

# 'Nonprofits' and 'Third Sector': from Definitional Vagueness to Potentials for Innovation

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## Abstract

In this article it is argued that behind the lack of clarity that characterises such common notions like 'nonprofit' and 'third sector', there are strong potentials for innovation and change. It is our contention that the notion of 'nonprofit' calls for a process of sharpening and specification capable to free it from its definitional vagueness. The notion of 'third sector' awaits its inherent potential for innovation to be appreciated and developed. For such challenges to be met, there is a need for a thinking paradigm that goes beyond the conventional economic rationale, and a new terminology, beyond the mainstream economic language we are so used to. This would allow for a rethinking of the potential role of the 'third sector' as an optimal ground where the limitations of the first and second sectors can be averted in favour of alternative organisational solutions.

## The vague notions of 'nonprofit' and 'third sector'

A review of literature on the various interpretations of the notion of 'nonprofit' in its relation to the third sector shows the equivocal nature of the issue. A general approach would include in the third sector mainly nonprofit organisations of a public nature as embodied by universities, hospitals, foundations, etc and of a voluntary nature, as embodied by charitable-helping, mainly welfare, institutions. This is the current understanding of the Third Sector according to the John Hopkins study (Salamon and Anheier, 1994). According to one of the authors of the study, these organisations share a number of features: they are organisations with some institutional identity; they are private and not part of a state apparatus; they do not distribute profits; and are self-governing and voluntary. Underlying these features are such values as altruism, compassion, sensitivity to those in need and commitment to the right of free expression, as well as the values of individual initiative for the public good; of solidarity and of obligations to themselves and to each other (Salamon, 2002).

The exclusion of co-operatives from the third sector on the ground that they "distribute profits" puts the John Hopkin's approach at variance with the European approach. In the early 1990s Gui (1991) suggested to regard the third sector "(...) as composed of organisations where a category of agents other than investors is awarded the role of explicit, intended

beneficiaries of the organisational economic activity": 'Other than investors' include of course co-operative and related organisations where the 'distribution constraint' plays a less binding role than in 'public benefit organisations'. Including co-operatives in the category of nonprofits and - as such - in the third sector, helped the emergence of the concept of *Economie Sociale* as part of the third sector and - as in many countries of the European Union - a close to synonym for it. This distinction, however, does not seem to have lessened the lack of clear boundaries between the third sector, 'nonprofits', and a variety of other notions, all sharing their non inclusion in the first sector (the public one) and in the second sector (the business one). Table 1 offers three examples of the variety of definitional and conceptual associations evoked by the notion of 'nonprofit' and third sector.

The notion of 'nonprofit' is nowadays applied to such diverse organisations as philanthropic and charitable institutions, voluntary associations, foundations, NGOs, groups dealing with ecological, cultural and sport activities, and - in the European Union and Canada - social co-operatives and social enterprises. This explains the richness of the notions evoked in our above Table, each case reflecting the specific cultural-geographical context under consideration, the emphasis - in the UK example - being on the co-operative-community dimension, whereas in the two Italian examples this is included under the "social economy", or "civil economy".

Table 1: Nonprofits and Third Sector: Examples of Associative terms		
1. Conceptual definitions and socio-cultural context	2. "A list of fuzzy definitions"	3. A related terminology
Nonprofit sector	The nonprofit sector	Independent sector
Charitable sector	Charitable sector	Third sector
Philanthropic sector	Community regeneration: community initiatives outside the market	Economie sociale
Informal sector	Co-operatively owned businesses	Economie civile
Third sector	Employee share ownership plans	Private-social sector
Independent sector	Credit unions	<i>(Tubaro, 1999:12)</i>
Voluntary sector	Mutually administered public services	
Private non-governmental sector	<i>(Arthur, Cato, Keenoy and Smith, 2003)</i>	
Economie sociale		
Intermediary system		
Private initiative		
<i>(Colozzi e Bassi, 2003:17)</i>		

