ENABLING SOCIAL ENTERPRISE THROUGH REGULATORY INNOVATION: A CASE
STUDY FROM THE UNITED KINGDOM

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Nicholas Edward Florek, B.B.A

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Nicholas E. Florek, B.B.A.

Thesis Advisor: Gillette Hall, Ph.D.

ABSTRACT

Social enterprise, broadly defined as the innovative use of resources to achieve social goals, is a new and emerging part of the global economy that has the potential to address pressing social problems ranging from education to health care. It is a growing component of what is often referred to as the third sector; the part of the economy that encompasses organizations that are neither governmental nor for-profit business institutions. Within the last two decades, governments have begun to take note of this trend and make policy changes to support the sustained emergence of these enterprises. One policy option that has recently emerged in Europe and the United States is the creation of a separate regulatory framework for social enterprises via new forms of legal organization. This paper uses the United Kingdom as a case study to explore the effectiveness of one new type of social enterprise legal organization, the community interest company. By analyzing data collected from the UK's *National Survey of Third Sector Organisations* in 2009, this paper examines if organizations operating as community interest companies exhibit some of the characteristics that policy makers intended to foster when drafting the new legislation. Do community interest companies have easier access to a variety of funding sources and thus utilize a wider range? Also, are community interest companies relying on earned income as a primary and major source of funding as the legislation was intended to ease restrictions on market activities? The hypothesized relationship is positive in both of these cases

but results of the analysis support only a positive relationship between community interest companies and prioritization of earned income. Community interest companies are more likely to rely on earned income for at least 50% of their funding than any other organizational form among third sector organizations.

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INTRODUCTION

An innovative idea, if cultivated appropriately, has the power to significantly impact pressing social problems. For example Teach for America, conceived by Wendy Kopp, now employs 8,200 corps members in underperforming schools across 39 separate regions of the United States. Far across the globe, the Grameen Bank of Bangladesh and Muhammad Yunus^a received the Nobel Peace Prize in 2006 for efforts to “create economic and social development from below (The Nobel Foundation, 2006).” Since the 1970’s Grameen has provided over \$8.7 billion in loans to the poor. On the surface, these two organizations appear to be very different. One turns recent college graduates into teachers in low-income communities in the United States and the other provides micro-credit loans, operating primarily in the developing world. However, they both have one key aspect in common. They are excellent examples of the potential impact that social entrepreneurship can have in addressing difficult social problems. In fact, both Wendy Kopp and Muhammad Yunus have been recognized by the organization Ashoka as exemplary social entrepreneurs.

As early as the 1970’s, the term “entrepreneur” was plucked from the business world and adapted to be used to describe management focused on solving social problems in addition to profit maximization (Banks, 1972). What exactly constitutes a social entrepreneur (and social entrepreneurship more broadly) depends on who one may ask, but these individuals generally operate in what is often referred to as the third sector; the part of the economy that encompasses

^a This paper acknowledges the current controversy surrounding Muhammad Yunus and the Grameen Bank. However, this should not detract from the original power of the idea of micro-finance and the scale to which it has currently reached.

organizations that are neither governmental nor for-profit business institutions. These individuals mobilize resources in innovative ways towards solving a particular social goal that may not currently be adequately addressed by existing organizational structures and paradigms. The organizations formed and run by social entrepreneurs are referred to as social enterprises and can take a broad variety of forms including both nonprofit and business like entities. In general, however, there has been some convergence on the idea that a social enterprise is an organization that has a primary purpose of addressing a particular social problem through innovation and may also be at least partly financially self-sustaining (SBA Office of Advocacy, 2007; UK Office of Third Sector, 2006).

Recently governments worldwide have recognized the opportunity for social enterprises to tackle problems traditionally addressed by governments, and multilateral organizations. They have taken steps toward supporting these enterprises which have included initiatives such as the creation of the Social Enterprise Unit of the UK government in 2002, the White House's Office of Social Innovation in 2009, and capital funds in Europe and the United States designed to specifically support emerging social enterprises. What may be most interesting and promising however is the effort underway in many countries to create a new legal entity identifying social enterprises as distinct types of organizations that are neither profit maximizing businesses, nor typical nonprofit organizations. This new legal recognition is intended to allow social enterprises to bypass some of the regulatory burden associated with nonprofit organizations, provide flexibility, create a more standardized industry, and allow for more rigorous quantitative assessment of the performance of social enterprises. Such legal entities have been created in

Italy, Portugal, Spain, Greece, and Britain among other European countries as well as a handful of U.S. states.

The case of Britain is particularly interesting given the general support for social enterprise to play an important part in society, and the government's attempt to foster and measure the effectiveness of its third sector. In fact, it is perhaps the only country in the world to conduct a comprehensive assessment of the state of the third sector and the level of support they receive from the government. Using data from the *National Survey of the Third Sector Organizations* (2009), this paper examines whether a new legal entity in the United Kingdom, the community interest company (CIC), has been effective in reducing the challenges faced by social enterprises organized under more traditional legal structures. Specifically, it analyzes whether the easier access to multiple capital sources leads community interest companies to utilize a more diverse array of funding sources. It also examines if community interest companies prioritize earned-income as their primary revenue source given that the legislation provides a specific mechanism profit to be used for a social purpose. The results will provide insight to policymakers in other countries as they consider passing similar legislation.

DEFINING AND ENCOURAGING SOCIAL ENTREPRENEURSHIP

The first mention of the term social entrepreneur in academic literature arises in Banks (1972) who used the term in an analysis of different approaches to management with a focus on achieving social goals. In the remainder of the decade, however, the term was scarcely mentioned again except for work by Etzioni (1973) that discusses the emergence of a sector at

the intersection of the public and private sectors. While he does not explicitly use the term “social entrepreneur” or “social entrepreneurship,” the concept he discusses very closely aligns with contemporary definitions. In the 1980’s, Bill Drayton founded the organization Ashoka whose mission includes creating a global environment that allows social entrepreneurs to thrive (Ashoka, n.d.) and the concept of social entrepreneurship started to gain both popular and academic traction. Since that time, there has been a growing recognition of these third sector enterprises, and in parallel, a body of primarily qualitative research that has focused on defining social enterprise and entrepreneurship as well as examining how it fits among existing organizational structures (Nicholls, 2006). Further research has looked at the policy and institutional mechanisms that encourage successful social entrepreneurship and social enterprise creation (SBA Office of Advocacy, 2007, UK Strategy Unit, 2002, UK Office of Third Sector, 2006).

