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DO GOODERS VERSUS GOOD DOERS: AN EMPIRICAL EXAMINATION OF GROWTH VERSUS EFFICIENCY IN SOCIAL ENTREPRENEURSHIP



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ABSTRACT

Constrained by the regulatory requirements of a nonprofit, researchers have been tempted to posit that commercial ventures and nonprofit social ventures share different interpretations of the contribution of growth and profit to success measures. Social ventures must nonetheless tackle sustainability or they too risk marketplace failure. Robb-Post et al (2010) posited that a model of sustainable contributive advantage can explain the social value creation mechanism beyond simple economic profit. This study examines the concepts of growth and profit in the context of social ventures by using several variables that define “growth” and “efficiency” measures within social ventures in order to test hypotheses regarding their relationships and ability to achieve success.

INTRODUCTION

The confounding structure of non-profit status within social entrepreneurship has spawned the academic assumption that social ventures and economic ventures share different interpretations of success. The rapid surge of academic interest in social entrepreneurship has pushed the need to develop a new set of lenses by which to evaluate how success can be compared across social ventures. As the need to create social value frequently conflicts with the need to achieve direct economic profits, social ventures must tackle sustainability or face, as any venture, the reality of marketplace failure.

The variables of growth and profit, often used in the study of economic ventures, are problematic in the context of social entrepreneurship due to their dual-goal nature. While some social ventures, such as non-profit organizations, do not record “profit,” they do possess metrics that provide an efficiency measure. This study uses several variables to define and analyze the “growth” and “efficiency” measures within social ventures in order to test hypotheses regarding their relationships. The initial exploratory study used revenue growth (growth) and a ratio of revenue vs. expenses (efficiency) as measures. The results indicated that the path to “success” within social entrepreneurship is somewhat different than the path of economic entrepreneurship. These measures have been expanded to provide several different lenses for analysis such as asset growth, fundraising efficiency, working capital, program efficiency, program expenses, etc.

We examine a specific industry sector utilizing Resource-Based Theory (RBT) in order to expand and test the concept of *sustainable contributive advantage*. Similar to the concept in RBT of sustainable *competitive advantage* (SCA), sustainable *contributive advantage* (SConA) incorpo-

rates the additional social value creation mechanisms at play within social enterprises. A venture has *sustainable competitive advantage* if it is able to create more economic value than the marginal competitor in its product market (Peteraf and Barney, 2003). A social entrepreneurial venture has *sustainable contributive advantage* if it is able to consistently create more social value than the marginal contributor in its social problem area.

The definitional debate surrounding what social entrepreneurship is, or isn't, continues among the field. There are some that would argue that social entrepreneurship is limited to non-profit organizations. While most would disagree, this study does not posit a definitive answer on the issue. However, within the social entrepreneurship framework, the study examines a specific type of social venture, the donative nonprofit (to be defined later).

Profits and Policy in Nonprofit Organizations

This study examines a specific type of social venture, the nonprofit. An old consulting expression in the nonprofit sector states "there is nothing nonprofit about a nonprofit other than its tax status." While this could be considered a narrow view of the nonprofit reality, there is some truth to the expression. Similar to a for-profit venture, nonprofits attempt to generate revenue and keep costs low. Sometimes this results in more revenue than expenses. Just as with a for-profit entity, any annual excess of revenues over expenses will result in a "profit". In nonprofit accounting terms, the result of "profit" is often referred to as "a change in net assets." This "profit" is tax-free and while nonprofits are allowed to earn a "profit" within a given year, it is expected that these profits will provide future mission-related services for which the organization was formed (Hansmann, 1980).

It is somewhat naïve to assume (and research does not support) that such profits occur only due to unforeseen donor generosity or poor forecasting skills of the organization (Chang and Tuckman 1990). Rather, operating profits (or positive change in net assets) may be a goal of management in an effort to expand the organization, or to protect the organization from revenue shocks (Calabrese, forthcoming). However, a positive change net assets is still not an appropriate measure for how efficient or "profitable" a nonprofit may be. This is due to the simple fact that market prices for the outputs of nonprofit organizations and even for some inputs (for example, volunteers' work) do not exist (Speckbacher, 2003).

