CHAPTER 1

Introduction

How Nonprofits Are (and Are Not) Like Businesses

It is not enough to do good. It must be done well.

—Vincent de Paul (1581–1660)

What are we to make of for-profit charities like Google.org or nonprofit corporations like the furniture purveyor IKEA[1] and (before 2006) that icon of American capitalism, the New York Stock Exchange? These crossover examples serve to remind us that nonprofits and for-profit businesses have much in common. However, their rarity also indicates fundamental differences.

Finance Fundamentals for Nonprofits sheds light on similarities and differences between nonprofits and for-profit businesses. It is intended to provide a foundation in nonprofit finance for graduate students, assist nonprofit managers, and instruct corporate executives on nonprofit boards. It does not delve into finance techniques that are the same in nonprofit and for-profit businesses.

The book's subtitle (*Building Capacity and Sustainability*) signals its emphasis on two concepts of particular importance to nonprofits. Whereas for-profit managers are concerned with maximizing their firm's market value, nonprofit managers may have many financial goals.[2] *Finance Fundamentals for Nonprofits* proposes that nonprofit managers should be primarily concerned with having the financial capacity their mission requires and sustaining it over time.

Financial capacity for a nonprofit consists of the resources necessary to seize opportunities and respond to threats.[3] The amount needed depends on its mission, service delivery method, operating environment, and risks of potential adverse economic events. Maintaining assets takes time, effort, and money, so managers choose a capacity level that balances the costs of maintaining capacity with its benefits.

Financial sustainability is simply the rate of net change in financial capacity. It is a clear-cut issue for most profit-maximizing businesses. By maximizing profit, assets grow as fast as possible and sustainability takes care of itself. However, sustainability is an issue for nonprofits that trade off surpluses (the profits of nonprofits) in favor of serving more people and serving them better. They must take care not to spend too much on such worthy objectives because over the long run they must be able to keep their assets in good shape *and* maintain their reserves at a level commensurate with anticipated economic risks. A *sustainability principle* requires consistency between the short run (as measured by annual surpluses) and the long run (as measured by asset growth). This is the subject of Chapters 6 through 9.

A major difference between nonprofit and for-profit financial management is that many nonprofits generate income from sources other than selling goods and services as for-profits do. Such *alternative income* includes gifts, grants, dues, and income from endowments. Even if a nonprofit has no sources of alternative income it can choose to develop them, which gives it strategic options foreclosed to a for-profit firm.

Financial models used by for-profit managers must be modified before applying them to nonprofits, because alternative income reverses financial logic. In for-profit firms production creates revenue through sales; but in nonprofits with alternative income the amount of income determines how much can be produced.

This chapter introduces the book's agenda, beginning with a discussion of alternative definitions of nonprofit—or *not-for-profit*, as accountants call them—attempting to discern the essential character of "nonprofitness." Then it describes the intrinsic similarities and differences between for-profit and nonprofit corporations, highlighting the advantages and disadvantages of the nonprofit type.

A few technical terms are necessary for this discussion. Later chapters on related topics will define them. In the meantime, readers may consult the Glossary at the end of the book to clarify unfamiliar terms.

What Are Nonprofits?

The simplest and most common definition of a nonprofit organization is one that is "barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees'' (Hansmann 1980).[4] The prohibition on distributing net earnings to private parties is widely known as the *nondistribution constraint.* The principal shortcoming of this legalistic definition is that it makes no reference to noneconomic values, which is the social justification for nonprofits. The United Nations (UN) uses a more robust definition, which defines nonprofits as:

> *organizations that do not exist primarily to generate profits, either directly or indirectly, and that are not primarily guided by commercial goals and considerations. [They] may accumulate surplus in a given year, but any such surplus must be plowed back into the basic mission of the agency and not distributed to the organizations' owners, members, founders or governing board.* (United Nations 2003, 18)

This definition is not explicit about the noneconomic values because it must apply in all countries despite their cultural differences. *Finance Fundamentals for Nonprofits* uses the UN definition because it implies the primacy of values. In the United States, tax exemption laws address nondistribution through intermediate sanctions and keep nonprofits mission-focused by specifying acceptable exempt purposes (see Chapter 5).