Social entrepreneurship and social enterprise specifically have been described in a number of different ways, which tend to carry the same overall theme. For example, Hulgard (2010, p 4) characterizes social entrepreneurship as “the creation of a social value that is produced in collaboration with people and organizations from the civil society who are engaged in social innovations that usually imply economic activity” while Reis (1999, p 15) defines it as “applying business expertise and market-based skills in the nonprofit sector.” Dees (2001, p 4) provides a more nuanced definition, suggesting that social entrepreneurs play the role of change agents in the social sector through “adopting a mission to create and sustain social value; recognizing and pursuing new opportunities; engaging in a process of continuous innovation, adaptation, and learning; acting boldly without being limited by resources; and exhibiting

heightened accountability to the constituencies served and for the outcomes created”.

Additionally the Department of Trade and Industry in the UK (2002, p 7) characterize social enterprise as a “business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profit for shareholders or owners.” And the White House’s Office of Social Innovation and Civic Participation has as its mission a “bottom-up, innovative, and results-oriented community solutions agenda (The White House: About SICP, n.d.). As one can see, even without one solid definition, it is clear that a social enterprise is a type of entity that has a primary social purpose, often generates revenue, and is innovative in the means by which it achieves its goals.

Given the positive effects that social enterprises can often have on society, governments have undertaken efforts to identify what types of policies and institutional changes can help support the emergence of such organizations. The United States Small Business Administration, in its 2007 report to the President, uses case studies to determine some of the most effective ways that government can encourage social entrepreneurship. These include encouraging social innovation through seed funding, creating an enabling environment by removing policy barriers, rewarding performance with government purchase or additional funding, scaling success with government help, and producing knowledge by ensuring organizations have reliable and accurate data. The report also cites how states such as Louisiana have created a state office specifically dedicated to encouraging social entrepreneurship. The *Social Enterprise Action Plan* (2006) released by the UK government echoes many of these objectives. Specifically it identifies the government as playing an enabling role by fostering a culture of social enterprise, ensuring the

right information and advice are available to those running social enterprises, facilitating access to appropriate finance, and enabling social enterprises to work with the government. Mandelson (1997) also notes how the New Labour Party has supported social enterprise by drawing on the tradition of community development and associated action aimed at inclusive individual and community empowerment.

BACKGROUND ON NEW LEGAL ENTITIES

One specific mechanism that legislative bodies have begun to support more frequently is the creation of separate legal status for social enterprises. This trend has roots dating back to the early 1990's in Italy. In an effort to start supporting new forms of cooperatives that had formed to serve the unmet needs of broad community groups, the Italian Parliament passed legislation creating a new legal entity called a "social co-operative." Since that time, other countries in Europe have followed suit, albeit in their own unique ways. Belgium created the "social purpose company" legal framework in 1996 as a classification that existing business corporations can adopt if they define a profit allocation policy in accordance with a social purpose. Portugal created the "social solidarity co-operative" in 1997 to support organizations with objectives of fostering integration of vulnerable groups, such as children, people with disabilities, and socially disadvantaged families and communities (Defourny and Nyssens, 2009). Spain and Greece created "social initiative co-operatives" and "limited liability social co-operatives" respectively in 1999, and France passed a law in 2002 creating the "collective interest co-operative society." To date, these frameworks have seen mixed results. The "social co-operative" framework was

utilized by over 7,300 organizations in Italy in 2005, yet the new structures in France and Belgium have seen little success (Defourney and Nyssens, 2009).

Perhaps the most successful effort, as evidenced by its rapid uptake and popular support, to create a supportive legal framework for social enterprises is the community interest company (CIC) created by the British Parliament in 2005. At that time, the UK government estimated that there were 55,000 social enterprises in the country that represented a contribution of £8.4 billion to national GDP (UK Office of Third Sector, 2005). Traditionally, social enterprises in the UK were organized either as unincorporated charities, companies limited by guarantee (CLG), or industrial and provident societies (IPS). However, these forms of organization each have certain restrictions that present challenges to social enterprises. Among the main difficulties from these structures include restrictions on commercial activities and high regulatory burdens for charities, lack of asset protection and limits on equity financing for both CLG's and IPS's, expensive registration for IPS's, and weak social enterprise branding within all of these frameworks^b (UK Cabinet Office: Strategy Unit, 2002). In light of these pitfalls, the UK government presented a case for creating a new legal entity specifically designed for social enterprises. In 2005, this came to fruition when the Companies (Audit, Investigations and Community Enterprise) Act formally created the Community Interest Company. Among other benefits, the Community Interest Company was intended to be a more flexible form of organization, easier to register, allow access to a wide range of debt and equity funding sources, and facilitate socially motivated profit-making activity. As of December 2010 there have been 4,396 (CIC regulator) organizations registered as CIC's in the United Kingdom.

^b For a more in-depth description of these legal frameworks please reference appendix A

ORGANIZATIONAL REVENUE RELIANCE

As one of the aforementioned intended benefits of the CIC structure is to allow access to a wide range of debt and equity funding sources, it is important to consider what other determinants may influence the revenue sources an organization relies upon. The body of literature examining revenue reliance of nonprofit organizations provides a solid base to build upon. One body of work in this area focuses mainly on the advantages and disadvantages that accrue to nonprofits as the result of diverse revenue streams (Thompson, 1967; Evans and Archer, 1968; Galbraith, 1977; Pfeffer and Salancik, 1978; Fuller and Farrell 1987; Chabotar 1989). Most theories suggest that nonprofits find many advantages in developing multiple revenue streams including the probability of remaining financially viable by reducing instability (Evans and Archer, 1968; Fuller and Farrell, 1987). Another body of work focuses on identifying the determinants of such diversification. Chang and Tuckman (1994) provide a theoretical foundation for measuring revenue origins and diversification, determining that the activities of a nonprofit, as well as its financial position, are determinants of the concentration of an organization's revenue sources. Geographic locations, tax level, membership in an association, maturity, and size have also been found to affect revenue origins and diversification (Brooks, 2000; Derryck and Abzug, 2002; Kimberly, Miles, and Associates, 1980; Bowman, Keating, and Hager, 2007). In addition, further work by Okten and Wiesbrod (2000) demonstrates that revenue generated from government grants or commercial activity does not crowd out private donations. The most recent research, however, comes from Young, Fischer, and Wilsker (2010) who show that sources of revenue depend on the public or private nature of

the benefit provided and that the proportion of revenue generated from earned program revenue is highest for organizations that provide private benefits.