The other side of "profits" within the nonprofit sector is what has become known among researchers as a "nondistribution constraint" which is the "absence of stock or other indicia of ownership that give their owners a simultaneous share in profits and control" (Hansmann, 1980). In other words, unlike the for-profit sector, nonprofits are not able to distribute their excess revenues to shareholders. These excess revenues must be distributed in one of three ways, each of which that will contribute to the overall mission of the nonprofit: increases operating expenses, investment in fixed assets, or kept in retained earnings.

The Internal Revenue Service has no restrictions or regulations regarding net asset accumulation and no public policy exists regarding how much surplus a nonprofit may earn in a given year, nor how long these surpluses may be retained (Calabrese, forthcoming). However, public views and recent government regulations have pushed for such restrictions to exist. In 2001, the American Red Cross became the subject of public scrutiny and a House of Representatives special hearing when it was discovered that the American Red Cross kept a portion of the donations made on behalf of 9/11 victims in order to set aside funds for future catastrophes. The public outcry was

so significant, the organization's president publicly resigned. Another noteworthy example is the Higher Education Act, passed in 2008, which requires universities to spend at least 5% of their net assets each year on lowering tuition.

Market Failure

The regulations and tax exemptions provided to nonprofits (specifically those of 501(c)3 status) were designed to assist nonprofits in the costs of providing services to those that either the government or the market failed to provide. Weisbrod's groundbreaking work in 1975 identified two types of failures that lead to the role of the nonprofit: market failure and government failure. To summarize, markets fail to provide adequate quantities of collective goods to those in need of them and governments provide these goods in accord with the will of the people. Those who want higher levels of service than the government provides then support nonprofits.

Nonprofits work to fill needs and gaps that neither markets nor governments are able to fill (or choose to fill). Therefore, nonprofits operate in a unique environment where supply and demand functions and their effect on price do not function normally. Over the past 20 years in the United States, the number of nonprofits has increased by 63% and data from the National Center for Charitable Statistics at The Urban Institute suggest that nonprofit numbers will continue to rise (Kerlin, 2006). As more and more nonprofits enter this unique non-market environment, obviously resources for the support of these nonprofits will become harder to acquire. However, in the face of increasing competition for resources among nonprofits, it becomes important to examine how competition behaves in a non-market environment.

This study attempts to unveil certain behaviors of nonprofits as they relate to their for-profit counterparts. The first step in this approach is to examine what the common measures of for-profit "growth" and "profit" equate to within the nonprofit environment. As will be detailed later, "growth" and "profit" will be examined in several combinations. Additionally, the public view and policies surrounding whether a nonprofit uses their "profit" toward growth and capacity building versus immediate program spending becomes an overall framework for discussion. In examining which kind of strategy, profit or growth, tends to lead to stronger performance by the nonprofit, this study aims to shed light on this burgeoning issue at hand in the United States nonprofit sector.

Profit Versus Growth in Economic Ventures

In looking at economic ventures and their behavior in the marketplace, growth and profit dimensions have helped to define firm success (Davidsson, et al., 2007). Additionally, the dimension of growth helps to ascertain if indeed an enterprise is entrepreneurial in nature, as growth has been claimed to be the very essence of entrepreneurship (Sexton and Smilor, 1997). Recent studies, see Davidsson et al., 2009 and Brännback et al., 2009, have begun to ask the question of which dimension is more important for long term success, growth or profit?

The collective results of both studies show that while both are important for the success of an economic venture, normally the path to success is through profitability first, then growth. Their results are opposite to the traditional school of thought. Managers of these ventures may benefit from their findings if they purposely carve their strategies toward a path of profitability prior to the path of growth.

In wanting to shed light on the path to success in social ventures, the logical step forward is to ascertain what growth and profit dimensions look like in social ventures. As previously stated,

social ventures have a different view of how profitability and other financial measures relate to how they view success. They must deal with a dual-goal of running their organization in a sustainable way and creating social value via methods that may not have an economic return. To simply argue the importance of growth or profitability in a social ventures is a disjointed argument because it does not reflect the true reality of these social ventures.

