

6-11-2011

## THE ENTREPRENEURIAL ADVANTAGES OF COOPERATIVE AND NONPROFIT FIRMS IN EMERGING PRODUCT MARKETS: EVIDENCE FROM THE PERSONAL FINANCE INDUSTRY

R. Daniel Wadhvani  
*University of the Pacific*, [dwadhvani@pacific.edu](mailto:dwadhwani@pacific.edu)

---

### Recommended Citation

Wadhvani, R. Daniel (2011) "THE ENTREPRENEURIAL ADVANTAGES OF COOPERATIVE AND NONPROFIT FIRMS IN EMERGING PRODUCT MARKETS: EVIDENCE FROM THE PERSONAL FINANCE INDUSTRY," *Frontiers of Entrepreneurship Research*: Vol. 31: Iss. 15, Article 2.  
Available at: <http://digitalknowledge.babson.edu/fer/vol31/iss15/2>

This Paper is brought to you for free and open access by the Entrepreneurship at Babson at Digital Knowledge at Babson. It has been accepted for inclusion in Frontiers of Entrepreneurship Research by an authorized administrator of Digital Knowledge at Babson. For more information, please contact [digitalknowledge@babson.edu](mailto:digitalknowledge@babson.edu).

## THE ENTREPRENEURIAL ADVANTAGES OF COOPERATIVE AND NONPROFIT FIRMS IN EMERGING PRODUCT MARKETS: EVIDENCE FROM THE PERSONAL FINANCE INDUSTRY



*R. Daniel Wadhvani, University of the Pacific, USA*

### ABSTRACT

Using historical research, this paper finds that new entrants established as nonprofits and mutuals hold advantages over investor-owned counterparts in establishing the social and political legitimacy of new products in the early stages of market development. We propose that the advantages of the nonprofit form arise in emerging product markets that lack socio-political legitimacy because the potential value of the new product or service is not compromised by customer and stakeholder concerns about the profit motives of investors. Nonprofits and mutuals can hence play an important role in establishing the legitimacy of new markets. However, as these markets become established and grow, advantages shift toward investor-owned firms. Joint-stock entities hold advantages in acquiring the capital and human resources needed for fast-growing and mature product markets. Nonprofits and cooperatives, in contrast, were more limited in their ability to scale their businesses.

### INTRODUCTION

When and why do entrepreneurs establish cooperative or nonprofit organizations rather than for-profit firms in order to pursue new opportunities? What advantages do such organizational forms have over joint-stock corporations, partnerships, and other ways of organizing the ownership of new firms?

Research on nonprofit and cooperative startups has most typically fallen into one of several categories. The most significant, from the perspective of entrepreneurship research, has been in the area of social entrepreneurship, and has focused on the mission of the founders and resources they need to pursue social opportunities (Austin, Stevenson, and Wei-Skillern, 2006; Moray and Steven, 2009). The nonprofit form, in this perspective, may facilitate the organization of firms focused on a social mission, while cooperatives allow the creation of organizations focused on the needs of members. A second major stream of research on the choice of organizational form comes out of transaction cost theories of the firm. According to this work, entrepreneurs choose nonprofit and mutual forms of organization when the information and monitoring costs of transacting with resource providers and customers will be lower than if the firm is formed as a stock company (Hansmann, 1980, 1996). Finally, a third approach (Weisbrod, 1988) understands nonprofits as providers of public goods that governments fail to offer.

This paper takes a different tack by examining patterns of organizational choice longitudinally at the level of the industry, as well as at the level of the firm. It focuses, in particular, on new firm formation during the emergence of four products in the personal finance industry: personal

savings accounts, life insurance, mortgage lending, and consumer lending. Each of these product markets represented significant new market opportunities when they developed, and hence offer an opportunity to build theory from multiple cases (Eisenhardt, 1989; Eisenhardt and Graebner, 2007) by examining new entrants' choice of organizational form during the early stages of market emergence. By necessity, the study is longitudinal and historical in order to capture changes in the choice of organizational form over time.