CONCEPTUAL MODEL

What determines which and how many revenue sources an organization taps into to finance its operations? This paper examines whether the creation of a new organizational legal form is sufficient to provide social enterprises access to more funding sources than existing structures as well as facilitate using earned revenue as a primary means of supporting their social goals. Thus, it is important to identify what other factors influence organizational decision-making and behavior when selecting funding sources. Since historically many social enterprises have operated under the legal framework of traditional nonprofit organizations, it reasons that the same theoretical determinants of revenue diversification and reliance on earned income for nonprofits can be applied more broadly to all social enterprises regardless of legal status.

Broadly speaking, past research has pointed to three overarching factors that tend to influence how nonprofit organizations decide upon where to obtain their financing: (1) the nature of the organization's activity, (2) characteristics of the organization itself, and (3) characteristics of the environment in which the organization operates (See Chart 1). No complete model has been constructed that includes all possible factors encompassed by these categories, but researchers have identified certain key determinants within each category that appear to have a relationship with the type and number of revenue sources an organization relies upon (Chang and Tuckman, 1994; Fischer et al., 2010).

The nature of an organization's activities has been linked to how that organization obtains revenue in two manners. In the first manner, type of activity was shown by Chang and Tuckman (1994) to have a significant relationship with diversification of revenue sources. They posit three reasons for this relationship. First, certain activities by their nature are easier to finance from multiple sources. The example cited is a cancer clinic which can rely on revenue from patients, donations, government, and community organizations. This is compared to an environmental group which may be restricted to membership dues and governmental grants. Second, they believe that specific donors, governments, and consumers prefer to fund some activities over others. Lastly, administrators of certain nonprofits may simply have access to a broader range of sources than others. The second manner in which an organization's activities have been linked to revenue sources is through the public or private nature of the good provided. Fischer et al. (2010) show that nonprofits that provide goods of an economically private nature tend to rely more on earned program revenues than nonprofits that provide goods of an economically public nature. This makes sense as private goods are easier for individuals to value and thus they are more willing to pay for such services.

The characteristics of an organization itself have been theoretically linked to revenue reliance via organizational size, financial position, and maturity. Bowman, Keating, & Hager (2007) propose that larger organizations have more resources in reserve funds, endowments, and infrastructure. Thus, the incentive to diversify revenue sources or generate new income streams is less than smaller organizations. Chang and Tuckman (1994) demonstrate a positive relationship between financial position and revenue diversification, suggesting that more profitable organizations have more diversified revenue sources. However, the causal nature of

the relationship is not entirely clear and warrants further investigation. Lastly, the maturity or age of an organization has been linked to reliance on specific revenue sources in two competing theoretical views. The first is that newer nonprofits may be more likely to rely on a variety of donor and public funds as they are often piecing together resources to stay afloat (Chambre & Fatt 2002; Young, 1985). The second view suggests an opposite relationship, given that a mature nonprofit is led by an experienced manager who consciously makes the decision to differentiate resources (Kimberly et al., 1980).

Environmental characteristics include those aspects of the operating environment that could potentially influence decision-making by organizations when identifying sources of revenue. Fisher et al. (2010) propose a relationship with geographic location which may reflect differences in needs for services as well as policy choices such as tax levels. Locations that are poorer economically tend to receive a greater amount of public funding as these areas may be a priority for redistributive aspects of government policy (Clifford et al., 2010). Taxes also have the possibility to encourage or discourage private donations depending on how the tax code is structured. Additional research by Derryck & Abzug (2002) has suggested that membership in a regional or national association may reduce the funding risk a nonprofit faces and furthermore it's incentive to diversify.

Chart 1: The Determinants of Where an Organization Obtains Financing

Note: There determinants of which revenue sources an organization decides to rely upon to pursue its mission can be divided into three broad categories: (1) the nature of the organization's activities, (2) characteristics of the organization itself, and (3) characteristics of the external environment in which it operates. These categories can be further broken down into specific attributes that can be identified for any particular organization under observation.

Thus, when identifying the effect of a new organizational legal form on revenue diversification and prioritization of earned income for social enterprises, the above factors must also be considered. While the strength and nature of these relationships are not always theoretically clear, their potential impact could influence the robustness of any other proposed relationship with organizational form. This paper proposes specifically that the community

interest company organizational form is a predictor of what type and how many revenue sources an organization relies upon. Therefore, a complete conceptual model includes organizational legal form as a key component of the regulatory environment that an organization operates in. This factor, combined with other environmental characterizes, organizational characteristics, and the nature of activity define fully the potential influencing factors that determine where organizations obtain their funding. The hypotheses to be tested are thus as follows:

- 1.) Community Interest Companies utilize more sources of revenue than traditional third sector organizational structures.
- 2.) Community Interest Companies are more likely to prioritize earned income as their primary source of revenue than traditional third sector organizational structures.

DATA DESCRIPTION

The dataset used to examine the proposed hypotheses is the *National Survey of Third Sector Organisations* (TSO's) commissioned by the UK Office of the Third Sector, distributed and completed in 2009. The survey was distributed to a representative sample of 104,391 third sector organizations in the 149 upper-tier local authorities (delineation for local governments) in England. Within each local authority, the sample was stratified by organization type (Charity, Community Interest Company, Company Limited by Guarantee, or Industrial and Provident Society) and by income. In those authorities with relatively fewer TSO's, the survey was distributed to all organizations in the sampling frame in order to achieve the targeted number of

respondents. In authorities with relatively more abundant TSO's, the survey was only distributed to a representative portion of those in the sampling frame.