Utilizing a Resource-Based Approach

Robb-Post et al (2010) posited that a model of sustainable contributive advantage (SConA) helps to explain the social value creation mechanism beyond a simple economic profit. This view becomes important as the concepts of “profit” and “growth” are applied from a nonprofit perspective. Based in resource-based theory and the cornerstones of competitive advantage offered by Peteraf (1993), SConA offers a way at looking at the competitive environment while taking social value creation into consideration. An enterprise has *sustainable competitive advantage* (SCA) if it is able to create more economic value than the marginal competitor in its product market (Peteraf and Barney, 2003). An enterprise has *sustainable contributive advantage* if it is able to consistently create more social value than the marginal contributor in its social problem area. SCA in a social entrepreneurial context includes SConA that is; an organization cannot achieve SConA without *also* achieving SCA.

In the case of donative nonprofits, they have chosen to serve an additional set of consumers that may not have the “ability” to pay regardless of their “willingness” to pay for perceived benefits. An important distinction should be made regarding what the researchers in this study have termed a donative nonprofit. A donative nonprofit is one in which the organization chooses to serve a group of constituents who are unable to pay, whole or in part, for the services or products the nonprofit provides.

This is somewhat of a departure from the legal definition of a donative nonprofit, which may include such entities as opera houses, certain hospitals, or universities that may operate on a profitable transactional basis. Those nonprofits that rely on profitable transactional business models to survive are termed commercial nonprofits, rather than donative nonprofits (Hansmann, 1980). Some nonprofit organizations derive all their resources from commercial operations, and in this sense are just as much “for profits” as any for-profit venture. (Steinberg, 2006). Subsequent literature has focused on the differences between donative and commercial nonprofits; some are donative in that they rely mostly on donations and others on commercial activity. This study focuses on the donative nonprofit, which differs in that they have dedicated their business model, in whole or in part, to a transactional process that is unprofitable at the time of the transaction.

It is easy to see then that in the case of the donative nonprofit, the concept of “perceived benefit” becomes distorted. For example, the perceived value of a hot meal is not converted or realized when the homeless person agrees to consume it, *regardless of how valuable the homeless person perceives the value to be*. Therefore, the donative nonprofit has an additional step in their value creating and capturing process. The perceived benefit must be converted and realized by a party *not directly enjoying the benefit* the donative nonprofit is creating.

If an organization is able to achieve SConA, it is able to utilize value-creating and capturing strategies. These strategies enable the organization to grow from within and through its economic and social resources it is able to generate transactions of creating both social and economic rents. It then captures value by monetizing social rents into new economic equivalents. The accumulation of social rents do not equate to profit directly, it is in fact the accumulation of social rents, which needs to be converted into economic profit.

In tying this to Peteraf's (1993) model for sustainable competitive advantage, Robb-Post et al. (2010) offered two additional components focusing on the social value creation (social rents) and the conversion of the social rents to economic rents. The basic premise of resource-base theory is the assumption of *heterogeneity*, meaning that all resources across all organizations are different and competitive differences can be found in them. What keeps the heterogeneity of resources in place for a firm is the *imperfect mobility* of their resources. These allow ventures to keep their resources uniquely valuable to the firm. The additional cornerstones of *ex post limits to competition* (barriers in place after entering the market) and *ex ante limits to competition* (barriers in place prior to entering the market) speak to more of the external forces of the market.

In translating these cornerstones to donative nonprofits, the internal-related cornerstones of *heterogeneity* and *imperfect mobility* are easily applicable. However, the externally-related cornerstones of SCA *ex post limits to competition* and *ex ante limits to competition* require some translation in the non-market environment in which the donative nonprofits operate.

Thus, the accumulation of social rents through transactions of creating social value needs to be converted into economic profit for the organization. Because it is a two-step process, a nonprofit wishing to have SConA must deal with *ex post limits to competition* but it must *ALSO* deal with a cornerstone termed *limits to scarcity* in order to sustain social rents. Limits to Scarcity is demonstrated by the nonprofit's ability to create social value in a more efficient or preferred manner, therefore the organization is able to create the same social value that another nonprofit is, but with less effort, lower expenses or with more effectiveness. Limits to scarcity contribute to *ex post limits to competition* and the result of which will be seen via economic profit. However, the nonprofit must focus on both the conversion of the social rents *AND* the creation of social rents via limits to scarcity.