For each of the product markets mentioned above, firms founded as nonprofits and cooperatives predominated during the emerging years of a new market, but joint-stock firms surpassed cooperatives and nonprofits as the markets for these products grew and reached maturity. In other words, the nonprofit and cooperative forms seem to have been preferred early in the industry lifecycle, but gave way to for-profit firms as the market was established. I use the cases to build theory about the role of nonprofit and mutual forms in establishing socio-political legitimacy in emerging industries (Aldrich and Fiol, 1994). Specifically, I posit that nonprofit and mutual firms help establish legitimacy in situations in which the transactions in an emerging market or industry are considered socially or politically questionable. They do so by eliminating the concern that innovating entrepreneurs are pursuing the development of the opportunity solely for their own reward rather than creating value for other stakeholders. Once the legitimacy of such markets is established, however, nonprofits and mutuals are often constrained in their ability to marshal the larger amounts of capital and managerial talent to pursue scale.

The paper begins by considering current theories of nonprofit and mutual enterprise and by highlighting the need for longitudinal and multi-level perspectives. I next explain the sources and methods used for the paper, and why historical research is appropriate given the scope of the paper. Next I briefly summarize the research from the four cases of new market development, focusing on the role of nonprofit and mutual enterprise over the product lifecycle. Finally, I turn to a discussion of the broader theoretical implications of the case studies for our understanding of the organizational form chosen by entrepreneurs during industry emergence.

### THEORIES OF NONPROFIT ENTERPRISE

Existing theories of nonprofit and mutual enterprise largely focus on firm-level factors that shape the choice of organizational form. Research in social entrepreneurship, for instance, typically focuses on the social mission of the organization and the resources and organizational structures needed to pursue this social mission (Austin, Stevenson, and Wei-Skillern, 2006; Moray and Steven, 2009). The choice of organizational form, in this case, can be considered a function of how well it furthers the pursuit of the social opportunities identified by the organization (Mair and Marti 2006).

A second stream of research on nonprofits and mutuals grows out transaction cost theories of the firm. Hansmann (1980, 1996) and others have argued that nonprofits and mutuals arise as solutions to contracting problems between a firm and its resource providers or customers. In situations where information and monitoring costs are high and parties to the transaction have incentives and the ability to act opportunistically, the reasoning goes, nonprofit and mutual forms may provide lower transaction costs than joint-stock or other investor-owned firms. In particular, by reducing incentives for the firm to act opportunistically vis-à-vis customers and suppliers, nonprofits and mutuals enhance trust and reduce the need and costs of monitoring.

Finally, a third stream of research has theorized that nonprofits and mutuals form in response to “government failure” or the failure to provide certain “public goods” (Weisbrod, 1988). Both because of limitations on government and because a majority of voters may not support funding for certain public goods (e.g. public concerts, gardens, environmental causes), nonprofits and mutuals arise as private solutions by a group of concerned citizens pursuing these needs.

While building on these theories of the nonprofit sector, this paper takes a different tack by considering the role and advantages of nonprofits over the industry and product lifecycle. While the theories described above provide robust firm-level explanations for the existence of nonprofits and mutuals, they provide little insight into why the choice of organizational form changes over time, or how they are affected by industry-level considerations. By considering the changing role of nonprofits over the industry lifecycle (particularly during the early stages of new market development), this paper seeks to add longitudinal and multi-level dimensions to our understanding of when and why entrepreneurs choose to establish nonprofit or mutual firms rather than investor-owned entities in pursuing a new opportunity.

### CONTEXT, SOURCES, AND METHODS

The basic approach employed by the paper is that of building theory from multiple case studies (Eisenhardt and Graebner, 2007). In this instance, since the level of analysis of interest is the industry or market rather than the firm, the cases examine the emergence of four product markets in the United States over time. In doing so, the paper builds on recent calls for greater attention by entrepreneurship scholars to industry and market emergence and the ways in which entrepreneurs deal with the risks, uncertainties, and institution building required to establish new markets as well as new firms (Forbes and Kirsch, 2010; Aldrich and Fiol, 1994). In this sense, it also responds to a long-standing concern that entrepreneurship research should more frequently engage in longitudinal investigations (Chandler & Lyon 2001).

The cases chosen consisted of “theoretically relevant samples” (Eisenhardt & Graebner, 1989) because they each meet the conditions that are relevant to the questions under consideration. Specifically, each case tracks an emerging market from inception through the point at which it is well established enough to be experiencing rapid growth and adoption. And second, each case allows us to track variations in the organizational form of new entrants into the market and to examine the reasons why such organizational forms were chosen.