Overall, a response was received from a total of 48,939 organizations (47% response rate). A detailed analysis of response rate by a number of identifying factors is included in the original survey technical report. The analysis maintains the representativeness of the sample by showing that response rate did not vary greatly along any one dimension. The only noticeable exceptions are by location and organization type. TSO's in London maintained a response rate of 37% compared to a high of 53% for the South West region. In addition, registered charities tended to respond with more frequency (52%) than other organizational forms (IPS: 38%, CLG: 29%, CIC: 33%). Since the analysis in this paper is designed to show a relationship between CIC's and dependent variables of interest at the national level, any weighting adjustments by location are not necessary. Furthermore, the difference in response rate by organizational type suggests that the sample includes proportionally more charities than may be true of the population as a whole. However, due to potential implications of non-response bias and the unlikelihood that this will significantly affect results, no weighting along this dimension is performed either.

The original purpose of the survey was to determine the extent to which local statutory or governmental institutions supported the activities of the surveyed organizations and contributed to a thriving third sector. A national indicator based on a subset of survey questions was created to measure the extent that local government and its partners support the successful operation of independent third sector organizations. In addition, the survey also provides a wealth of comprehensive information about third sector organizations that has not been compiled in such a

complete fashion previously. It asked questions regarding organizational size, structure, role, funding sources, target groups, and scope, among other things on which this paper capitalizes.

DATA ANALYSIS PLAN

This paper uses two regressions techniques to allow for analysis of the proposed research question. The first regression is an ordinary least squares (OLS) regression that estimates the number of revenue sources an organization relies upon and the second is a probit specification to determine the probability that an organization relies upon earned income as its primary revenue source. In both cases, the main independent variable of interest is organizational legal form. To determine the effect of registering as a community interest company on each of the dependent variables, the following econometric models are used:

H1:

$$\begin{aligned} \text{Number of Revenue Sources} = & \beta_0 + \beta_1 \text{Organizational Legal Form} + \beta_2 \text{Main Area of Work} \\ & + \beta_3 \text{Role of Organization} + \beta_4 \text{Geographic Deprivation Level} + \beta_5 \text{Scope of Work} + \\ & \beta_6 \text{Adequacy of Financial Resources} + \beta_7 \text{Annual Income} + \beta_8 \text{Registration Year} + u \end{aligned}$$

H2:

$$\begin{aligned} P(\text{Earned Income Primary Source}=1|x) = & \beta_0 + \beta_1 \text{Organizational Legal Form} + \beta_2 \text{Main} \\ & \text{Area of Work} + \beta_3 \text{Role of Organization} + \beta_4 \text{Geographic Deprivation Level} + \beta_5 \text{Scope of} \\ & \text{Work} + \beta_6 \text{Adequacy of Financial Resources} + \beta_7 \text{Annual Income} + \beta_8 \text{Registration Year} + u \end{aligned}$$

An OLS regression is used in the first case because the number of revenue sources an organization relies upon can be modeled as a continuous variable ranging from one to nine depending on the survey response. The probit specification is appropriate in the second case because earned income is either regarded as the primary source of revenue or it is not. This model allows one to analyze such a dichotomous dependent variable to determine the probability that an organization will prioritize earned income as its primary source. A complete discussion of the two dependent variables, independent and control variables, as well as potential econometric issues follows.

Population Specification and Missing Data

About 72% of the organizations that responded to the survey did not answer all of the questions. However, 80% answered at least 32 of the 35 total questions. Since the questions that organizations failed to answer tended to relate to organizational income and its sources, missing data could have a potential impact on econometric results if not accounted for appropriately. For purposes of eliminating any potential item non-response bias, 7,045 organizations who did not report their income are removed from the sample used in analysis. This reduces the sample from 48,939 organizations to 41,894. Summary statistics comparing the set of organizations with missing data to the entire sample do not identify any particular dimension along which organizations not reporting income seem to cluster. However, a regression of missing income on the dependent variables of interest does display a significant relationship. This suggests that there may be an unknown characteristic of the organizations who did not report income that may

bias results. In light of this, these organizations were dropped from the sample and any results should be interpreted in light of this fact.

The other source of missing data came from registration year which was only available for registered charities. Since registration year data is banded in the data set, the last band (2005 – 2008) could be applied to CIC's as they did not exist prior to 2005. This left 7,976 observations missing registration year data which were all of the CLG and IPS organizational legal form. Given the correlation between missing registration year data and organizational legal form, registration year is not included as a control variable in the primary regressions. To account for the potential implications of an organization's age on the dependent variables, a separate regression is run comparing CIC's to registered charities only for organizations registering in the 2005 – 2008 band.

Dependent Variables

The first dependent variable analyzed, number of revenue sources, is derived from the survey question that asks, "Does your organization receive income from any of the sources listed below?" Organizations were given nine different options plus an option for "None of these" or "Don't know." Based on the number of sources an organization selects, a continuous variable was constructed that ranges from one to nine. The last two options are considered missing data and the appropriate imputation method is performed. Organizations that selected "None of these," "Don't know," or did not answer were assigned a zero.

The second dependent variable, earned revenue, is a dichotomous categorical variable that equals 1 if an organization states that earned revenue accounts for 50% or more of total income and 0 if an organization states otherwise. This is derived from the survey question which states, “If your organization earns income from contracts or from trading, do these sources account for 50% or more of your total income when combined?”

Independent Variable of Interest

Organizational Legal Form – This is the main independent variable of interest. Organizations in the dataset are classified as either registered charities, companies limited by guarantee, community interest companies, or industrial & provident societies. For purpose of analysis, a separate dummy variable is created for companies limited by guarantee, community interest companies, industrial & provident societies, and charities. The hypothesized relationship is that community interest companies will have greater revenue diversification and also prioritize earned income over all three other types of organizational legal form.