The lack of clear boundaries between the various notions seems to be a broad phenomenon. Even in France, where the Social Economy was born in the nineteenth century - although with a different meaning - the point has been raised recently whether there exists a clear and widely accepted definitional and operational approach to the social economy (Vienney, 2000). In the light of the macro-corrective policies expected of it, ("the social economy is born and develops as a response to the failings of the dominant economy, and particularly to those needs that the markets fail to address" Defourny et al, 2001:20) one may wonder whether the various organisations of the social economy are really willing and prepared to tackle the issue of "inventing a new socio-economic order" (Motchane, 2003).

The term 'nonprofit' is commonly used interchangeably with 'Third Sector', with some geographical variances. In the US, the preference is for the 'Independent Sector' to distinguish it from the state and the market. In the UK, the term 'Charitable Sector' may be more recurrent; in France it will be the 'Social Economy', and likewise in Italy, together with the 'Solidary Economy' and the 'Civil Economy'.

The tendency of the social economy (comprised of the co-operatives, the mutuals and the associations) to present itself as an

alternative to the capitalist system, suggests a deep difference from the American approach.

Since the term of reference in the American culture is the profit interest in a market system, an organisation willing to distinguish itself from the mainstream economics, has no alternative but to connote itself as 'nonprofit' (Zamagni, 2003: 265).

The capitalist thinking labels as 'nonprofit' whatever fails to meet the profit maximisation of classical economics. Hence the 'distribution constraint' of nonprofits, to denote the opposite to the distribution of profits, an essential of 'rational' economics. The problem is that under the term 'nonprofit' we find organisations representing two opposed trends:

- 1) an **acquiescent** one, which operates within the economic mainstream accepted as a fait accompli, without attempts to change it;
- 2) an **alternative** one, which aims to challenge the economic mainstream.

The first suggests 'difference with no-change'; whereas the second suggests a difference based on an organisational model that offers new behavioural and organisational standards,

beyond the bureaucratic and self-interested paradigm of the first and second sectors, respectively.

Apparently, such an alternative vocation fits the residual connotation commonly attributed to the third sector. Under the assumption that the latter is neither the first nor the second sector, it should be encouraged to do what neither can, or are willing, to do. We know, however, that maintaining the status quo is easier than attempting a change, especially when by status quo is meant the prevailing capitalist system.

To confer on the notion of 'nonprofit' and 'third sector' an innovative interpretation we have to realise what does it mean to be nonprofit without changing the prevailing economic system, as compared to a 'nonprofit' that questions this system and challenges it. In other words, an **acquiescent** versus an **alternative** kind of nonprofit.

Let us examine these two aspects in turn.

## The profit/nonprofit argument and the 'distribution constraint'

A number of propositions are advanced:

- As economically change oriented organisations, co-operatives, and less so mutuals and associations making up the 'social economy', aim to generate an annual surplus (not a profit).<sup>1</sup>
- Co-operatives, mutuals and associations are member and not investor organisations. As such, the role of capital herein is totally at variance from that in a capitalistic firm, playing no role neither in the process of decision making, nor in that of distribution (if any) of surpluses. In fact, decisions are taken according to the 'one man – one vote' principle and distribution is made according to the participation of each in the activity of the organisation.<sup>2</sup>
- A member organisation can distribute surpluses and still be nonprofit.
- A member organisation can abstain from distributing surpluses and still be an economic enterprise; This implies doing away with the assumption that the mere 'distribution constraint' is sufficient, by capitalist standards, to characterise a state of absence of entrepreneurial activity.

It ensues that a social organisation, at odds with the prevailing capitalist model, can be entrepreneurial and nonprofit at the same time. More generally, a 'social enterprise' – as most organisations of the social economy can be termed, can be part of the market without necessarily surrendering to the hegemony of capital.