Following a plethora of recent calls for the use of historical methods in entrepreneurship research (Baumol & Strom, 2007; Landström & Lohrke, 2010; Jones & Wadhvani, 2006), this study’s sources and methods are fundamentally based on historical investigation. Historical methods are particularly appropriate for a study like this because they allow us to examine both change over time and variations in institutions that would be difficult or impossible to capture by examining the present alone. While historical research involves tradeoffs in the consistency and quality of data that can be collected, in this case the questions posed about change over time and in different historical contexts plays to one of the strengths of historical methods.

Specifically, the paper uses archival records and other primary sources in combination with published secondary sources to examine the origins and development of the markets under consideration and the role of nonprofit firms within them. As Forbes and Kirsch (2010) have pointed out, such records provide an especially promising and untapped source of information for under-

standing the emergence of new markets and industries. In particular, they allow researchers to partly reconstruct and understand the uncertainties entrepreneurs face at the origins of a new market in a way that is difficult to capture in the present because such markets often develop over long periods of time.

The sources were analyzed and synthesized using traditional historical interpretation processes, including critical source interpretation (Howell & Prevenier, 2001), triangulation among multiple sources (Jick 1979), and hermeneutic methods of moving between texts and contexts to reconstruct overall patterns of development (Phillips 1993). The author is a trained historian who has used such methods in other published work on entrepreneurship and organizations. Finally, following Eisenhardt (1989), the findings were used to draw out theoretical implications that cross the various cases.

## FINDINGS

### **Case Study 1: The Emergence of the Market for Savings Accounts**

The market for savings accounts emerged in the early nineteenth century in the United States in response to the expanding wage and cash economy. Though people had long found ways to save for periods of need, much of this saving typically took place through informal lending to others. The increasing dependence of the working population on wage income in the late eighteenth and early nineteenth centuries, however, created a growing need for secure, professionally managed methods of financial management for periods of illness, unemployment, and old age (Keyes 1876).

The first organizations established specifically to meet these needs were mutual savings banks. Mutual savings banks were financial institutions controlled and managed by independent trustees on behalf of small savers. The trustees were typically business or civic leaders of high status and managed mutual savings banks on a voluntary basis (Keyes 1876, Olmstead 1976). As the public pronouncement of one of the first savings banks in the United States put it, the founding trustees agreed to “take no emolument or pay for their service, having undertaken it solely to promote the interests of the town, and of the persons... described who may put their money therein (Provident Institution Petition, 1816).” Nearly all the savings banks established in the decade and a half after the first institution was founded in 1816 were organized along similar lines. As Figure 1 shows, not until 1829 was the first savings bank established that had a separate class of stockholders with rights to the residual profits of the institution.

Mutual savings banks seem to have predominated because of high levels of public distrust in joint-stock banks and financial institutions. In early America, popular suspicion that bankers were untrustworthy mixed with widespread political concerns that concentrated financial power corrupted democratic principles. The nonprofit corporate form of the savings banks helped allay some of these social and political concerns about the legitimacy of establishing financial institutions for the public by placing barriers to profit-taking by those that controlled the institution. By prohibiting profit-taking by those who established the institution, savings banks allayed concerns about legitimacy and focused the organization on proving that demand for savings accounts could be effectively met by the model of the savings institution (PSFS & Provide Institution Archives).

Over time, however, the number of investor-owned companies entering the market increased significantly. (See Figure 2.) The first of these were joint-stock savings banks, which began to be established in significant numbers beginning in the 1830s. Even more significantly, investor-

owned commercial banks and trust companies – which were institutions established to provide short-term enterprise finance – began to diversify in the late nineteenth century and became major competitors in the market for savings accounts. At the same time, the rate of mutual savings bank formation slowed, and eventually came to a virtual halt by the late nineteenth century as the market for savings banks grew (Welfling, 1968).

The changing ownership and governance structure of new entrants seems to have been related to managing the challenges of growth in the market. Mutual savings bank expansion and new entry was constrained by the availability of trustees willing to establish savings banks on a purely voluntary basis, especially now that the legitimacy of savings accounts was widely legitimized. In contrast, investor-owned intermediaries were able to relatively easily marshal the managerial talent and the capital needed to expand as the market grew. With the risks of illegitimacy reduced, the attractiveness of entering the market on a profit-making basis increased significantly. By the early twentieth century, mutual savings bank share in the market was declining precipitously even as the market was growing rapidly (Welfling, 1968).