Control Variables

Main Area of Work – The main areas in which an organization does work has a potential impact on sources of revenue. There are separate dummy variables for the following categories: Economic, Advocacy or Civic, Culture, Education, Environment, Health, Religious, and Capacity Building. Note that these are not mutually exclusive categories as a survey respondent could select as many or a little as applied to his or her organization. Based on Chang and

Tuckman (1994), each of the main areas of work should have a positive and significant relationship with number of revenue sources. The relationship to the prioritization of earned income is expected to vary depending on the area of work as certain areas better lend themselves to a pay per service model.

Role of Organization – The role an organization plays also has a potential impact on the dependent variables as certain roles lend themselves better to generating earned revenue than others. The role an organization plays could also affect its ability to diversify through public grants, etc. As with the previous variable, this is represented by dummy variables for each of the categories in the survey. They include Community Development and Aid, Provider of Services, Buildings/Facilities, Advocacy, Support Services, and Grants or Financing. The hypothesized relationship in this paper is that organizations involved in providing services will be more likely to prioritize earned income over other groups. This variable in addition to *Main Area of Work* is believed to be sufficient enough to capture the public/private nature of an organization's activity and thus a separate variable was not constructed for this.

Geographic Deprivation Level – The geographic region where an organization is located could impact the dependent variables due to necessity of donations and public funding to achieve organizational goals. The dataset includes an index of multiple deprivation (IMD) for which more economically deprived geographic regions receive a higher score. Prior analysis suggests that a higher percentage of organizations in more deprived areas rely on public funding (Clifford, Rajme, Mohan, 2010). Thus, the hypothesized relationship with prioritization of earned income is negative. Organizations in more deprived areas are also likely to be less diversified as they are highly reliant on public funding.

Scope of Work – This refers to the geographic scope in which an organization operates. This variable is 1 if the organization operates at the national or international level and 0 otherwise. Organizations that operate at the national level should have access to a larger pool of resources and thus a greater number of revenue sources. There is not likely a strong relationship with prioritization of earned income. This variable is included as an extension of the concept that geographic location has an impact on where an organization obtains its revenue from.

Adequacy of Financial Resources – This variable refers to the confidence level that an organization has in its ability to meet its target goals. It is taken from the survey question “Did the organization believe it had adequate income in the last year to meet its main objective?” The variable equals 1 if the organization answered yes and 0 if the organization answered no. The hypothesized relationship is that more confident organizations will have more diversified revenue streams but will be less likely to prioritize earned revenue. As demonstrated by Chew (2008), a driving factor for third sector organizations to rely on earned income is the lack of funding from donations and the public sector. If an organization believes it has adequate existing resources, it is likely not motivated to generate its own revenue.

Annual Income – This serves as a proxy for organizational size. The variable is derived from banded data on income. The mean value for each of the bands is used to give a relevant estimation of magnitude and convert to a usable continuous variable. Overall, the expected relationship is that larger organizations will have less diversity in revenue sources as well as less of an incentive to generate earned revenue as proposed by Bowman, Keating, & Hager (2007).

It should be noted that any specific regional government tax policies or association membership data was not included in the survey. Thus, these two aspects are not present in the econometric analysis performed and the results should be considered in light of this fact.

DESCRIPTIVE STATISTICS

The following two tables present descriptive statistics for the sample of 41,894 organizations used for analysis.

Table 1: Descriptive Statistics for Continuous Variables

Variable	Mean	Standard Deviation
<i>Dependent</i>		
<i>Number of Revenue Sources (How Many Revenue Sources does an Organization Rely Upon?)</i>	2.33	1.45
<i>Independent</i>		
<i>Income Level*</i>	£224,456	£666,257
<i>Registration Year*</i>	1990	12.84
<i>Geographic Area Level of Deprivation*⁺</i>	20.39	15.81

*Original banded data was converted to a continuous variable by replacing each band with it's mean.

⁺ Level of Deprivation is derived from the index of material deprivation associated with the local area in which an organization is based. A higher score represents a more deprived geographic area

Table 2: Frequency Distribution for Categorical Variables

Variable	Frequency	Percent
<i>Dependent</i>		
<i><u>Earned Revenue</u> (Does Earned Revenue Account for 50% or More of an Organization's Total Income?)</i>		
Yes	4,889	11.67%
No/Missing	37,005	88.33%
<i>Independent</i>		
<i><u>Organizational Legal Form</u></i>		
Community Interest Company	242	0.58%
Industrial and Provident Society	2,074	4.95%
Registered Charity	34,834	83.15%
Company Limited by Guarantee	4,744	11.32%
<i><u>Main Area of Work*</u></i>		
Economic	13,029	31.10%
Advocacy or Civic	4,054	9.68%
Cultural	14,148	33.77%
Education	14,365	34.29%
Environment	1,746	4.17%
Health	7,448	17.78%
Religious	5,103	12.18%
Capacity Building	1,331	3.18%
<i><u>Role of Organization*</u></i>		
Community Development	7,308	17.44%
Service Provider	11,231	26.81%
Buildings and/or Facilities	6,396	15.27%
Advocacy	10,846	25.89%
Support Resources	9,470	22.60%
Grants or Financing	6,439	15.37%
<i><u>Adequate Income</u> (Did the Organization Believe that it had Adequate Income in the Last Year?)</i>		
Yes	21,339	50.94%
No	20,555	49.06%
<i><u>Scope of Operations</u> (Does the Organization Operate at the National or International Level?)</i>		
Yes	7,464	17.82%
No	34,430	82.18%

Note: This table presents descriptive statistics for all categorical variables used in analysis. It is separated by dependent and independent variables. Organizational Form is the main variable of interest. The variables marked by * are not mutually exclusive categories.

The statistics in Tables 1 and 2 show that most TSO organizations rely on a little over two sources of revenue and that only 11.67% prioritized earned income as a primary source of revenue. It is also not surprising that registered charities make up a large portion of the sample given their traditional role in the third sector. The average income level of £224,456 is being pulled up by a small number of organizations that have very large budgets compared to the sample as a whole. In fact, 50% of organizations in the data set reported annual income of £25,000 or less. The Geographic Deprivation score is based on an index that ranges from zero to 75+ and 63% of observations had a ranking below twenty. The other descriptive statistics provide an accurate picture of the remaining characteristics of the organizations in the sample.