For-profit firms may espouse social values, but these values usually are secondary to maximizing a firm's economic value or they are instrumental toward that end. The Body Shop and Ben & Jerry's are well-known examples of values-centered for-profit firms, but it is significant that they earned their reputations *before* going public—meaning before selling stock on a public exchange—and acquiring investor-owners.

Social values are the *business* of nonprofits. As Rose-Ackerman says, nonprofit customers ''are buying reified ideology'' (1997, 128). Nonprofits practice *values-centered management*—a control regime in which social, cultural, and spiritual values join with economic necessity to define an organization's management objective.[5] The absence of owners seeking a handsome return on their investment enables nonprofits to practice values-centered management.

''Cooperatives, mutuals [mutual benefit organizations], and self-help groups share some, if not most, of the defining features of a nonprofit organization, and fall into a 'grey area' between the nonprofits and for-profit businesses. In some countries they are considered legally to be nonprofits; in others, not'' (Anheier 2005, 52). The source of confusion is the fact that the purpose of a membership association, and especially cooperatives, is to confer benefits on its members and patrons.

Cooperatives strive to maximize economic benefits to their patrons, which may include an explicit distribution of annual surplus.[6] However, cooperatives are typically committed to social goals of common interest to the group. In Francophone regions these organizations form a very important cluster known as the Social Economy. The UN standard is sufficiently broad to include them, so *Finance Fundamentals for Nonprofits* treats membership associations, including cooperatives, as if they were nonprofits.[7]

Why Are There Nonprofits?

The standard economic paradigm explaining why nonprofits exist is based on a three-sector structure of society consisting of market, government, and nonprofits. Each sector serves to check excesses and compensate for the shortcomings of the other sectors.[8]

Weisbrod (1975) proposed that a bloc of people will always be dissatisfied with the amount of goods and services provided by government. Individuals who want more of a service will form a nonprofit organization to provide it with voluntary donations. This is known as the *government failure* model.

Hansmann (1980) argued that nonprofits are needed as a response to situations where consumers cannot easily compare products and prices, negotiate with a provider, or determine whether the provider complied with an agreement and obtain redress if it did not. In his view, a legal nondistribution constraint solves the problem neatly. This is known as the *market failure* or *contract failure* model. The antiexploitive nature of the nondistribution constraint is intrinsically attractive to stakeholders, preventing them from shirking (Valentinov 2008).

Salamon (1987) turned these explanations on their heads, arguing that it is more reasonable to suppose that people initially organize to provide a new service voluntarily and then turn to government to finance expansion, or even provide it directly, after the product was proven and demand established. History is on his side: Voluntary fire brigades date to Roman times, and libraries in the United States were initially organized as membership associations.

However, nonprofits have limitations that are more easily overcome by markets or government: Nonprofits may favor one particular group over others and some groups may go without service (particularism). The interests of donors, not the needs of the community, may determine choices nonprofits make about whom to serve and how to serve them (paternalism). Nonprofits attract well-meaning people, but either as employees or volunteers they are often in over their heads (amateurism). This is known as the *philanthropic failure* model (Salamon 1987).

Steinberg (2006) refers to this set of explanations as the Three Failures Theory of the nonprofit sector. Recent empirical research casts doubt on the underlying assumption of Hansmann's contract failure model. Although survey data confirm that consumers say they are more likely to trust nonprofits, the data reveal that a high proportion of consumers is unable to identify whether well-known organizations are in fact nonprofit. Even frontline staff working for those organizations often were unable to correctly identify them as nonprofit (Handy, Seto, Wakaruk, Mersey, Mejia, and Copeland 2010).

