

How Nonprofits Solve Social Enterprise's Three Big Problems: Money, Trust, and Information

by Curtis Child

While it may rankle social enterprise ventures to have to admit the extent that their effectiveness and success depend on the nonprofit sector, an ethos of wholehearted acknowledgment of the connections, rather than of competition, would do better to prevail. For social enterprise is far from likely to crowd out civil society organizations—in fact, as this article explains, the opposite is true.

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SOCIAL ENTERPRISE BUSINESS VENTURES are all the rage. Entrepreneurs and consumers (not to mention scholars, policymakers, donors, and other stakeholders) see in them a solution to vexing social problems—a promise of salvation from the organizational baggage that weighs down more traditional approaches to tackling the ills that plague society. Disciplined by market forces, social enterprises are creative, nimble, and ever responsive to consumer demands. Even better, they possess that most coveted quality: sustainability, or freedom from the obligation to chase grant money and charitable contributions—not to mention an ability to succeed (or the opportunity to fail) on their own merits. Released from bureaucratic encumbrances and the burden of begging for money, the market-based

social enterprise is poised to offer an altogether different approach from the traditional strategies (read: nonprofit and governmental ones) that have so far failed to deliver us from our most pressing social problems.

Well, sort of.

That story—familiar as it has become—is deeply problematic. While the high praise of social enterprise (defined here as businesses that actively pursue both revenue-generating and socially beneficial goals) may sometimes be deserved, it is often framed in contrast to well-intentioned but old-fashioned and ineffective philanthropy. It is this contrast that is off target: the dismissal of the work of the nonprofit sector as antiquated at best and inept at worst. In fact, scratching below the surface of social enterprise businesses reveals that they depend

significantly on the nonprofit sector for their effectiveness and survival.

Over a three-year period, I studied intensively two social enterprise industries: *fair trade* and *socially responsible investing*.¹ What I found is something I did not go searching for: a scaffolding based in civil society that allowed the businesses in these industries to flourish. Specifically, I came to understand how for-profit social enterprise ventures rely fundamentally on elements of civil society for (1) providing credit and other financial support, (2) broadcasting their trustworthiness, and/or (3) generating difficult-to-access information. All of these are resources often overlooked in our collective celebration of the social enterprise business.

Although examples abound, I highlight these three ways in which social

enterprise businesses depend on the work of the nonprofit sector (and other parts of civil society) because they are readily apparent and, more important, because they solve fundamental problems for the business ventures in question. After taking stock of the ways in which nonprofits solve problems for social enterprise, the lesson for me is clear: It is logically inconsistent, and potentially damaging, to lionize for-profit social enterprise and at the same time characterize it as somehow a replacement for the work of the nonprofit sector. Rather, it is the work of the latter that in many ways enables the success of the former.

The Money Problem—Borrowing Nonprofits' Financial Support

One aspect of the civil society infrastructure I'm referring to is financial in nature and evident, especially, in the fair trade industry. The fair trade businesses I examined source and/or sell ethically produced goods such as tea, coffee, and handicrafts. They commit to abiding by widely shared standards of practice, such as working directly with artisans and farmers (often cooperatively organized) instead of through intermediaries, paying a living wage, and, often, paying a "social premium" intended to fund community development projects in producer communities.

In pursuing their mission to "do good," these fair trade social enterprises have an interest in working with small farming groups rather than well-established, single-owner plantations. Doing so is challenging, however. Coffee growers, who are often in economically marginalized positions, need financial support before the harvest comes in. For conventional importers, though, making pre-harvest payments to coffee growers introduces risk—risk that they can avoid by working with large coffee operations

that are more economically secure. But what of the social enterprise business that is committed to working with small-scale farmers?

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As much as social enterprise entrepreneurs like to talk about their "market-based approach" to supporting communities, here is an example of how that ideal is hard to realize. In fact, the fair trade coffee market is not self-sufficient and autonomously performing. Rather, it leans on nonprofit organizations like Root Capital for providing the much-needed financing that makes it possible for farmers and importers to work together.

Established in 1999, Root Capital offers financial support and financial management training to grassroots enterprises. During the first two quarters of 2018 alone, it worked with nearly two hundred businesses to connect more than half a million small farmers to markets.² It does so in part by providing pre-harvest loans to farmers—something that conventional banks are reluctant to

do.³ With this financial support in place, Root Capital helps socially minded businesses realize their missions to source coffee at a fair price from farming communities that are too large for micro-finance support but too small to attract the attention of banks or private equity. By supporting farming communities, Root Capital enables the social enterprise businesses that source from them, like the well-known Sustainable Harvest Coffee Importers; the long-time leader of the fair trade movement and cooperatively organized Equal Exchange; and the more traditional businesses like Starbucks, Whole Foods Market, and Green Mountain Coffee Roasters.