RESULTS

Table 3: Effect of Legal Registration Status on Number of Revenue Sources (OLS Regression)

Variable	Company Limited by Guarantee as Baseline	Registered Charity as Baseline	Industrial and Provident Society as Baseline
<i>Organizational Form</i>			
Community Interest Company	0.0485 (0.0796)	-0.363*** (0.0782)	0.0726 (0.0826)
Industrial and Provident Society	-0.0241 (0.0326)	-0.435*** (0.0288)	
Registered Charity	0.411*** (0.0194)		0.435*** (0.0288)
Company Limited by Guarantee		-0.411*** (0.0194)	0.0241 (0.0326)
Constant	-0.0972*** (0.0286)	0.314*** (0.0231)	-0.121*** (0.0367)
Observations	41,894	41,894	41,894
Prob > F	0.0000	0.0000	0.0000
R-squared	0.288	0.288	0.288

This table displays the OLS regression results for the independent variable of interest, organizational form, on number of revenue sources. Control variables are not displayed here but can be found in appendix B. The regression was run three times, with a different organizational form as the baseline in each case. The columns represent which baseline was used. Rows correspond to the regression coefficients on each organizational form dummy variable compared to the baseline. *** p<0.01, ** p<0.05, * p<0.1

Table 3 presents the results for the OLS regression of organizational form on number of revenue sources. The main variable of interest, community interest company, is significant only when compared to the registered charity baseline. Thus, there is no predictable difference in the amount of revenue sources that community interest companies rely upon compared to companies limited by guarantee or industrial and provident societies. However, the statistically significant results compared to registered charities are in direct conflict with the proposed hypothesis, as it appears that community interest companies rely on fewer revenue sources than registered charities. This may be striking, but it is also important to take note of the magnitude of the

coefficient. While the results are statistically significant, a predicted difference of .369 revenue sources may not be material in the context of the real world since revenue sources only come in discrete whole numbers. A more thorough explanation is proposed when analyzing these results in combination with the results of the probit regression.

Table 4: Effect of Legal Registration Status on Prioritization of Earned Income (Probit Regression)

Variable	Company Limited by Guarantee as Baseline	Registered Charity as Baseline	Industrial and Provident Society as Baseline
<i>Organizational Form</i>			
Community Interest Company	0.547*** (0.0908)	1.069*** (0.0891)	0.387*** (0.0941)
Industrial and Provident Society	0.160*** (0.0377)	0.681*** (0.0334)	
Registered Charity	-0.522*** (0.0248)		-0.681*** (0.0334)
Company Limited by Guarantee		0.522*** (0.0248)	-0.160*** (0.0377)
Constant	-2.635*** (0.0516)	-3.157*** (0.0479)	-2.476*** (0.0586)
Observations	41,894	41,894	41,894
Prob > chi2	0.0000	0.0000	0.0000
Pseudo R-squared	0.181	0.181	0.181

This table displays the probit regression results for the independent variable of interest, organizational form, on the probability that an organization will prioritize earned income. Control variables are not displayed here but can be found in appendix B. The regression was run three times, with a different organizational form as the baseline in each case. The columns represent which baseline was used. Rows correspond to the regression coefficients on each organizational form dummy variable compared to the baseline. Since this is a probit specification, the magnitude of the coefficients should not be interpreted directly without some type of transformation. However, they can provide directional guidance in this form.

*** p<0.01, ** p<0.05, * p<0.1

Table 4 presents the results of the probit regression of organizational form on the probability that an organization prioritizes earned income. In this case, there are statistically significant results at the 99% confidence level that community interest companies are more

likely to prioritize earned income as their primary revenue source than registered charities, companies limited by guarantee, or industrial and provident societies. While the coefficients cannot be interpreted directly as in an OLS regression, the direction of the coefficients supports the hypothesis that CIC's are more likely to prioritize earned income than other forms of TSO organizations. For interpretation of the coefficient size in the probit model, appendix C walks through an exercise where the effect of organizing as a CIC on the dependent variable can be estimated by assuming all other control variables are at their mean values. While this can only demonstrate the magnitude change in one scenario, it provides additional insight when comparing CIC's to registered charities, CLG's, and IPS's. In particular we see that if all control variables are held at their means, organization as a CIC results in an increase in the predicted probability of prioritizing earned income of 7.1% over IPS's, 11.0% over CLG's, and 27.7% over registered charities. Thus, the magnitude changes appear to be robust.

The results of the probit regression allow for a more nuanced understanding of the OLS results. While legal registration as a community interest company provides access to a more diverse array of revenue sources; it does not guarantee that organizations will actually take advantage of all of these sources. If organizations registered as CIC's prioritize earned revenue as their primary source of funding, they may actually have less of a need to draw upon other sources of revenue. This would result in revenue concentration rather than diversification. In fact, Chang and Tuckman (1994) show this relationship when comparing nonprofits that rely on commercial income versus those that rely primarily on donations.

One issue that remains is the relationship between organizational age and the two dependent variables of interest. Since both CLG's and IPS's did not have registration year

information in the dataset, including organizational age as a control in the above analysis was not possible. Since all CIC's were registered in 2005 or later, it is entirely possible that the results are being driven largely by the newness of these organizations compared to other TSO's rather than the CIC organizational form itself. To investigate this issue, two additional regressions are run on a restricted sample of 4,226 CIC's and charities that have registration dates of 2005 or later.

**Table 5: Effect of CIC Status on Diversification of Revenue Sources and Prioritization of Earned Income
(New Organizations Only: Registration Post 2004)**

Variable	Number of Revenue Sources (OLS Regression)	Prioritization of Earned Revenue (Probit Regression)
Community Interest Company	-0.247*** (0.0843)	1.158*** (0.0976)
Constant	0.565*** (0.0790)	-3.121*** (0.164)
Observations	4,266	4,266
Prob > F	0.0000	
Prob > chi2		0.0000
R-squared	0.263	
Pseudo R-squared		0.184

This table displays the OLS and probit regression results for the independent variable of interest, CIC organizational form, on number of revenue sources and prioritization of earned income. CIC's are compared against Charities only with a registration date between 2005 and 2008. Control variables are not displayed here but can be found in appendix D. *** p<0.01, ** p<0.05, * p<0.1

The similarities of the coefficients on the community interest company dummy variable to those in tables 3 and 4 provide support to the previously stated results and suggest that organizational newness may not necessarily be accounting for the observed relationship between CIC's and the dependent variables of interest. CIC's are predicted to have .247 less revenue sources than registered charities and have a higher probability of prioritizing earned income.