The Three Failures Theory is demand-driven. There is only one supply-side theory. Young (1983) posits that certain personality types are particularly inclined to be nonprofit founders. He shows how different types respond differently to the nature of a service, social priority, ethic of service, degree of professional control, income potential, bureaucratic structure, and ego. His supply-side model explains why there are no nonprofit automobile repair shops, despite being a clear case of contract failure, but fixing cars is not high on the list of priorities of people who are motivated to establish a nonprofit. (It should be noted that auto repair is not an exempt purpose in tax law.)

Nonprofits as Businesses

Although nonprofits are not in business to make money, they are nevertheless in business: They hire people, they produce goods and services, and they have bills to pay. This section explores how nonprofits are similar to, yet different from, for-profit businesses.[9]

"Whether an association will function satisfactorily in relation to third parties is to a very high degree a question of whether it becomes a [corporation], i.e., a body which is regarded in law as having a personality and existence distinct from that of its members." Corporate status greatly enhances the ability of an organization to own, manage, and defend property in all of its forms (Hemström, 2006, 27).

Eleemosynary organizations and membership associations pioneered the development of corporation law. The first corporations emerged in first-century Rome (Avi-Yonah, 2005, 772). Their principal use was for municipal governance, guilds, religious cults, and philanthropic foundations. Romans did not use corporations for business enterprises. Medieval companies of significant size were quasi-permanent partnerships involving multiple partners. Precisely when the first application of the corporation to for-profit business occurred is unknown; however, we do know that by the year 1283 family corporations had become "common" in Florence (Hunt 1994, 76). These business corporations were akin to modern cooperatives because their stock was not transferable.

In 1650 Massachusetts awarded the first corporate charter in America to Harvard College (O'Neill 1989, 54). The first commercial corporation was not chartered until Connecticut took the step in 1732 (Micklethwait and Wooldridge 2003, 43). Alexis de Tocqueville's *Democracy in America,* first published in 1835 and still in print, is considered one of the most insightful commentaries on American society. Some oft-quoted phrases are: "Americans of all ages, all conditions, and all dispositions constantly form associations. . . . Wherever at the head of some new undertaking you see government in France, or a man of rank in England, in the United States you will be sure to find an association" (Tocqueville 2007, 452).

His observations are often taken as "timeless truths about charity, philanthropy, and voluntarism in American life" (Gross 2003, 30) but it is tempting to speculate that he was merely observing the consequences of differences in the relative ease of forming corporations in the United States compared with Britain and France. At the time of de Tocqueville's visit, it required an act of Parliament to incorporate in Britain and incorporation did not become common in France until the late nineteenth century.

"By the end of the 18th century many states had general incorporation laws for religions, academies, and libraries, but *not business corporations*" (Roy 1997, 48, emphasis added). "General acts provided incorporation for a broad range of charitable, religious, and literary purposes in Pennsylvania in 1791 and for libraries in New York in 1796 and in New Jersey in 1799. Fire companies could be chartered under general acts of Virginia of 1788 and of Kentucky of 1798" (Hurst 1970, 134).

What are the advantages of corporate status? All corporations are legal persons possessing a minimal set of common attributes (Vikramaditya 2005): (1) they have an indefinite life (i.e., self-perpetuating self-government), (2) they are able to sue and be sued in their own name, (3) they are able to own property in their own name, (4) they have centralized management empowered to act in their name (subject to laws regarding fiduciary responsibility), and (5) liability for the organizations' debts is limited to the organizations' capital.[10] Without protection from personal liability for an organization's debts, potential transactions costs of doing business would be far higher and persons would understandably be reluctant to become actively involved.

Laws typically grant all corporations considerable flexibility to govern themselves through bylaws of their own devising. Business corporations can change their line of business and nonprofit corporations can change their mission, provided they follow whatever process their bylaws require.

As commonly perceived, the nonprofit sector consists of small organizations coexisting with a few wealthy research institutes, universities, and hospitals. This is true but small organizations are equally prevalent in the for-profit sector. According to Table 1.1, small organizations comprise approximately one-half of the 29 million for-profit businesses and the 1.7 million tax-exempt nonprofits (including religious congregations).