## The Third Sector and its potentials

Though sufficient to distinguish the third sector from the first and the second ones (public and business, respectively) and however laudable, the aforementioned properties and values attributed to the third sector (see Salamon and Anheier, 1994) do not necessarily entail the idea of a change in the prevailing economic system. A third sector with such characteristics has no pretensions to tackle the economic system and can accept the dominance of mainstream economics as a *fait accompli*. This is all the more eased by the possibility – as aforementioned – to exclude the co-operatives from the third sector. By contrast, in the European case the co-operatives make up the main component of the Social Economy. We know that the fact that they can distribute surpluses (not profits) does not deprive them of their nonprofit orientation. Together with the mutuals and the associations, they are expected to challenge the prevailing economic system by offering, if not an alternative to it, at least a means to counter its hegemonic position.

It is argued that including/excluding co-operatives and related organisations in the third sector is what makes the difference between a sector that has the potential for changing the prevailing economic system, or, alternatively, a sector that performs a variety of nonprofit – mainly welfare – activities, while accepting the prevailing economic system as a *fait accompli*. (Levi, 2003) More specifically, it is argued that including co-operatives, and by implication the social economy, in the third sector, makes it possible to substitute a bottom-up and democratic organisational style for the top-down bureaucratic and paternalistic approach typical of the first sector, and a not-for-profit entrepreneurial economic system for the self-interested profit maximisation of the second sector.

A value-laden, rather than simply residual, approach to the third sector seems in order. According to the *End of Work* (Rifkin, 1995)

scenario and further to increased downsizing in both the first and the second sector, the third sector is expected to become a shelter for all those excluded from the public and the business domain. From now on, as per Rifkin's interpretation, the third sector calls for the establishment of a civil society, to prevent it to turn into an incubator of social unrest and delinquency. The civil society option needs a value-laden approach of the kind offered by the social economy and related ideologies based on the combination of economic entrepreneurship and social organisation. Seen from such a perspective, the third sector can be considered as an opportunity to undertake those bottom-up, democratic and not-for-profit activities that are - by definition - outside the scope of the first and second sectors. (Figure 1).

Seizing these alternative opportunities may open up to the third sector new avenues enabling it to become a synonym with social economy, as in a good many European countries a distinction has to be made between "third sector" and social economy. Logically, the social economy falls within the area of the third sector, together with a variety of groups and organisations that fail to meet the criteria of the social economy. While all the components of the social economy are by definition nonprofit, not all nonprofits are part of the social economy. In a general way, it is well established that the

social economy is distinct from the private enterprise by ruling out a profit motivation and from a public institution by avoiding a charitable and helping approach to social issues. It is the combination of economic enterprise and social organisation (according to the classical co-operative model) that can allow for a distinction between the 'acquiescent' and the 'alternative' types of nonprofit, as will be elaborated below.

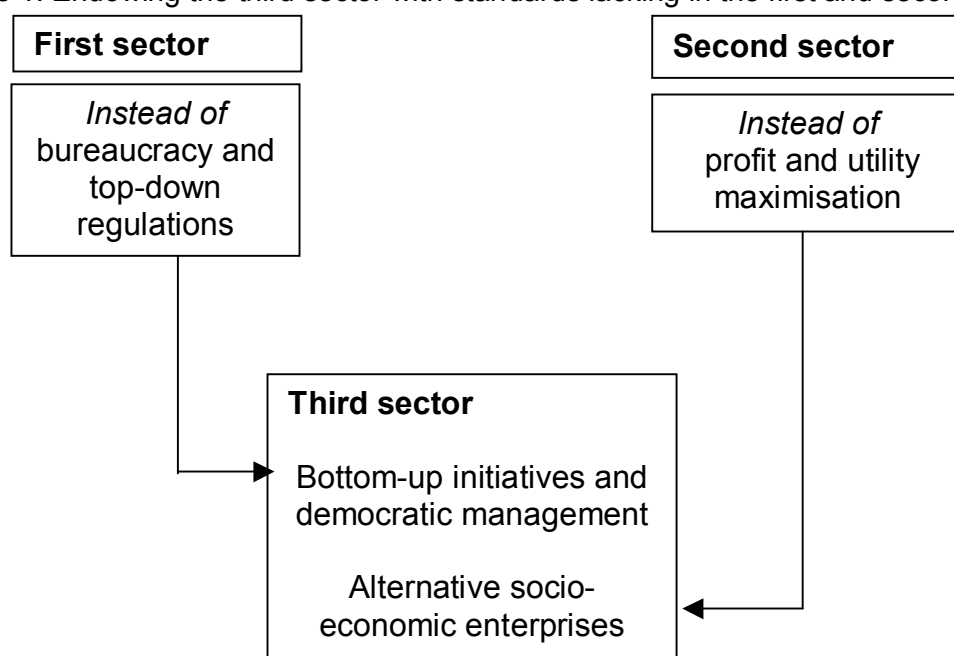
Failure to size up these opportunities may give rise to a third sector that, even though sizable<sup>3</sup> has no pretension to provide a socio-economic alternative.