### **Case Study 2: The Emergence of the Market for Life Insurance**

Like the need for savings accounts, the need for life insurance grew significantly in early nineteenth-century America. The transition to a system of wage labor and geographical mobility created a situation in which older forms of insurance through kinship obligations became less tenable. Formal life insurance developed in response to the need to provide for dependents in an increasingly wage dependent and mobile society.

The first few life insurance companies to be established were in fact investor-owned, joint-stock firms, but these organizations met with little success. They were only able to sign up a limited number of policyholders. As J. Owen Stalson (1942) has pointed out, public concerns about the moral legitimacy of placing a financial value on death and the notion that stockholders and policyholders could “gamble” on this dampened the broad adoption of such policies.

It was not until the 1840s, when a significant number of mutual life insurance companies entered the market, that the new product began to gain adoption and acceptance. Mutual insurance companies successfully established the market in part by allaying concerns that a group of investors was profiting by investing in the lives and deaths of others. Instead, mutuals structured their firms as cooperatives, owned by the policyholders themselves. Profits were hence returned to policyholders, typically in the form of reduced premiums. In this sense, mutual insurance companies claimed not to capitalize on death and misfortune but, as Sharon Murphy (2010) has put it, to be “investing in life.” The entry of mutuals proved to be a significant turning point in the emergence of the industry.

Mutual insurance companies were better at scaling than their counterparts in the savings bank industry. This was partly because the institutions were not capital and geographically constrained, as were mutual savings banks. Insurance companies based in the Northeast could send agents anywhere they felt that markets might develop. Nevertheless, once the legitimacy of life insurance was established, joint-stock life insurance companies were able to make significant in-roads as the market expanded. In fact, most of the newer life insurance companies established after 1860 were joint-stock firms because they could more easily assemble the capital required as a buffer against initial losses (Murphy 2010). Thus, after capital constraints on entry increased, the rate at which

entrants were established as mutuals decreased significantly, and the rate at which stock insurance companies were formed soared.

### **Case Study 3: Emergence of the Market for Institutional Mortgage Lending**

The development of institutional mortgage lending to finance homeownership provides yet another instance of the role of nonprofits and cooperatives in the emergence of a new product. The market for institutional mortgage lending emerged in the late nineteenth century. Though residential mortgage loans existed throughout the nineteenth century, these loans tended to be between individuals and their volume was quite limited. The only significant institution to make such loans were savings banks (mentioned above) and these tended to be focused on larger building projects (Snowden 2010). Even then, savings banks and other institutions represented only a small fraction of the market of the market for mortgage loans.

The limited presence of institutions in mortgage lending for ordinary homeowners during most of the nineteenth century persisted even as urbanization, rising home prices, and policies promoting homeownership made demand for small mortgage financing even greater. One of the main constraints on institutions was a socio-political one: the persistence of usury laws in the United States that limited the interest and fees chargeable on loans (often to about 6 percent). Usury laws sought to protect borrowers, especially small borrowers who policymakers and others felt were in a poor position to protect themselves from predatory lenders. The effective result of strict usury laws, however, was that small mortgage loans were unattractive and unprofitable for most institutions to engage in. The relatively large information, monitoring and administrative costs of engaging in such small loans combined with their own cost of capital made such markets unattractive for institutional lenders to enter given legal restrictions on interest and fees.

The first institutions to break through this constraint at a significant scale were building and loan associations, and it is their entry into the market that established the foundations for the modern market for institutional mortgage lending. Building associations were cooperatives, owned and managed by their members. Members paid weekly “dues” into the association and took turns borrowing from the treasury as funds accumulated. The sequence of borrowers was based on a process of competitive bidding for who was willing to offer the biggest “discount” on the loan. Members then paid back their loans through continuing payment of dues, but were also subject to late fees and other charges (Mason 2004).