TABLE 1.1 Nonprofit Organizations and For-Profit Businesses in 2005

	Total*	Small Organizations†
Nonprofits		
Federally tax-exempt public charities	876,164	310,683
Including religious congregations (est.)	*1,176,164*	*610,683*
Federally tax-exempt nonprofits	1,401,454	528,023
Including religious congregations (est.)	*1,701,454*	*828,023*
Nonprofit corporations (est.)	3,503,635	Unknown
All voluntary nonprofits (est.)	9,000,000	Unknown
For-Profit Businesses		
Publicly traded corporations (est.)	18,000	18,000
For-profit business corporations	5,558,000	4,241,000
All for-profit businesses	28,696,000	12,090,000

*For nonprofits, this is the number registered with the Internal Revenue Service (IRS) in 2005. For businesses, this is the number filing tax returns with the IRS (with or without reportable net income) in 2004.

†This refers to nonprofits with less than $25,000 of revenue. For businesses, it is tax filings that report gross receipts of less than $25,000.

Sources: Bowman (2011b); Wing, Pollak, and Blackwood (2008), Tables 1.1 and 5.1 (estimates by author based on Grønbjerg and Smith 1999); *Statistical Abstract of the United States, 2008 edition*, Tables 721 and 722.

Although for-profit corporations are three times more numerous than nonprofit corporations, nonprofits are *more likely* to be incorporated. One-third of all 9 million nonprofits are incorporated compared to one-fifth of all 28.7 million for-profit businesses.

Why? A large number of small businesses consist of self-employed individuals whose personal finances are intertwined with their business, so incorporating offers no special advantages. However, nonprofit activity is inherently a group activity, so it is important for there to be a fire wall between the finances of the group and the individuals who govern and manage it, although there is little advantage to incorporating a nonprofit that owns no assets.

The most prominent advantages of incorporation to nonprofits are: immortality, collective ownership of assets, and limited liability. Immortality is especially important for philanthropic projects initiated by persons who intend their perpetual continuation. Because nonprofit corporations are immortal and controlled by multiperson boards, they are indispensable vehicles for protecting capital from misappropriation by custodians and for transmitting that capital to subsequent generations.[11]

There is only *one* difference between nonprofits and for-profit businesses—nonprofits are not investor-owned. It might be said that they own themselves. The implications of this sole difference are powerful. It gives nonprofits the flexibility to decide whose interests it will serve and for whom it will act as fiduciary. [A *fiduciary* is an entity "who obligates himself or herself to act on behalf of another . . . and assumes a duty to act in good faith and with care, candor, and loyalty in fulfilling the obligation" (Findlaw 2011).]

Every organization is a fiduciary in some sense. For-profits have a fiduciary duty to stockholders. Among nonprofits different types of nonprofit alternative income imply different fiduciary duties: Dues imply a duty to members, endowment income implies a duty to future generations, and donations imply a duty to the current generation.[12]

Advantages and Disadvantages of Being Nonprofit

An absence of investor-owners confers advantages on nonprofits: attractiveness to donors, insulated management, protected management, and endowment ownership.

- *Attractiveness to donors.* Individuals are more likely to donate to a nonprofit organization than to a for-profit one regardless of exemption or deductibility of donations, especially if they perceive nonprofits to be more trustworthy and/or public-spirited (Hansmann 1980; Valentinov 2008).[13] Deductibility of donations merely provides further incentives.
- *Insulated management.* Some nonprofits are sponsored by another nonprofit or by a unit of government because donors want assurance that their gifts will not disappear into the general treasury, and by controlling the board donors can exert a countervailing influence to political processes.[14]
- *Protected management.* If a for-profit publicly traded corporation performs poorly, a group of investors may buy it. Then, using their newly acquired power, they can replace the management team. Except for membership associations with elected leaders, only state attorneys general may sue to remove management, which occurs rarely (Fremont-Smith 2004).
- *Endowment ownership.* An endowment is a portfolio of investments managed so as to produce a perpetual source of income to subsidize goods and services below their cost of production indefinitely. If a for-profit firm produced a product that cost more to produce than it earned, the firm would drop it, not endow it. If it did attempt to endow it, a group of investors would surely emerge to take control of the organization and its endowment. Protected management enables nonprofits to own endowments.