### The third sector and its socio-economic components

The increased commitment of European countries - as from the 1970s - to occupational integration through economic initiatives, brought about the development of three main types of organisations, in part revived and in part created anew. To the first category belongs, as aforementioned, the social economy in its new version, ie comprised of the cooperatives, the mutuels and the associations. Its relative few distinctive elements (see Table 2) enabled more specific and articulated organisational models to emerge and develop.

Chronologically, the first were the social

Figure 1: Endowing the third sector with standards lacking in the first and second sectors



co-operatives. These aim at particular categories of beneficiaries, the 'disadvantaged' and the larger community. The Social Co-operatives were formally established by the Law 381 of 1991 enacted by the Italian Parliament. The Law provides for two types of co-operatives:

- 1) type A, consisting of activators co-operatively organised for the supply of social and educational services to 'disadvantaged' people;
- 2) type B, dealing with productive activities aiming to introduce to gainful work 'disadvantaged' people.

These have to be not less than 30% of the total labour force of the co-operative and can be members of it. The number of voluntary members should not exceed 50% of the membership. By emphasising a specific solidarity – rather than mutualistic – aim, the

social co-operatives pursue “the general interest of the community, the general wellbeing and the social integration of the citizens” (article 1). This Law generated other similar legal enactments in Belgium, Spain, Portugal and France. By servicing categories of people beyond the classical realm of members; by providing for a strong presence of voluntary work and by admitting for a variety of stakeholders (disadvantaged or not; members or not; remunerated or not) the social co-operatives clearly depart from the traditional model of the single-stakeholder co-operative and, by so doing 'violate' some of the ICA principles (Borzaga, 1995).

As the social co-operatives have a specific priority for 'disadvantaged' people, the need was felt to design organisational frameworks that, while preserving a nonprofit orientation, could reproduce the basics of co-operative self-help, democratic control and financial autonomy, although with a more flexible

**Table 2: From the Third Sector to the Social Enterprise: An additive view of organisational attributes**

	<b>Nonprofit third sector</b>	<b>Social economy</b>	<b>Social cooperative</b>	<b>Social enterprise</b>
<b>1</b>	Formal constitution	Priority of man	Pursuing the interest of the community	Production of services & goods
<b>2</b>	Juridical private bodies	Free association	Providing social welfare and educational services	Managerial autonomy
<b>3</b>	Self-management	Internal & external solidarity	Providing employment for disadvantaged people	Minimal economic risk
<b>4</b>	Voluntary adherence	Democratic management	Volunteers up to 50% of membership	Presence of paid manpower
<b>5</b>	Distribution constraint	Indivisibility of reserves	Multi-stakeholders (members and not)	Innovative supply
<b>6</b>	–	Disinterested devolution	Limited distribution of profits	Citizens' initiative
<b>7</b>	–	–	–	Link to the territory
<b>8</b>	–	–	–	Decision-making delinked from capital
<b>9</b>	–	–	–	One man – one vote
<b>10</b>	–	–	–	Limited profit distribution
<b>11</b>	–	–	–	Social purpose
	<i>(Salamon, 2002)</i>	<i>(CECOP, 2002)</i>	<i>(Borzaga, 1995)</i>	<i>(Defourny, 1997 and OKAPI, 2000)</i>

approach toward the issue of member shares and distribution of surpluses. Thus the 'social enterprise' emerged.