Largely because they were mutuals, building associations were permitted to engage in lending at real rates that would have been deemed “usurious” for investor-owned institutions (Endlich 1893). The competitive bidding for discounts and the leveling of various charges and fees meant that building associations’ rates were often above the limit on usury. However, building associations were typically lauded by both policymakers and the public because these “returns” were going back to members themselves. Rather than being seen as predatory, building associations were heralded as promoting self-reliance, saving, and homeownership (Endlich 1893, Mason 2004). In fact, the laws and rules governing building association loans were more lax in other ways as well because of the effective political legitimacy of such loans. For instance, they were permitted to loan at greater loan-to-value ratios and to lend on longer maturities than savings banks and other institutions (Snowden 2010).

The ability to both borrow on mortgage and to receive higher rates of return on such lending attracted increasing numbers of both savers and borrowers to the industry. It also demonstrated

that mortgage loans could effectively be made to small borrowers in ways that were both safe and lucrative for investors and attractive to borrowers. The “proof” created by this demonstration led to a relaxation of rules of mortgage lending for other institutions as well (Snowden 2010).

In part because of their size and organizational structure, however, building associations organized on the cooperative model tended to be more limited in their possibilities for growth. Individual mutual associations remained small. Newer entrants, especially ones that sought to achieve scale, were often organized with a class of joint-stock owners and separate savers who didn't borrow but simply sought attractive returns on lending on real estate (Mason 2004). The first stock associations were actually large national organizations established in the 1880s and 1890s, but they experienced trouble when local cooperative associations effectively lobbied states to prevent the development of inter-state associations. Nevertheless, interest in stock associations persisted and large state-level stock building and loans were established after the turn of the century. Eventually other investor-owned organizations followed into the mortgage market. Unlike mutual associations, investor-owned organizations found it relatively easy to scale by raising the capital and attracting the management needed to grow. By the 1920s, most of the newer entrants into the mortgage market were organized as joint-stock corporations.

#### **Case Study 4: Emergence of the Market for Consumer Loans**

The emergence of the market for consumer loans in the early twentieth century followed patterns that were very similar to those for mortgage loans. Demand for consumer loans had grown significantly in the wage economy as working and middle class Americans sought ways to smooth personal consumption while dealing with uncertainties and instability in income. However, usury laws and a general predisposition of policy and lawmakers against consumptive lending formed prohibitive constraints on the development of a legal small lending sector; the costs of administering and monitoring such loans and dealing with loan losses made it simply prohibitive to operate such businesses according to the terms of usury laws. The result was that consumer lending in the late nineteenth century was essentially an industry dominated by loan sharks and other illegal lenders (Calder 1999).

The entry of nonprofit remedial loans societies in the late nineteenth century into the market for consumer loans paved the way for establishing consumer lending as a legitimate, legal industry. Remedial loan societies were essentially charitable loan funds that received money from donors who agreed to limit dividend payments to no more than 6 percent, well below market rates given the risks and costs involved in small consumer lending. Remedial loan societies were typically established by local charitable organizations and sought to both provide reasonable cost loans to “worthy borrowers” and to educate them in the ways of thrift and self-reliance. Still, to sustain the organization and pay the necessary 6 percent dividend, the organizations needed to charge approximately 12 percent a year to borrowers. While this rate was well below the rates charged by loan sharks and illegal lenders, it was above the usury ceiling in most states, and hence required the passage of special legislation permitting remedial loan societies to conduct such business. Remedial loan advocates justified these organizations as legal entities on the basis that they provided a philanthropic service to needy borrowers, and lawmakers passed special legislation permitting their existence (Calder 1999).

Given their attractive loan terms, demand for the services of remedial loan companies far outstripped the loanable funds such organizations could raise. Raising money at “philanthropy plus 6 percent” simply was not sufficient to attract the capital needed to scale up based on the



nonprofit model. What the nonprofit remedial loan societies did establish, however, was that there was a legitimate need in the market among worthy borrowers for consumer loans and financing such needs sustainably required charging rates well above what policymakers had set as the ceiling on usury. Remedial loan advocates themselves began to understand that to serve demand for consumer loans effectively, a higher (albeit still regulated) rate was necessary and hence began to work with some of the leaders of the illegal loan shark businesses to define legitimate rates and practices for the industry. The result was a proposed model “small loan law,” forged between philanthropic remedial loan leaders and moderates among the illegal loan lenders designed to establish small loan lending by investor-owned loan companies on a legitimized, legal, and regulated basis. It permitted lending at rates of 3.5 per cent per month, above what remedial loan societies charged but well below what many loan sharks exacted from their clientele (Calder 1999).