The foregoing discussion focused on intrinsic differences between nonprofits and for-profits due to the absence of investor-owners. However, public policy also favors nonprofits. Heading the list of these advantages is tax exemption.

Despite popular perceptions, nonprofit status and tax exemption are not congruent. In Indiana, for example, the number of nonprofits recognized by the IRS approximately equals the number not recognized (Grønbjerg, Liu, and Pollak 2010). (Technically, the IRS does not confer exemption; it *recognizes* an organization as being exempt.) Charitable nonprofits further benefit from deductibility of contributions by donors.

Bankruptcy laws are more favorable: A nonprofit's creditors cannot force it to involuntarily liquidate, and when nonprofits choose to reorganize in Chapter 11 they remain debtors in possession.[15]

Unlike publicly traded companies, the law does not require nonprofits to have an annual meeting open to the public or to have their financial statements audited. The most recent federal law on corporate accountability (Sarbanes-Oxley) exempted nonprofits from all but two provisions. The U.S. Supreme Court has made it clear in a series of decisions that state and local laws cannot compel nonprofits to disclose their fund-raising and administrative costs to prospective donors.[16]

The only information available to the public about tax-exempt nonprofits is from an informational return they are required to file annually with the IRS (see Chapter 5); but one-quarter of nonprofits with at least $500,000 in donations reported no fund-raising expenses, and a significant number of Form 990 reports allegedly contain material omissions, misrepresentations, or falsifications (Hall 2000).

These advantages, taken together, enable nonprofits *to behave* differently. Their *business* is promoting values and even in industries with the greatest dependence on commercial income they act differently. To some observers, nonprofit hospitals are "large and highly commercial" enterprises that "do not look, feel, or act very much like the mental images that most of us have of nonprofit organizations" (Hodgkinson and Weitzman 2001, 5).

Schlesinger and Gray (2006, Table 16.1) reviewed all peer-reviewed research on the topic and found that in 114 comparative hospital studies, nonprofits performed better in terms of economic performance (21 studies), quality of care (14 studies), and accessibility for unprofitable patients (28 studies). Only 11 of these studies found that proprietary hospitals performed better on these same criteria. Furthermore, in 68 empirical studies of nursing homes, for-profit homes had better economic performance (19 compared to 5) but nonprofit nursing homes unambiguously performed better in terms of quality and accessibility (26 compared to 6). However, there are several disadvantages of being nonprofit.

- *Mission constraint.* State laws typically restrict the purposes that they allow nonprofits to undertake, and tax laws discourage others (see Chapter 5). However, arguably these limitations and disincentives do not affect the outcome much. To repeat an earlier example: Although auto repair may not be a permitted purpose for incorporation and is not an exempt purpose for relief from taxation, there are probably few people who want to do it anyway.
- *Capital constraint.* This may be the most important disadvantage. Although nonprofits receive gifts of capital, these are not free. Fundraising costs may be substantial. In addition, the pool of major donors is limited for nonprofits, whereas the pool of capital available to for-profits is virtually unlimited and truly global. When a for-profit has an initial public offering (IPO), its stock sells out in a day. Although the investment banker is well compensated, the amount of money raised relative to issuance expenses is small compared to fundraising (Bowman 2011a).
- *Mission drift and waste.* Although having no investor-owners provides space for amateurs to learn on the job and make mistakes, this advantage comes with an increased prospect of mission drift and wasteful management. (See the opening vignette of Chapter 11.) If a for-profit company is not doing a good job of looking out for its investor-owners' interests, one or more of them can make a tender offer to buy a controlling share and replace ineffectual management. There is no mechanism for replacing derelict directors and officers of nonprofits other than a state attorney general filing a lawsuit.
- *Risk.* In for-profit corporations stockholders share business risks. Individually they can mitigate their risk exposure by selling the company's stock (if they shun risk) or buying more (if they like risk). Because nonprofits have no stockholders, their clientele absorbs the entire risk alone and, unlike a for-profit's stockholders, clients of nonprofits have no way to mitigate risk. Nonprofit directors and officers must be more sensitive to the risk associated with various revenue sources and services offered, particularly new ones with unknown risk characteristics.