Root Capital thus paves the way for business-minded but socially conscious entrepreneurs to engage in market transactions that might not otherwise have taken place. Referring to Root Capital, one veteran of the fair trade coffee industry put it this way: "At moments when we [might have] had to just walk away from business because we couldn't afford to finance it, they'd come in and say, 'OK, we'll do that deal.'"⁴ He continued, "They have provided financial stability out there to the co-ops that we work with that then indirectly contributes the next year or the next year [after that] to being able to get more coffee from those businesses."⁵

Surely, the social enterprise businesses like U.S.-based fair trade roasters or importers are doing valuable work; but a close inspection of the industry makes plain that they very much owe their success, at least partially, to the work of nonprofit organizations.⁶

The Trust Problem—Borrowing Nonprofits' Trustworthiness

There is a second way that nonprofit organizations undergird the practice of for-profit social enterprise: helping for-profit organizations broadcast their

trustworthiness. The fair trade industry, again, provides an illustration.

First, a little background is necessary. Scholars have long argued that nonprofit organizations solve a problem for consumers.⁷ The problem is that in many cases, consumers might not know how to value certain products. More precisely, they might have insufficient information to make good decisions. Take healthcare, for example: if I am concerned about a personal health issue, then I might be inclined to patronize a nonprofit medical care provider rather than a for-profit one. By virtue of the first organization's nonprofit status, the argument goes, I can take comfort in knowing that it is social-mission oriented and, more important, that there are no company owners who stand to enrich themselves by persuading me to accept unnecessary and costly procedures.

If the argument is true that nonprofit status signals trustworthiness, then it presents a major problem for for-profit social enterprises. No matter how clever their marketing, consumers might be skeptical. After all, what modern company doesn't claim that it has a mission to make the world a better place? And yet we know of many corporations that boast of their intentions to "do well by doing good" but seem to forget the "doing good" part.

What is a fair trade entrepreneur supposed to do, then, if she wants to establish a for-profit business that truly does have a social mission, and if the success of that business requires in the first place that other people believe her? To solve this problem, nearly all of the businesses I studied that trade in food items (such as coffee, cocoa, or produce) rely on nonprofit certification and labeling initiatives. Fair Trade USA is one of the more common certifiers, but other popular systems include

Fairtrade America, Rainforest Alliance, and Utz Certified.⁸

In submitting themselves to certification criteria and then displaying a certification logo on their websites, storefronts, and products, social enterprise businesses are borrowing from nonprofits one resource that nonprofits are uniquely equipped to possess: the confidence of consumers who might have more faith in a prosocial business venture if that business has been certified by a trustworthy nonprofit. In short, labeling initiatives allow for-profit businesses to share in nonprofits' credibility, which helps them interface with consumers who have become accustomed to corporate social responsibility lip service that may not be matched in substance. In the end, a social enterprise business is just another profit-seeking venture until it can convince consumers of its prosocial value; and its ability to do so is very much aided by the work of nonprofit organizations.

The Information Problem— Borrowing Nonprofits' Grassroots Connections

Nonprofit organizations solve a third problem for social enterprise businesses—an information problem. This is apparent in the socially responsible investment industry, in which businesses depend critically on difficult-to-access information, which is often produced by nonprofit and social movement organizations.

Socially responsible investment firms are companies that offer investment products—such as mutual funds—whose portfolios are screened and selected according to various social, ethical, or religious guidelines. In order to screen these funds, portfolio managers and their research teams often need access to on-the-ground information: How does Toyota treat its

workers across the supply chain? Which apparel companies source from sweatshops? Answers to questions like these are very difficult to find, so investment analysts rely on NGOs, social movement organizations, and other elements of civil society to expose issues that would affect their assessment of a potential or ongoing investment.

Indeed, it is through their connections to nonprofit and civil society actors that many socially responsible investment firms first learn about the issues they need to investigate. One analyst at a well-known socially responsible investment firm told me that many of the issues his firm ultimately addresses with companies are articulated initially by nonprofits and NGOs.⁹ "I can't possibly know what's happening with a gas pipeline in Burma," another analyst at a socially responsible pension fund explained, "but EarthRights International does, so I can use their research."¹⁰ And one of her industry colleagues observed, "I can't go visit subsidiaries and check out their labor practices there, but I'm certainly going to listen to the watchdog that's looking at that. Part of my job is keeping up with some of these sorts of extended networks."¹¹ Evident from my data, such "extended networks" include human rights organizations, product safety advocates, labor unions, foundations, civil rights and environmental groups, public health professionals, community development organizations, and the like.

