

Chapter 2



REVIEW CONCEPTS

- Agency Problem:** The difficulty supervisors or organizations have in aligning the behavior of their subordinates or contractors with their own objectives or missions.
- Asset Lock:** A legal prohibition against distributing the assets of an organization to unauthorized outside parties.
- Benefit Corporation:** A for-profit legal form in the U.S. that requires the firm to pursue a general public benefit, consider nonfinancial interests of its shareholders, and issue a report on how well it is achieving its social or environmental mission.
- Charity:** A nonprofit organization that meets a public benefit test, as determined by the IRS for such criteria as relief for the poor; advancement of religion, education, or science; erection or maintenance of public building, monuments, or works; lessening the burdens of government and neighborhood tensions; elimination of prejudice and discrimination; defense of human and civil rights secured by law; and combating community deterioration and juvenile delinquency (IRS-501(c)(3) (Mook et al., 2015).
- Community Interest Company:** A legal form of social enterprise in the United Kingdom that must pursue a community benefit, abide by a modified asset lock and profit distribution constraint, and include non-financial stakeholders in its governance.
- Constraint:** A specified limit on an economic quantity affecting behavior of an economic actor, e.g., a nondistribution of profits constraint, or an annual budget constraint.
- Donor-Advised Fund (DAF):** A fund administered by an institution such as a commercial charity or a community foundation that allows donors to donate cash or an appreciated asset such as stock or real estate and receive an immediate tax deduction.
- GDP:** The total economic value of traded goods and services produced by the economy of a country in a year.
- Incentive:** An economic reward or penalty that encourages an economic actor to behave in a particular way, for example, a tax incentive that encourages charitable giving or an unrelated business income tax that discourages unrelated business activity by a nonprofit organization.
- Limited Profit Constraint:** A legal requirement for a social enterprise to keep the amount of profit it can distribute to owners or financial investors within certain bounds.
- Market Failure:** Conditions under which a market fails to achieve an efficient allocation of societal resources (see Chapter 13).
- Mixed Industry:** An industry or field of service in which nonprofit organizations compete with for-profit firms and/or government agencies.
- Mutual Benefit Organization:** An organization whose mission is to serve its members as opposed to the public at large.
- Nondistribution (of profits) Constraint:** A legal prohibition against distributing financial surpluses to individuals who own or control the organization.
- Nonprofit or Not-for-profit Organization:** A self-governing organization that is formed to serve the public or a membership (Salamon, 1996). It is prevented from distributing profits to those individuals who control the organization (Hansmann, 1980), and many are classified by the IRS as tax exempt.
- Operating Deficit:** An annual shortfall of operating revenues to cover annual expenses of an organization.
- Productivity:** The output achieved from a given level of input resources.

Public Benefit Organizations: Organizations that address the needs of broad segments of the public; for U.S. nonprofits, classified under section 501(c)(3) of the federal tax code; also known as public charities.

Retained Earnings: Percentage of net earnings not paid out as dividends but retained by the company to be re-invested in its core business or to pay debt.

Social Business: A social business is designed and operated just like a “regular” business enterprise with products, services, customers, markets, expenses, and revenues. It is a no-loss, no-dividend, self-sustaining company that sells goods or services and repays investments to its owner, but its primary purpose is to serve society and improve the lot of the poor (Mook et al., 2015).

Social Economy: That part of the economy, outside government, consisting of many different types of self-governing organizations that balance social objectives with success in the marketplace.

Social Economy Organization: An organization that prioritizes its social objectives over its economic objectives.

Social Enterprise: A private organization or venture whose purpose is to include a social goal.

Social Welfare Organization: A U.S. organization (classified as 501(c)(4) in the federal tax code) devoted to a social cause and permitted to engage substantially in political advocacy activities.

Tax-exempt Bond: A bond issued by a government agency, possibly on behalf of a nonprofit organization, for which the bond purchaser is exempt from paying personal income tax on the interest.

Unrelated Business Income Tax: A tax on the profits of a nonprofit organization from business activity that is not substantially related to the organization’s mission.

Work Integration Social Enterprise (WISE): A social enterprise that employs marginalized workers as a strategy to improve their economic welfare and employment readiness.

EXERCISES

1. Identify four industries in the U.S. economy as follows:

- (a) An industry in which all service-providing organizations are private, nonprofit;
- (b) An industry in which none or very few participating service providers are private, nonprofit;
- (c) An industry in which private, nonprofit providers co-exist with for-profit and governmental providers;
- (d) An industry in which private, nonprofit and for-profit providers co-exist but government does not participate as a provider of service.

In each case, offer an economic explanation of why we find the particular distribution of nonprofit versus other providers.

- 2. How would you classify the United Way of Cleveland according to the various taxonomies offered in the text? The American Cancer Society? The Sierra Club?
- 3. Discuss the size and scope of the nonprofit sector in the U.S. What is the economic importance of these organizations? Why are nonprofit organizations growing faster than government or profitmaking business?
- 4. Does it make sense to say that an organization that prioritizes its social objectives has economic goals as well? Explain and give an example.
- 5. Describe a range of organizational forms varying from ones that strongly prioritize their social objectives to those that weakly do so. If you are considering starting a new social venture or being employed by one, discuss the advantages and disadvantages of each organization in the range.
- 6. Joe Richguy is a *nouveau riche* philanthropist. Why should he consider putting his money in a donor-advised fund versus giving directly to his favorite charities or setting up his own charitable foundation?
- 7. Alice Dogood is board chair of the Community Foundation of Greater Gotham which administers its own donor-advised funds, has its own endowment and makes grants to local nonprofit organizations. What should she advise her board on whether the foundation should compete or collaborate with commercial charities?