A nonprofit wishing to have SConA must deal with *ex post limits to competition* but it must *ALSO* deal with *abilities to scale* in order to have the ability to significantly grow social rents, especially in the case of an economic downturn where demand for services increases and the price for services is expected to decrease. Abilities to scale contributes to *ex ante limits to competition* primarily because the decisions to invest resources in creating more social value are made without knowing if the investment will directly contribute to SConA. The nonprofit that is able to increase its capacity and abilities to scale will in turn grow in terms of social rents. If those growing social rents are converted and the contribution to *ex ante limits to competition* is successful, the result will be growth, either in terms of revenue, assets, program services, etc.

SCA from a RBT perspective in economic ventures reflects the assumption that ventures should pursue growth opportunities that match their resource advantages that would allow them to grow profitably (Sirmon et al., 2007). Therefore, in the framework used by Davidsson et al. (2009) and Brännback et al., (2009), SCA stems from high-growth and high-profitability. They propose those ventures operating at this level have been able to achieve SCA. In beginning to apply this language to social enterprises, the concept of SConA is important to translate.

The concept of growth in a social venture relates directly to their capacity to contribute or "growth" (related to abilities to scale). As the goal of a social venture is to create value, the concept of growth relates directly to the ability to create social value on a larger scale. Similarly, the concept of profit in a social enterprise relates directly to their efficiency of contribution (related to limits to scarcity). Profitability becomes the contributive efficiency of the venture in its ability to run and manage operations.

In times of scarcity when an economic downturn occurs, charities experience increased demand and decreased revenue coupled with the public expectation to persevere. They are expected to serve more when the time of need is greatest and when the general public domain of resources (i.e. donations, grants, government subsidies) are at its lowest. This departure from the normal market demand behaviors and their impact on “growth” and “profit” in social ventures create compelling questions as to what strategies may be best for social ventures. The social value creation requirement and non-market orientation behavior create the need to examine these questions using RBT and SConA as research lenses.

As previously discussed, the economic flow within donative nonprofits creates a time lag in the transactional processes within the nonprofit business model. This time lag, as this study shows, creates a state of high volatility and risk for donative nonprofits. The conversion process of a social rent to an economic rent requires additional steps in the nonprofit business model. The additional cornerstones of *limits to scarcity* and *abilities to scale* are essential to the success and sustainability (sustainable contributive advantage) of donative nonprofits and become important to frame the discussion and methodology of the study at hand.

METHOD

A data set was compiled of 147 animal-welfare related, nonprofit, 501(c)3, social ventures in the United States that contains historical financial data (3-7 years), as reported on the Internal Revenue Service Form 990. The reason for this specificity of industry and organizational type is two-fold. The first lends to the RBT view of a firm, as most of this type of work is best carried out on a limited sample of ventures within a single industry. This helps establish the link between the resources and strategies in question (Barney & Clark, 2007: 223). The second reason for specificity is the reduction in ethical issues surrounding some more controversial sectors such healthcare, religion, arts, education or environment.

It is worth repeating that in research on economic ventures success measures were modeled using the independent variables of growth and profit to evaluate the nature of high performing ventures, i.e., those ventures that reach the desirable state of high growth and high profitability. By contrast, social ventures such as the nonprofits contained in this data set do not report the same comparable profitability measures due to regulatory limitations. Therefore, in this study, it was necessary to construct variables that express profit from internal measures that alternatively measure firm efficiency. In this resource-based context then, efficiency to the social venture is a comparable desired success criteria as profitability is to the commercial venture.

Following the method of Brännback et al. (2009) as a starting point, the 147 nonprofit ventures were plotted in a 2 x 2 matrix of growth and efficiency (exchanged for profit) and were categorized as above or below industry average on each dimension. The four categories created were:

- high growth, high efficiency (STAR VENTURE)
- low growth, high efficiency (EFFICIENCY VENTURE)
- high growth, low efficiency (GROWTH VENTURE)
- low growth, low efficiency (POOR VENTURE)

As it related to economic ventures, Davidsson, et al. (2009) and Brännback, et al. (2009) were not interested in trying to predict which ventures would become Star ventures (high growth, high efficiency) but rather to investigate the probability that a venture in one state would have the

ability to migrate to any other state in the next time period. Please see Figure 1 for graphical illustration. From the context of a resource-based advantage, Davidsson, et al. (2009) forwarded that Profit ventures would have the edge in underlying competitive advantage over Growth ventures. The researchers attributed this to the resource sparing behavior of Profit ventures and posited that Growth ventures are relatively unlikely to build resource advantages in achieving superior performance. Conversely, it was further assumed that those ventures that cannot reach Star status would strategically desire to avoid falling into the Poor category as a result of the inability to sustain competitive advantage. Similar attributions were drawn that Profit ventures were more likely to be more resilient to economic distress than Growth ventures. Profit ventures were less likely to fall to a Poor venture due to their resource acquiring behavior. Thus in applying the Efficiency for Profit exchange we apply the same formulated hypotheses:

***H1.** Social ventures that show high efficiency and low growth (Efficiency ventures) are more likely to reach a state of high growth and high efficiency (Star ventures) in subsequent periods than are ventures that first show high growth at low efficiency (Growth ventures).*

***H2.** Social ventures that show high growth and low efficiency (Growth ventures) are more likely to reach a state of low efficiency and low growth (become Poor ventures) in subsequent periods than ventures that first show high efficiency and low growth (Profit ventures).*

In addition, because of the additional requirements of SConA proposed by the model of Robb-Post et. al (2010) any social venture that finds themselves in the Poor category may be tempted to employ a rapid growth scenario in order to rapidly capture more social value than other competitors in their category. This resource consuming process is doubly tempting to the social venture because the lag of social rent conversion that is delayed to the next fundraising cycle is promoted by the need to appear contributive in addressing the social need as a desirable outcome rather than efficiency. Thus in this study we add a third hypothesis:

***H3.** Social ventures that show low growth and low efficiency (Poor ventures) are more likely to reach a state of high growth and low efficiency (become Growth ventures) in subsequent periods than high efficiency and low growth (Profit ventures).*

Davidsson, et al. (2009) used sales growth as the growth measure and return on assets (ROA) as a profitability measure. Brännback, et al. (2009) used sales growth as the growth measure and earnings before interest and taxes (EBIT) as the profit measure. As social ventures have the added need to provide social value, this study explored several different measures of social and economic contribution as variables in exploring the relationship between growth and efficiency. As it relates to those measures that correlate with the concept of growth within the 990 Form, revenue is broken down among some 13 different sources (e.g., contributions, fees for services, membership dues). Additionally, within the 990 Form, expenses are broken down into three categories: program, management and fundraising expenses that can be used to develop approximations of profit measures.

For modeling purposes the combinations of growth and efficiency were analyzed in three separate scenarios:

Scenario 1: Total revenue growth versus total efficiency ratio

The sum of all reported sources of revenue on the 990 Form were coded as total revenue for the growth measure. The 'profit' measure was calculated by dividing total revenue by total expenses. While dividing total revenue by total expenses does not reflect the true 'profit' or effectiveness of the organization, it does provide a baseline comparison across the organizations for determining the efficiency of their operations and ability to leverage resources. For purposes of clarity, the profit measure is renamed 'efficiency.'

Scenario 2: Total revenue growth versus fundraising efficiency

One of the strategies employed by nonprofits to communicate to the public their own assessment of success is through fundraising efficiency (Keating & Frumkin, 2003). As nonprofits spend money to raise money, fundraising efficiency is calculated by dividing fundraising expenses by the total contributions received. In other words, fundraising efficiency is a measure of how much a nonprofit spends to generate \$1 in charitable revenue. In order to evaluate the strategic power of this approach, fundraising efficiency was placed as the 'profit' variable. The growth measure was the same as used in Scenario 1.

Scenario 3: Composite growth capacity versus Composite efficiency capability

In order to capture a greater contribution of the factors within a social venture that may contribute to growth or efficiency a composite model employing both social value capture and economic value measures was analyzed. McKelvie and Wiklund (2010) advocate the use of hybrid models of various contributing modes of growth to enhance our understanding of theoretical underpinnings of growth as it applies to venture success. The growth variable was formed as a scaled combination measure of both economic and social value creation consisting of; revenue growth, program expenses growth (evidence of social services growth), and working capital ratio. The efficiency variable was formed as a scaled combination measure of program expenses, administrative expenses, fundraising expenses and fundraising efficiency.