Although socially responsible investment firms are the ones marketing any particular investment product, what they are really selling—hard-to-access information about corporate behavior—is actually produced in its raw form in civil society. Investment firms are, in this sense, second-order entities that sift through the information and

package it in a way that appeals to investors. Because such firms are the face of socially responsible investing, it is easy to overlook the civil society underpinnings on which their success rests.

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When I started studying fair trade and socially responsible investing, I was curious to understand how for-profit social enterprises accomplish their work. I wasn't looking for their interdependencies with nonprofits, but it is something that I came across again and again. These nonprofit organizations were not marginal to the work of social enterprise businesses. Rather, they were helping them to address very fundamental problems: how to get access to the financing that would keep markets working, how to persuade consumers of their trustworthiness despite their status as businesses, and how to gain access to the very information that sets them apart as social enterprise businesses.

It is appropriate to lift up the work of such social enterprise business ventures as the U.S.-based fair trade coffee importers that work productively with farming communities, or the socially responsible investment funds that help promote ethical engagement with the stock market. It is inaccurate, however, to see these businesses as somehow replacing the work of nonprofit organizations.

Unfortunately, this is an observation that is often lost on the people working in social enterprise. In interviews my colleagues and I conducted, entrepreneurs working in social enterprise businesses reaffirmed a popular narrative that characterizes nonprofits and philanthropic efforts as "the runoff of a broken system," "inherently inefficient," reliant on "handouts," not

"sustainable," "not competitive," and the like, and social enterprise businesses as something separate and better: "disciplined," "empowering," "more tightly run," "honest," and "cleaner."¹²

It is understandable, perhaps, that advocates of a new breed of organizations would try to justify their work by drawing sharp distinctions like these. But treating for-profit social enterprise and the work of nonprofit organizations as contrasting obscures the complexities at play and extols the virtues of for-profit social enterprise at the expense of the steady work of those in the nonprofit sector.

What does all of this mean for the future of the nonprofit sector, especially as for-profit social enterprise grows in popularity? For one, although popular representations imply that for-profit initiatives will crowd out the need for organizations in civil society, we should instead expect that the growth in market-based methods for addressing social problems would actually require added support from civil society. In other words, the proliferation of social businesses will likely portend an increase, not a decrease, in the value of nonprofit organizations.

NOTES

1. Curtis Child, "Tip of the Iceberg: The Nonprofit Underpinnings of For-Profit Social Enterprise," *Nonprofit and Voluntary Sector Quarterly* 45, no. 2 (April 2016): 217–37.
2. *Performance Report Q2 2018* (Root Capital, 2018).
3. Brian Milder, "Closing the gap: Reaching the missing middle and rural poor through value chain finance," *Enterprise Development and Microfinance* 19, no. 4 (October 2008): 301–16.
4. Interview with the author, August 16, 2010.
5. Ibid.

6. As a nonprofit, Root Capital has a charitable mission and relies significantly on charitable resources to accomplish it (nearly half of its \$22 million in revenues came in the form of contributions and grants in 2017). See Root Capital's Form 990 for 2017, accessed October 10, 2018, rootcapital.org/about-us/financial-information/. Other examples of nonprofit organizations that provide direct and indirect support to for-profit social enterprise are Acumen and RSF Social Finance.

7. Henry B. Hansmann, "The Role of Nonprofit Enterprise," *Yale Law Journal* 89, no. 5 (April 1980): 835.

8. Certifications for apparel and handicrafts are new to the scene; so, many fair trade businesses that trade in nonfood products participate in or rely on nonprofit membership associations (such as the Fair Trade Federation or the World Fair Trade Organization) for credibility. These membership organizations are the functional equivalents of proper certification regimes.

9. Interview with the author, October 29, 2009.

10. Interview with the author, March 18, 2010.

11. Interview with the author, February 3, 2009.

12. Curtis Child, Eva M. Witesman, and David B. Braudt, "Sector Choice: How Fair Trade Entrepreneurs Choose Between Nonprofit and For-Profit Forms," *Nonprofit and Voluntary Sector Quarterly* 44, no. 4 (August 2015): 832–51.

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