The passage of uniform small loan laws in the 1910s and 1920s in turn paved the way for scaling up the industry. Constrained by the ability to raise capital, the number of remedial small loan companies in the United States peak in 1916 at approximately 40 and never grew much beyond that. But by establishing the basis for the legitimization of the small consumer loan business and its legalization, it established the foundations for investor-owned small loan businesses to be established and regulated more widely and at an attractive enough rate to allow rapid growth in the industry (Calder 1999).

## DISCUSSION AND THEORETICAL IMPLICATIONS

The case studies above suggest a number of broader theoretical propositions about why entrepreneurs may choose to establish nonprofit and mutual firms and how this decision is shaped by the industry and product lifecycle.

### **Establishing Socio-Political Legitimacy**

Aldrich and Fiol’s (1994) classical article on the challenges of new organization formation in emerging industries provides a useful point of departure for understanding and drawing propositions from the cases above. They argued that the liabilities of newness faced by entrepreneurs “are especially severe when an industry is in its formative years” because an emerging market itself may lack “cognitive and sociopolitical legitimacy.” The cases above speak particularly well to the challenges faced by entrepreneurs when new products and markets lack sociopolitical legitimacy. In each of the cases of new product market development described above, rising demand for the product by itself was insufficient to establish viable, legal organizations in the industry. The socio-political constraints created by popular suspicion of banking institutions, the social unease with placing a price on death, and the customs and laws that prohibited usury each constituted significant constraints on legitimization of the emerging market.

The lack of legitimacy constituted a significant risk to entrepreneurs who might seek to tap such a new opportunity. To the extent that investor-owned companies nevertheless trudged into these markets – as happened with a handful of early life insurance companies – they met with little success. Just as often, however, the markets that lacked legitimacy ended up being pursued by individuals (as was the case with mortgage lending) or illegal entities (such as loan sharks in the case of consumer lending). Few legal investor-owned companies seem to have succeeded at this “pre-emergence” stage of new market creation.

In each of the cases, nonprofits and mutuals seem to have played a crucial role in market emergence by helping legitimize the new product market and by helping establish the institutional rules on which they would operate. The success of nonprofits and mutuals seems to have been attributable to the fact that by excluding the interests of a separate class of profit-oriented shareholders, these organizations avoided some of the perceived conflict of pursuing socially and politically questionable markets for private gain; that is, they could avoid the suspicion that such markets had little or no value for customers but were being pursued for the interests of shareholders alone. Nonprofits and mutuals instead could claim that they were structured in a way that avoided taking advantage of vulnerable customers, and instead were focused on establishing the value of the service for customers and the public. In turn, their successful efforts to enter these markets helped establish the legitimacy of the new service as something that could fulfill a productive need without violating the underlying social and political principles.

We may also specify that the role of nonprofits and mutuals in establishing legitimacy is likely limited to emerging markets in which the product or service is considered questionable given prevailing institutional norms and rules. While we do not exclude the idea that nonprofits and mutuals may serve a role in removing other forms of uncertainty in emerging markets (such as technological or cognitive uncertainty), the cases above cannot address that issue. Instead, they all suggest that the legitimizing role of nonprofits and mutuals pertains specifically to emerging markets plagued by problems of social, cultural, and political acceptance. Other pertinent contexts may include markets for such goods as cutting edge biomedical treatments, social and personal services, and environmentally sensitive products and services.

*Proposition 1: In emerging product or service markets that lack social and/or political legitimacy, new entrants organized as nonprofits or mutuals have advantages in gaining customer adoption over investor-owned startups because the value of their service is not considered compromised by the interests of profit-oriented investors.*

### **Resource Constraints**

While the nonprofits and mutuals in the four cases above had competitive advantages in emerging industries that lacked social and political legitimacy, they nevertheless seemed to face constraints on growth as the market itself became established and began to grow. In particular, they seemed to lack the ability to mobilize key resources at scales needed for rapid growth. In contrast, investor-owned firms seemed better positioned to mobilize these resources once the uncertainty surrounding the social and political legitimacy of the industry were removed. As a result, the founding rates for nonprofits and mutuals fell and the rates for investor-owned entities increased as the markets in question became established and began to grow.