A Markov chain analysis was used to estimate the transition probabilities between these states over a three-year period, following work that analyzed the relationship between growth and profitability in entrepreneurial economic ventures (Brännback et al., 2009). Mixed Markov Latent Class models make statements about transitions from one point in time to another. In order to estimate the transition probabilities, the observed transition path is first defined for each organization. We have four potential outcomes (listed above) for an organization at time period t and – given a fixed outcome at t – again the same four potential outcomes at time $t + 1$. For example, an organization indicating below median growth and above median efficiency in 2006–2007 and above median in both dimensions in 2008 was defined to have followed the path Efficiency–Efficiency–Star and an organization showing below median values in both dimensions all three years was defined to follow the path Poor–Poor–Poor. The transition probabilities were estimated applying the Panmark software of van de Pol et al., (1991). The calculations are based of the frequency distribution of the observed 147 cases over the potential transitions (4 possible paths in each of the three periods, i.e. $4^3 = 64$ combinations).

RESULTS

Previous studies show that in economic ventures, sound growth starts with achieving sufficient levels of profitability (Davidsson, et al., 2009; Brännback et al., 2009). Using RBT and SConA as frameworks for discussion and analysis, we propose nonprofits, particularly nascent donative

nonprofits, should position their resources toward a strategy of efficiency (profit) first, rather than growth in order to achieve a position of SConA. Our empirical results support those found for economic ventures that the concepts of growth and efficiency (profitability) are distinct and appropriate constructs to view strategic objectives within social ventures. In addition, empirical results suggest support for the construct of SConA as an additive component to competitive advantage when the process of creating and capturing social value is present in the business model of a social venture.

Results of the Markov analysis time homogeneous transitions from 2006-2008 are presented for the three data scenarios in Tables 1-3. The majority of the transition probabilities for the time-homogeneous Markov-models are significant at the 5% level – all other transition coefficients are significant at the 10% level. The significance level is calculated by the software Panmark using the estimates of transition coefficients and the standard errors and is therefore determined by our data. For each scenario the probability levels for the Likelihood Ratio and Pearson Chi square test are shown and in each case indicate an adequate model.

Markov analysis is an ideal methodological approach to view the behavior of the presence of these success sub-populations within the data set for these donative nonprofits. The goal is not to predict which ventures become Star or Poor but rather to compare whether Growth or Efficiency ventures are more likely to end up in the Star or Poor categories in the next time period. The robustness of the Markov model is in determining if these observed movements are due to the current state of the process influences where each venture goes next or if the movements are attributed to random chance (Hu and Yue, 2008). The selection of each set of variables selected does not indicate a causal awareness by a venture's management to accomplish Star success but rather highlights how viewing venture movements to Star are indicative of these resource-minded processes. Therefore, the three defined scenarios can be viewed as comparable lenses by which to evaluate growth and efficiency (profitability).

Interestingly, all three scenarios showed similar patterns to those observed for economic ventures by both Davidsson, et al., (2009) and Brännback et al., (2009). In general, a venture in one category is most likely to stay in its category. This can be seen as the probability values in the diagonal of the Markov transition matrix. However, when a transition occurs, they follow the path dependency specified in all three of the hypotheses. The significance level of the Likelihood and Chi Square statistic indicated that a category a particular venture is found in a particular time step is clearly not random and is strongest for composite variable model Scenario 3 as expected. Only the magnitudes of the transition probabilities differ between the three scenarios.

The question of whether Efficiency (Profit) ventures are more likely than Growth ventures to transition to Star ventures in H1 is confirmed in all three scenarios. This can be seen in the first column of the transition matrix by comparing the cell probability of each venture state. For example in Scenario 1 (Table 1) an Efficiency venture has 40.4% probability of transitioning to a Star venture compared to 27.7% for a Growth venture in the same time step. Only the magnitude of the transition probabilities differs amongst the three scenarios. Most noticeably is the noticeably large difference seen in Scenario 2 (Table 2) that reveals an 8x difference in movement to Star between a Efficiency oriented venture (37.1%) and a Growth venture (4.3%). This large difference supports the logic of SConA as fund raising is a form of social rent conversion and when achieved provides a path to enhanced contributive advantage enjoyed by a Star venture. Our results here are

consistent in movement with those found by both Davidsson, et al., (2009) and Brännback et al., (2009) for economic ventures.

