity, for example, runs a lot of these—that provide a social good with some government support, plus foundation or donation support from individuals, plus the income that can be earned through this activity. Green Institute in Minneapolis runs a reuse center and deconstruction services, and it has had about 60,000 customers since it opened. We are likely to also see businesses to retrofit buildings to reduce carbon emissions. A lot of those will be very profitable, but some of them are going to be businesses that aren't profitable. If you include the positive externalities of those activities, it's well worth doing. So you may see a growing nonprofit sector of hybrid nonprofits that serve this dual social and economic function.

STEVE DUBB is a senior research associate at the Democracy Collaborative at the University of Maryland, College Park. Dubb is the principal author of *Building Wealth: The New Asset-Based Approach to Solving Social and Economic Problems* and *Linking Colleges to Communities: Engaging the University for Community Development*.

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