However as time passes and more organizations form CIC's, additional research should be conducted to see if this relationship holds. Further research could also be conducted to see if the age of a CIC determines if the organization relies on more diverse revenue sources in earlier years until a sustainable profitability point is reached. Given the newness of all CIC's at this point in time, this analysis may have to wait.

Control Variables

The regression output results on the control variables can be seen in detail in appendices B and D. However, this section provides a brief discussion of main points of interest. Nearly all control variables display statistical significance in the primary models. In general, the Main Area of Work and Role of Organization dummies show a positive relation to number of revenue sources but the magnitudes tend to be small (<1). One exception of note may be work in a religious area, which predicts more concentrated revenue sources. This is likely due to targeted funding from religious institutions or faith-based funding sources. Organizations focused on religious work also predicted a negative relationship with prioritization of earned income. The other exception to note is that organizations with the role of providing grants or financing also predicted more concentrated revenue sources and a negative relationship with prioritization of earned income.

The remaining control variables also convey useful information. As the income level of an organization increases, it tends to rely on more revenue sources as well as prioritize earned income. This is contrary to the hypothesized relationship and suggests that larger organizations

either have access to a greater number of revenue sources or better realize the importance of revenue diversification for sustainability. The positive relationship with earned income suggests that larger organization may reach size limits with public and philanthropic funding, relying on earned income to grow. The scope of operations suggests that organizations operating at least at the national level have more concentrated revenue sources and are less likely to prioritize earned income. This is also contrary to the relationship hypothesized as it appears locally focused organizations may be able to better tap into a greater variety of small sources of funding as well as rely on earned income for operations. Organizations that are confident they have adequate financial resources show a positive relationship with the number of revenue sources but a negative relationship with the prioritization of earned income. These relationships are as predicted.

POLICY IMPLICATIONS AND CONCLUSIONS

The results of the econometric analysis clearly support the notion that community interest companies use earned revenue as their primary source of financing at a high rate than other forms of legal organization. This is important, given that the community interest company legal structure was designed specifically to provide a better framework for social enterprises that often tend to rely more heavily on earned income. If the results showed otherwise, there may be concern that policy makers were not supporting social enterprise in the intended manner. The second finding, that community interest companies have fewer revenue sources than charities, is counter to the proposed hypothesis but not entirely shocking. As proposed previously, it is likely

that as organizations rely more heavily on earned revenue, they become more financially self-sufficient and decrease their reliance on other revenue sources.

Policy makers in the UK and elsewhere should be able to look upon these results in generally favorable light. The community interest company legal structure is clearly facilitating revenue generating social enterprises just as the legislation was intended. The lack of a clear relationship between legal structure and revenue diversification warrants additional investigation, but should not be the source of any immediate concern. Structurally, the legislation creating the community interest company provides for access to a diverse range of funding sources. The extent that multiple sources are being used does not necessarily invalidate the specifications of the legal structure. Future research can further investigate the relationship between earned income and the reliance on a diverse array of revenue sources. It may also make sense to conduct this analysis again after the follow-up survey to the *National Survey of Third Sector Organisations* is completed this year. Given the newness of the CIC legislation, the nature and make-up of organizations opting for this legal form may change. It will be important to see if the results of this paper hold constant over time.

In this specific case study, the notion that organizational legal form has an effect on the decisions and behaviors that organizations undertake is supported. The decision to organize under a particular legal formation can alter the regulatory environment faced by an organization, making certain decisions regarding revenue sources both more feasible and preferable. Organizations are likely to consider this aspect of their operating environment in combination with the other aforementioned environmental, organizational, and activity characteristics during a decision-making process. A key distinction associated with the legal and regulatory

environment though, is the influence that policy makers can exert to guide the decisions and behaviors of organizations. The structure of a particular legal and regulatory framework can provide access to or limit certain sources of funding as well as encourage or discourage earned revenue generation. Beyond the aspects examined in this paper, a legal and regulatory framework has the capability to influence decisions such as innovation, risk taking, and partnerships among other factors.

As other countries look to create a better legal and regulatory structure for social enterprises, the results of this analysis suggest that the model in the UK could provide a good starting point when designing such systems. In particular, U.S. states have been experimenting with creating a similar legal structure called an L3C. This is modeled from an existing for-profit form of legal organization but incorporates restrictions ensuring that a social goal is of primary focus. While the legislation in the United States is not identical to CIC's, they both were created with the purpose of facilitating social enterprise. This paper, for the first time, provides quantitative support backing the creation of these new forms of legal identity so that policy makers can proceed with confidence (but also cautiously). With further data gathering and analysis, new legislation supporting social enterprise can be made stronger and help to catalyze the force of change that social entrepreneurship is having in the world.