If H1 is a measure of the transition of a venture toward performance success (Star), then H2 is a measure of transition to performance distress (Poor). In all three scenarios evaluated here, H2 was confirmed. Again our results mirror the transition expectations seen by Davidsson, et al., (2009); Brännback et al., (2009) for economic ventures. Again, only the magnitude of the transition probabilities changed between the three scenarios. For example in Scenario 3 (Table 3) the Growth venture has probability two times higher (23.8%) to perform worse and become a Poor venture as compared to an Efficiency venture (10.3%). Of interest in this regard are the results seen in Scenario 2 (Table 2). When viewed from the critical SConA need to manage fund raising efficiency a Growth venture has a 9x greater risk (41.5%) of slipping to a Poor venture than an Efficiency venture (4.5%). Thus for ventures pursuing a Growth strategy the path to either Star or Poor is problematic. Note that in this scenario the Markov analysis returned a 0% probability of a Star venture moving to a Poor venture. This result has to be viewed with care as it indicates only that within this sample population there were no observed transitions of this type. This does not mean they are precluding from occurring, but given the significant n (147) of the model it is interesting to note this transition absence.

When viewing the results of Brännback et al., (2009) for economic ventures it is curious to posit the path that vastly underperforming ventures (Poor) must take in order to accomplish Star status. Their results showed that Poor ventures have an equal probability to get to Star but are more likely to pursue a path to Growth. Given the support in H1, this transition signals a possible red flag to future transitions. Social ventures having to manage the added business objective of contributing social value face additional hurdles in attaining Star status and H3 was added formally added to see if this transition not addressed by Brännback et al., (2009) would be equally evident in social ventures. In all three scenarios H3 was supported with Poor ventures transitioning at higher probability to Growth than Efficiency ventures. In fact, poor ventures in all three scenarios for social ventures transitioned at a greater probability to Growth than Star which differs from that seen for economic ventures. While perhaps simply due to sample size differences between the two data sets the indication could point to differences in the strategies applied by Poor social ventures as they deal with strategies relating to future growth and efficiency (profitability.)

DISCUSSION

Nonprofit organizations provide valuable services to communities and act as a supplement to government programs that are unable or unprepared to meet the needs of its communities. Nonprofits, in general, however, are extremely under capitalized and often struggle to provide such services (Calabrese, forthcoming). While regulations are not in place to govern the amount of retained earnings, the public perception of a nonprofit with excess capital is highly frowned upon. The public expectation is that any donations will immediately be put to use directly toward the mission of the organization. This expectation and pressure is seen in nonprofit accounting statements. According to the Nonprofit Finance Fund, in 2009 over 60% of nonprofits in the United States lacked reserves in excess of three months of operating expenses (Calabrese, forthcoming).

If nonprofits are to survive and grow, they need to be not only able to, but also encouraged to attract *as well as retain* more capital. Nonprofit managers are constantly pressured by stakeholders to increase the scope of their social impact. However, they should also be pressured to increase its

profitability. As the results of this study indicate, when a nonprofit is in a state of growth, perhaps through the receipt of a large influx of money from a grant or donor, they then need to quickly achieve a state of profitability in order to remain sustainable. If a nonprofit expands its capacity using the influx of resources it must also then quickly replace their resources with new resources (i.e. revenue). The unfortunate reality is that many nonprofit managers respond to an increase in income with an equal increase in social value creation. While in some cases, this may be the appropriate strategy; the results of this study lend weight to the notion that nonprofits should, in fact, focus on the profitability of their social value creation simultaneously, if not first and foremost.

If the nonprofit fails to replace its new revenue and simply expend every dollar as it comes in to expand capacity or programs or services without keeping profit in mind, they will find themselves unable to sustain operations. This result we posit is largely to blame for the public view on nonprofit funding, from a policy standpoint as well as public opinion. When a dollar is donated to a cause, the donor largely expects that dollar to go to work towards the cause immediately, as demonstrated in the American Red Cross 9/11 example described previously. In addition to public scrutiny, according to watchdog agency standards, no more than 35% of a nonprofit's donations should be spent on administration and fundraising (Pallotta, 2008).

Retained earnings and operating margins are, in a sense, frowned upon in the majority of nonprofits. However, nonprofits must invest in building transactional engines that bring in revenue in order to remain sustainable. Largely, this investment is not an investment directly into programs as it may be an investment in such things as a development director (or development department), an earned income program, marketing of the organization, or an annual giving campaign. Unfortunately, if the capacity for programs is expanded and they are not able to fill in the costs of those new programs with new revenue, they fall to a Poor status rapidly.