The specificity of the 'social enterprise'<sup>4</sup> allows to go beyond the vagueness of the notions of 'third sector' and to bring us closer to the notion of 'alternative' nonprofit. The 'social enterprise' embodies the elements of self-help, self-management and nonprofit yet further sharpens them: self-help can typify a therapeutic group without necessarily implying an economic enterprise; self-management can typify a single or group enterprise without necessarily implying a not-for-profit orientation; non-profit can typify a philanthropic, public or charitable institution not necessarily controlled by the user-members or non members of the organisation, as the case may be.

The notion of 'the social enterprise' has been refined through a comparison with other nonprofit organisations that would fall, by our definition, under the label of an 'acquiescent' nonprofit, ie, a kind of activities that, however laudable from the ethical point of view and beneficial to the larger society, do not necessarily question the prevailing economic order.

- Compared with non-profit organisations, which perform mainly lobbying or advocacy functions, social enterprises give priority to their economic activity;
- Compared with social projects and charitable organisations, which are mainly financed by private and/or public donations, social enterprises earn their own incomes;
- Compared with public services, which are often subject to bureaucratic rules and controls, social enterprises enjoy an independence or a structural freedom that enables them not only to be innovative

but also to supply services more closely aligned with needs;

- Lastly, compared with private profit-oriented firms, the public utility-orientation of social enterprises enables them to operate in unprofitable or loss-making areas like the non-resourced or under-supplied markets of areas afflicted by poverty or crisis (*Birkhölzer and Lorenz, 1998*).

To sum up, regardless of whether or not the organisation at issue distributes surpluses, what makes it a 'social enterprise' is that it is established by the very users of the production and/or consumption function they are in need of; is democratically managed by its member and non-member users; 'belongs' to the territory where it operates and, most importantly, resorts to capital as a means to achieve social and community aims.

## To conclude

To go beyond the definitional vagueness of nonprofit and the blurred boundaries of the third sector, a clearer differentiation is suggested between an *acquiescent* and an *alternative* approach to the prevailing economic system. The confusion around our topic is not likely to be removed as long as we remain captive of a term borrowed from the capitalist language – *nonprofit* - used to enunciate two opposite concepts. The term 'surplus' should be preferred to 'profit'. The ensuing effect is expected to help to assert the 'cooperative difference' and, on a higher level, the legitimacy of an economic paradigm that does not necessarily have to accept the economic mainstream rationale. In other words, a conceptual and operational change has to be matched by an appropriate change of vocabulary.

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## Notes

- 1 While we are strongly of the view that organisations should strive for financial independence wherever possible, we would rather term any excess income generated as a 'surplus' than a 'profit' (Arthur et al 2003).
- 2 We are aware of the increased complexity of participation and remuneration in cases of multi-stakeholder co-operatives and mixed enterprises, yet believe that this does not change the importance of the democratic principle.
- 3 Israel can serve as an example of a country with a well-developed third sector (the fourth after Holland, Ireland, and Belgium in terms of the share of employment out of the national total, see the John Hopkins Research, Salamon and Anheier, 1994) where the notion of social economy is largely unknown.
- 4 The notion of 'social enterprise' and its diffusion in the European Union in spite of its 'incompatibility with prevailing economic theories' has been recently analysed by Borzaga (2001; Borzaga and Defourny, 2001).