One resource constraint that affected the expansion and proliferation of nonprofits in growing industries was in their ability to raise capital. Though nonprofits and mutuals could often raise nominal amounts of funding during the early stages of industry emergence from supporters and enthusiasts who saw potential impact from the development of the new industry, these sources were not adequate once larger amounts of capital needed to be raised in order to scale or as many new organizations entered the market. Investor-owned firms were in a stronger position to raise capital to scale because they could promise attractive returns to investors and lenders once social and political uncertainty had been removed. Thus, difference in ability to raise capital to expand was one reason for the shift in new entrants from nonprofits to investor-owned entities.

*Proposition 2A: The relative ease or difficulty of raising capital for growth creates a shift in founding rates away from nonprofits and in favor of investor-owned companies as a market moves from emergence to growth.*

Nonprofits and mutuals in most of the cases examined here also seemed to face constraints attracting sufficient managerial talent needed for growth. Mutual savings banks and building and loan associations were two types of organizations hampered by such considerations. In the case of mutual savings banks, one reason why the rate of founding significantly declined was that new managers and trustees found little reward in establishing such institutions once they became widely available. In contrast, investor-owned financial institutions that offered savings accounts were better positioned to reward talented management and hence could attract the human resources needed for growth. A similar pattern was found in the residential mortgage industry, where professional managers were more easily recruited and rewarded within investor-owned associations.

*Proposition 2A: The relative ease or difficulty of attracting managerial resources for growth creates a shift in founding rates away from nonprofits and in favor of investor-owned companies as a market moves from emergence to growth.*

## CONCLUSION

Using four case studies that examine the role of nonprofit and mutual firms in emerging product markets, this paper has developed product- and industry lifecycle-based explanations for the ownership and organizational structure chosen by new entrants. Most significantly, I have suggested that nonprofit and mutual firms may hold advantages over their investor-owned counterparts in the early stages of markets that lack social and political legitimacy. The structure of such firms can help establish the viability and value of products in such markets and establish institutional rules for their adoption. The value of this organizational form, however, is transient because new entrants organized as nonprofits and mutuals face greater difficulty mobilizing resources for growth once a market is established.

The paper makes a contribution to our understanding of the organizational form chosen by entrepreneurs, and particularly to our understanding of the conditions under which nonprofit and mutual enterprises prevail. Specifically, it adds industry-level and longitudinal perspectives to explanations of when and why new entrants establish nonprofit or mutual firms.

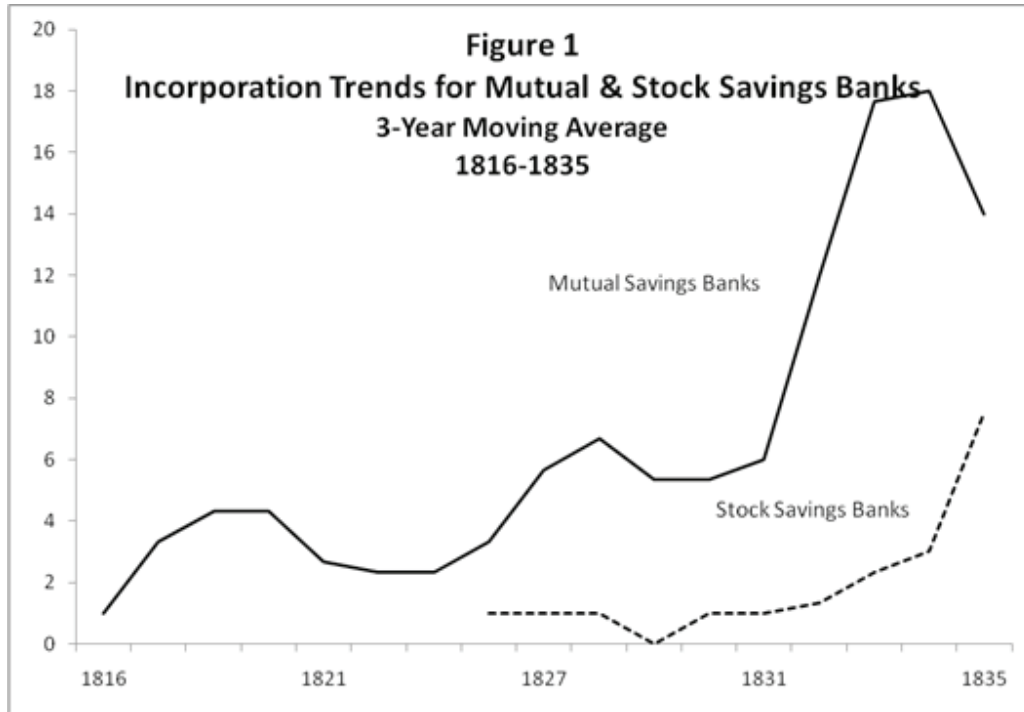
**CONTACT:** Dan Wadhvani; dwadhvani@pacific.edu; (T): (209) 946-7603; Eberhardt School of Business, 3601 Pacific Avenue, Stockton, CA 95211.