APPENDICES

Appendix A: Legal Form Overview

Organization Type	Description	Benefits	Drawbacks
REGISTERED CHARITY	A Charity is an organization that is established for public benefit and has purposes recognized as exclusively charitable. Once registered, charities have to obey a number of rules, which include regulations covering trustees, accounts, finances and management. Any profit or surplus can only be used for the organization's purpose.	Tax relief Organizational legitimacy Broad public recognition	Organizations are restricted to "charitable" activities only which could limit ability to generate earned revenue. Highly regulated resulting in large bureaucratic burden. Trading, political, and campaigning activities are restricted
COMPANY LIMITED BY GUARANTEE (CLG)	Used by third sector organizations in which members nominally own the "company" but have no right to a share in any surplus made. There is a wide range of possible membership structures which may range from consisting of only members of the board to all the users of the services provided.	Limited individual liability	Lack of asset protection Cannot raise equity
INDUSTRIAL & PROVIDENT SOCIETIES (IPS)	Closely associated with the cooperative movement, this form of organization can be used for a trading business or voluntary organization. There are two variants. 1.) Bona fide cooperatives operate for the mutual benefit of their members, with any surplus being ploughed back into the organization to improve services, or distributed as dividends to members. Co-ops can only operate for the mutual benefit of their members. 2.) Benefit for the community societies ("BenComs") are organizations primarily engaged in trade for a social purpose and which have special reasons for not incorporating as companies. They operate for the benefit of the wider community. An IPS generally has a share capital. However, in a not-for-profit IPS the share capital may be limited to a nominal amount. Both types of IPS have a share capital, but it is usually not made up of equity shares like those in a company limited by shares, which appreciate or fall in value with the success of the enterprise that issues them. Rather they are par value shares, which can only be redeemed (if at all) at face value. The profits and losses of an IPS are thus the common property of the members.	Limited individual liability Profit-making ability Some equity raising ability	Lack of asset protection Limits on the amount of equity a member can hold Expensive and complex registration process Weak branding and poor recognition
COMMUNITY INTEREST COMPANY (CIC)	Introduced by the UK government in 2005, community interest companies were designed specifically for social enterprises. They are limited companies with additional features created for the use of people who want to conduct business or other activity for community benefit. There is a "community interest test" and an "asset lock" which ensure that the CIC is established for community purposes and the assets and profits are dedicated to those purposes. Registration must be approved by the CIC regulator.	Social enterprise brand recognition Inexpensive to register Can raise debt and equity financing Highly flexible	Newer form, less recognition

* Information was drawn from Cabinet Office: Strategy Unit (2002). *Private Action, Public Benefit: A Review of Charities and the Wider Not-For-Profit Sector*, The CIC Regulator Website, and CharityFacts.org

Appendix B: Control Variable Regression Coefficients (Full Model)

Variable	Number of Revenue Sources (OLS Regression)	Prioritization of Earned Revenue (Probit Regression)
<u>Main Area of Work</u>		
Economic	-0.0656*** (0.0146)	0.0223 (0.0217)
Advocacy or Civic	0.185*** (0.0207)	0.0234 (0.0295)
Cultural	0.403*** (0.0137)	0.135*** (0.0205)
Education	0.106*** (0.0131)	0.0539*** (0.0198)
Environment	0.271*** (0.0298)	-0.0114 (0.0434)
Health	0.214*** (0.0168)	0.00130 (0.0249)
Religious	-0.560*** (0.0217)	-0.297*** (0.0385)
Capacity Building	0.312*** (0.0349)	0.193*** (0.0455)
<u>Role of Organization</u>		
Community Development	0.128*** (0.0174)	-0.0300 (0.0260)
Service Provider	0.300*** (0.0147)	0.267*** (0.0200)
Buildings and/or Facilities	0.127*** (0.0176)	0.381*** (0.0244)
Advocacy	0.269*** (0.0164)	-0.0505** (0.0249)
Support Resources	0.282*** (0.0155)	-0.0346 (0.0232)
Grants or Financing	-0.478*** (0.0178)	-0.464*** (0.0356)
<u>Other Variables</u>		
Log Income Level	0.186*** (0.00205)	0.161*** (0.00418)
Adequate Income	-0.0232* (0.0122)	-0.0606*** (0.0183)
Scope of Operations	-0.161*** (0.0163)	-0.182*** (0.0269)
Geographic Deprivation Level	0.00272*** (0.000395)	0.00286*** (0.000555)

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Appendix C: Probit Simulation

Baseline: Company Limited by Guarantee

The Predicted Probability of an Organization
Prioritizing Earned Income with Control Variables
set to Mean Values.

Predicted Probability when CIC = 0	0.0735
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Predicted Probability when CIC = 1	0.1832
--	--------

Difference	0.1097
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Baseline: Charity

The Predicted Probability of an Organization
Prioritizing Earned Income with Control Variables
set to Mean Values.

Predicted Probability when CIC = 0	0.0731
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Predicted Probability when CIC = 1	0.3503
--	--------

Difference	0.2772
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Baseline: Industrial and Provident Society

The Predicted Probability of an Organization
Prioritizing Earned Income with Control Variables
set to Mean Values.

Predicted Probability when CIC = 0	0.0736
--	--------

Predicted Probability when CIC = 1	0.1442
--	--------

Difference	0.0705
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Appendix D: Control Variable Regression Coefficients (New Organizations Only: Registration post 2004)

Variable	Number of Revenue Sources (OLS Regression)	Prioritization of Earned Revenue (Probit Regression)
<u>Main Area of Work</u>		
Economic	0.00830 (0.0466)	0.0133 (0.0724)
Advocacy or Civic	0.181*** (0.0588)	0.0647 (0.0863)
Cultural	0.434*** (0.0457)	-0.0710 (0.0713)
Education	0.0317 (0.0405)	0.0553 (0.0626)
Environment	0.247*** (0.0903)	0.0377 (0.134)
Health	0.189*** (0.0489)	-0.0959 (0.0746)
Religious	-0.641*** (0.0635)	-0.407*** (0.116)
Capacity Building	0.323*** (0.0941)	0.133 (0.126)
<u>Role of Organization</u>		
Community Development	0.0734 (0.0521)	-0.189** (0.0835)
Service Provider	0.301*** (0.0460)	0.212*** (0.0667)
Buildings and/or Facilities	0.232*** (0.0609)	0.287*** (0.0887)
Advocacy	0.224*** (0.0483)	0.0131 (0.0738)
Support Resources	0.133*** (0.0450)	0.0401 (0.0690)
Grants or Financing	-0.440*** (0.0575)	-0.480*** (0.120)
<u>Other Variables</u>		
Log Income Level	0.160*** (0.00666)	0.170*** (0.0142)
Adequate Income	0.0134 (0.0399)	-0.0771 (0.0619)
Scope of Operations	-0.447*** (0.0465)	-0.256*** (0.0807)
Geographic Deprivation Level	0.00152 (0.00115)	0.000772 (0.00169)

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

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