Table 1.2 summarizes the advantages and disadvantages of being nonprofit. For some activities, like producing microwave ovens, the disadvantages outweigh the advantages. For other activities, like disaster relief, the advantages outweigh the disadvantages.

From society's point of view, the advantages of a robust nonprofit sector outweigh the disadvantages. Nonprofits provide "a large variety of partially tested social innovations," which Smith (1973) calls "social

TABLE 1.2 Advantages and Disadvantages of Nonprofit Status and Tax Exemption

	Tax Exempt	Not Exempt
Nonprofit	Capital constrained* Donations* Protected and insulated managers Can be endowed* Restricted to exempt purposes	Capital constrained Donations Protected and insulated managers Can be endowed No purpose restrictions
For-Profit	Null	Capital available No donations Managers neither protected nor insulated Never endowed No purpose restrictions

*Tax-exempt nonprofits are likely to be less capital constrained and receive more donations and endowment-building gifts than if they are taxable.

risk capital.'' They create intellectual space for ''countervailing ideologies, perspectives, and worldviews''; searching for ''novelty and beauty''; providing ''fellowship, sociability, and mutual companionship''; preserving ''values, ways of life, ideas, beliefs, artifacts''; representing the sense of ''mystery, wonder, and the sacred''; and offering ''unique opportunities for personal growth.''

Nonprofits are custodians of society's values, and the most prominent values-driven organizations are affiliated with religious congregations. ''Universally, religious groups are the major founders of nonprofit service institutions. We see this in the origins of many private schools and voluntary hospitals, in the U.S. and in England, Catholic schools in France and Austria, missionary activities in developing countries, services provided by Muslim wacfs [religious trusts], and so on'' (James 1987, 404).

This Book's Agenda

Both for-profit businesses and nonprofits must pay their bills. When resources are chronically inadequate, liquidation is inevitable for both. As the saying goes, ''no money, no mission.'' However, nonprofit accounting rules are different, which has consequences for budgeting. Endowed nonprofits have additional legal constraints that affect their financial operations.

The next four chapters take a fresh look at common financial tools—financial statements, investment portfolios, and budgets—and tax law relevant to different types of nonprofits.

Chapter 2 reviews accrual accounting, highlighting treatment of noncommercial (alternative) income.

Chapter 3 covers legal and management issues an endowment raises. It describes the Uniform Prudent Management of Institutional Funds Act, which nearly every state has adopted in some form.

Chapter 4 explains how to configure budgets to be consistent with nonprofit accounting rules and how to reconcile a budget with a financial statement and IRS Form 990.

Chapter 5 describes how federal tax law classifies tax-exempt institutions and how this is similar to, yet different from, the archetypical nonprofits that define the themes of the following chapters. This chapter introduces each archetype with a brief history of important events in its evolution in the United States.

Each of the next four chapters focuses on a specific *archetype*, which is defined by the group of persons to whom a nonprofit organization owes a fiduciary duty, because it is reasonable to suppose that different responsibilities influence the range of normal financial behavior.

All archetypes are analyzed within a similar tripartite temporal framework: (1) in the long run the objective is to maintain or expand services, (2) in the short run the objective is resilience to occasional economic shocks, and (3) in the current period the objective is to pay bills on time.

Chapter 6 focuses on *ordinary service providers*. These nonprofits have a fiduciary duty to act in the best interests of one or more indefinite groups of living persons (Bowman and Fremont-Smith 2006). *Indefinite* means that members of the relevant group cannot be identified by name—only by common characteristics such as income, age, culture, and interests. The modifier *ordinary* indicates that they do not have endowments. It may seem a mundane descriptor but it serves to indicate that they are the most common type.