## SELECTED REFERENCES

### Full References Available From Corresponding Author

- Aldrich, H.E. & Fiol, C.M. (1994). Fools Rush In? The Institutional Context of Industry Creation. *Academy of Management Review* 19,4: 645-670.
- Austin, J., Stevenson, H. & Wei-Skillern, J. (2006). Social and commercial entrepreneurship: Same, different, or both? *Entrepreneurship Theory and Practice*, 30(1), 1-22.
- Baumol, W. and Strom, R. (2007). Entrepreneurship and Economic Growth. *Strategic Entrepreneurship Journal*, 1, 233-37.
- Calder, Lendol (1999). *Financing the American Dream: A Cultural History of Consumer Credit* Princeton: Princeton University Press.

- Chandler, G., Lyon, D., (2001). Issues of research design and construct measurement in entrepreneurship research: the past decade. *Entrepreneurship Theory and Practice* 25, 101–113.
- Eisenhardt, K. (1989). Building Theories from Case Study Research. *Academy of Management Review*, 14 (4), 532-550.
- Eisenhardt, K. and Graebner, M. “Theory Building from Cases: Opportunities and Challenges,” *Academy of Management Journal*, 50, 1, 25-32.
- Forbes, D. and Kirsch, D. (2010). The Study of Emerging Industries: Recognizing and Responding to Some Central Problems. *Journal of Business Venturing*.
- Hansmann, H. (1996). *The Ownership of Enterprise*. Cambridge: Harvard University Press.
- Hansmann, H. (1980). The Role of Nonprofit Enterprise. *Yale Law Journal*, 89, 835-901.
- Howell, M. and Prevenier, W. *From Reliable Sources: An Introduction to Historical Methods* Ithaca: Cornell University Press.
- Jick, T.D. (1979). “Mixing Qualitative and Quantitative Methods: Triangulation in Action,” *Administrative Sciences Quarterly* 24, 4: 602-611.
- Jones, G. & Wadhvani, R.D. (2006). “Schumpeter’s Plea: Rediscovering History and Relevance in the Study of Entrepreneurship,” HBS Working Paper.
- Keyes, E.W. (1876). *History of Savings Banks in the United States*. New York: Bradford Rhodes.
- Landström, H & Lohrke, F. (2010). *Historical Foundations of Entrepreneurship Research* Cheltenham: Edward Elgar.
- Mair, J. & Marti, I. (2006). ‘Social entrepreneurship research: A source of explanation, prediction, and delight.’ *Journal of World Business*, 41(1), 36-44.
- Mason, D. (2004). *From Building and Loans to Bail-outs: A History of the American Savings and Loan Industry, 1831-1995*, Cambridge: Cambridge University Press.
- Moray, N. & Stevens, R. (2009). The Organisational Goals of Social Entrepreneurs: How Social Are They? *Frontiers of Entrepreneurship Research*.
- Murphy, S. (2010). *Investing in Life: Insurance in Antebellum America* Baltimore: Johns Hopkins University Press.
- Phillips, N. (1993). Analyzing Communication in and around Organizations: A Critical Hermeneutic Approach *Academy of Management Journal* 36, 6, 1547-1576.
- Snowden, K. (2010). The Anatomy of a Residential Mortgage Crisis: A Look Back to the 1930s. NBER Working Paper.
- Stalson, J.O. (1942). *Marketing Life Insurance: Its History in America*. Cambridge: Harvard University Press.
- Weisbrod, B. (1988). *The Nonprofit Economy* Cambridge: Harvard University Press.



Source: Richard Sylla and Robert Wright, "U.S. Corporate Development Database"