Capacity building and transactional engine building can occur simultaneously. However, many nonprofits chose not to engage in both simultaneously, either due to the high probability of public retribution or a simple lack of business skills by the nonprofit leaders. This lack of business skills is also due to a public policy flaw that discourages salaries that meet the market value of a similar salary in the for-profit market. The median 2006 compensation for the leaders of the United States' largest nonprofits was \$315,969, about *seven times less* than the \$2.4M *median* salary for CEOs of the 500 largest United States companies (Pallotta, 2008). As a result, highly talented leaders often find themselves going into the for-profit market as it is far less expensive for them earn seven times more money and simply donate that difference back to the charity of their choice.

The regulations, public perceptions, and watchdog recommendations implied on nonprofits are, in a sense, limiting the potential of the donative nonprofit model. Stakeholders must be educated on the true economic models driving nonprofit success (sustainable contributive advantage) and not only support, but also publically defend the strategic decisions to focus on profitability and retained earnings. Future research in the framework presented here suggests examining the working capital and the fundraising efficiency ratios of a nonprofit to determine if they are truly a Star venture. As the working capital ratio indicates the ability to grow in the face of an economic downturn (abilities to scale) and the fundraising efficiency ratio would shed some light as to how effectively they are able to convert their social rents (limits to scarcity); it would be interesting to explore how these measures would be able to predict social venture performance. Additionally, future research would be valuable in taking a qualitative approach to examine how the leaders of these nonprofits view profit and growth within the context of their organization. The leaders'

perceptions of their board members, employees and volunteers view profit and growth would also be of interest as this lends some weight to the pressures felt by the leaders of these organizations as to shed qualitative data on the issues presented in this study.

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Table 1 Scenario 1: Total Revenue Growth v Total Efficiency Ratio

Indicator t	Indicator t+1		GROWTH	POOR	TOTAL
	STAR	EFFICIENCY			
STAR (St. error)	0.343 (.048)	0.323 (.047)	0.010 (.010)	0.323 (.047)	1.000
EFFICIENCY	0.404 (.072)	0.404 (.072)	0.021 (.021)	0.170 (.055)	1.000
GROWTH	0.277 (.065)	0.021 (.021)	0.298 (.067)	0.404 (.072)	1.000
POOR	0.257 (.044)	0.020 (.014)	0.376 (.048)	0.347 (.047)	1.000

Likelihood Ratio = 48.221; Pearson Chi Square (χ^2) = 42.836; Model Probability Level = 0.464

Table 2 Scenario 2: Total Revenue Growth v. Fund Raising Efficiency

Indicator t	Indicator t+1		GROWTH	POOR	TOTAL
	STAR	EFFICIENCY			
STAR (St. error)	0.396 (.067)	0.453 (.068)	0.151 (.049)	0.000 (bounded)	1.000
EFFICIENCY	0.371 (.051)	0.303 (.049)	0.281 (.048)	0.045 (.022)	1.000
GROWTH	0.043 (.021)	0.234 (.044)	0.309 (.048)	0.415 (.051)	1.000
POOR	0.017 (.017)	0.172 (.050)	0.431 (.065)	0.379 (.064)	1.000

Likelihood Ratio = 64.059; Pearson Chi Square (χ^2) = 57.029; Model Probability Level = 0.175

Table 3 Scenario 3: Composite Growth Capacity v. Composite Efficiency Capability

Indicator t	Indicator t+1		GROWTH	POOR	TOTAL
	STAR	EFFICIENCY			
STAR (St. error)	0.529 (.054)	0.230 (.045)	0.138 (.037)	0.103 (.033)	1.000
EFFICIENCY	0.246 (.053)	0.585 (.061)	0.015 (.015)	0.154 (.045)	1.000
GROWTH	0.190 (.049)	0.032 (.022)	0.540 (.063)	0.238 (.054)	1.000
POOR	0.118 (.035)	0.082 (.030)	0.235 (.046)	0.565 (.054)	1.000

Likelihood Ratio = 63.665; Pearson Chi Square (χ^2) = 60.720; Model Probability Level = 0.103

Figure 1 Categorization schema of ventures by growth and efficiency (adapted from Davidsson et al., 2009, Brännback et al., 2009)