Chapter 7 features *membership associations*. Membership associations have a duty to act in the best interests of a specific group of living persons, or other organizations, called members or patrons, who are usually able to participate in election of decision makers for the group. Dues are a financing source that is unavailable to providers of goods and services, and therefore these nonprofits need different benchmarks.[17] As indicated previously, cooperatives are difficult to classify. Chapter 7 treats them as membership organizations while indicating how they differ from noncooperative associations.

Chapter 8 is about *endowed service providers*. A growing body of literature calls attention to the importance of endowments and their unique management issues (Ehrenberg 2000; Gentry 2002; Fisman and Hubbard 2003; Bowman 2002b, 2007; Weisbrod, Ballou, and Asch 2008; Lerner, Schoar, and Wang 2008). These organizations, like ordinary service providers, have a duty to an indefinite group within the current generation but they *also* have a duty to future generations. The large investments of these organizations require modification of the diagnostic formulas for capacity and sustainability.

Chapter 9 highlights *grantmakers*. These organizations are agents of donors with a duty to act as the donors would under similar circumstances. There are three kinds of grantmakers: conduit, limited life, and endowed. Conduit grantmakers pass through current income from donors to service-providing nonprofits. Limited life grantmakers are established with the intention that they will spend themselves out of existence within a finite period of time. Endowed grantmakers serve future generations.

Table 1.3 summarizes the characteristics of these archetypes, showing how organizations are classified according to the nature of their fiduciary duty to present and future generations.

Chapter 10 explains how the types of goods and services produced affect the composition of revenues and describes how producers of goods and services can improve sustainability through revenue management.

Chapter 11 describes ethical duties of nonprofit organizations and applies the lessons of previous chapters to exploring the use and misuse of business principles by nonprofits.

TABLE 1.3 Nonprofit Archetypes

	Generation Served	
	Current	Future
Indefinite Group	Service providers and endowed grantmakers	Endowed service providers and endowed grantmakers
Definite Group	Membership associations and other grantmakers	Endowed membership associations (rare)

Note: Membership associations include cooperatives; other grantmakers include limited life and conduit grantmakers.

Concluding Thoughts

Returning to the questions that opened this chapter, what *are* we to make of the New York Stock Exchange operating as a nonprofit for nearly 200 years, for-profit charities like Google.org, and for-profit companies operating as nonprofits, like IKEA?

Until 2006 the New York Stock Exchange was a comfortable nonprofit membership association. Until recently it was competitive with other exchanges around the world. Then the market changed and it needed substantial fresh capital quickly to retool its operations and to combine with investor-owned exchanges. It had literally outgrown its nonprofit charter.

Google attempted to overcome the nonprofit capital constraint by using its ability to sell stock to finance an ancillary social mission. Its goal was nothing less than reinventing philanthropy, but it has yet to find a new workable model (Helft 2011). To an outside observer, DotOrg (as company insiders call the philanthropic division) appears to operate more like a venture capital firm with a social agenda. It is a novel and useful paradigm, even if it has not inspired other corporations to follow suit.

IKEA has enjoyed a near-monopoly in the do-it-yourself furniture market, so it has not needed external sources of capital to grow. The nonprofit arrangement has served its founder well by allowing him to remain firmly in control for decades. It remains to be seen how well the arrangement will serve the organization after he is no longer at its helm, especially if and when a rival company finally emerges to challenge its supremacy in its market niche.

It is interesting to note that IKEA has established what amounts to an endowment with retained earnings. However, its purpose is not to subsidize products below their cost of production as nonprofit endowments do but to be a pool of capital-in-waiting for establishing new stores. The definitive study of IKEA has yet to be written, but a probable consequence of self-financing is slower growth, which it accepted as the trade-off for tight control over all aspects of operations.

Each of these examples, odd as they seem at first sight, illustrates the advantages and disadvantages of being a nonprofit organization. Experimentation with hybrid organizations can be interpreted as efforts to combine the advantages of both pure types (nonprofit and for-profit), meanwhile diminishing their disadvantages.