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Nonprofit organizations and their local affiliates: A study in organizational forms

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Abstract

Growth in the nonprofit sector typically occurs through a system of franchises. This paper explores the factors which encourage franchising in the sector. Data are analyzed from a survey by the author which suggest that the choice by nonprofits of the franchise versus branch office form is consistent with the predictions made by agency theory. Mechanisms used by nonprofit franchises to enhance intra-organizational coordination are also explored.

JEL classification: L2; L3

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1. Introduction

In 1987, there were 907,000 organizations in the U.S. nonprofit sector (Hodgkinson and Weitzman, 1989). The large majority of these organizations were affiliates of national nonprofits, organized as either branch offices or franchises. This paper examines the structure of the relationship between national nonprofits and their local affiliates, as an efficient response to the particular characteristics of nonprofit production.

A principal reason why we see such an abundance of organizations in the nonprofit sector is that a substantial portion of nonprofit activity occurs through operations coordinated and run at the local level. Those nonprofits which are providing services, for example, the churches, scouting, reproductive counseling and the like, clearly must provide those services at a local level. Even those organizations primarily engaged in

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fund raising and the distribution of those funds, organizations like the United Way and the American Cancer Society, use local operations as a way to effectively mobilize volunteers. Consider the following examples: the Boy Scouts of America has over 400 local affiliates; the United Way has 2300 affiliates; Goodwill Industries has 179 affiliates. In each case, the affiliates are organized on a geographical basis. In this way, the almost 1 million nonprofit organizations that we see in the United States can actually be reduced to a much smaller number of really distinct operations.

The prevalence of local operations in the nonprofit world gives rise to the organizational question which motivates this paper: How should these local operations optimally be organized? When a particular nonprofit organization decides to expand its geographical coverage, should it establish a wholly-owned satellite or branch office or, as I will argue in this paper, does a semi-autonomous franchise operation best serve the expansion needs of most nonprofit organizations? In a previous paper (Oster, 1992), I had explored in a general way some of the advantages of the franchise form for nonprofits. In this paper, I extend these arguments and then test them using survey data on the nonprofit organization form. The results suggest that the same forces which were instrumental in creating the nonprofit in the first place have pushed those nonprofits in the direction of the franchise system.

2. The franchise system in the corporate and nonprofit world

The franchise system, as used in the corporate world, has four characteristics:

1. The franchiser transfers to the franchisee the exclusive right to use a trademark or sell a particular product. Often, though not always, this right is given over a particular territory.
2. In exchange the franchisee pays the franchiser. Typically, the fee involves some initial lump sum and then ongoing fees keyed to the level of business.
3. The franchiser provides some assistance, typically on technical, operating matters to the franchisee and maintains some control on the way in which the business is operated.
4. Any residual profits and losses from the business go to the franchisee.

While the number of franchises in the corporate world has been growing somewhat over time, they still play a relatively modest role, emerging in the sectors of fast foods, automobile distributors and, to a lesser extent, retail trade (U.S. Department of Commerce, 1985).

Now let us look at a few examples of the franchise system in the nonprofit world. Consider Planned Parenthood. In 1991, Planned Parenthood had 171 affiliates located throughout the country, each a separate 501c.3 organization. Each affiliate has the right to use the Planned Parenthood name, and receives from the parent organization certain educational, legal and technical assistance. In return, local affiliates or franchisees pay the national organization a percentage of their operating budget, where the fee rate depends on the wealth of the local area, in a "fair share" formula relatively common in the nonprofit sector. In 1989 the affiliates in the aggregate contributed 1.2% of their operating budgets to the national organization. The residual revenues earned by any particular Planned Parenthood branch, from its clinic operations or its fund raising efforts, belong to the local affiliate. In this sense, what we see is clearly a franchise relationship and not, for example, a branch office. In fact, unlike firms in the private sector, the Planned Parenthood affiliate is subject to the nondistribution constraint. Nevertheless, the local affiliate retains considerable discretion over the use of its funds and over its operations. For example, several years ago, a plan by the national Planned Parenthood organization to begin selling condoms failed, in part, because local affiliates refused to act as distribution outlets. In this matter, local affiliates were in control. On the other hand, the national organization can terminate local affiliates which stray too far from the overall mission of the organization. This control, coupled with the ongoing fee payment and with the technical help and oversight of the national organization, suggests that the local affiliates are clearly not independent operations.

A second example of a nonprofit franchising operation is the United Way. In 1990, there were 2300 separate United Way operations scattered throughout the United States. Each local operation has the right to call itself a United Way and to use the United Way logo. The national organization provides marketing support, works on governmental relations affecting the operation of all affiliates and provides some training. The national organization also provides some broad guidelines under which the local affiliates operate, though the extent of control by the national organization is much less here than in many other of the nonprofit franchises. And, in return, the local affiliates pay a fraction of their earnings in dues to the national organization. Once these dues are paid, the remaining funds collected by the local United Way are allocated strictly in accord with the decisions of that local affiliate and, indeed, there is considerable variation across local operations in how funds are used. Each United Way is governed by a local board of volunteers and, in this sense, is quite autonomous.

These two examples suggest the complementary roles of local affiliates and their national headquarters in many nonprofits. National operations invest in system-wide activities: the development of a national reputation, creation of administrative procedures and systems. Local affiliates conduct the operational work of the organization. For this division of labor, given nonprofit characteristics, the franchise system works extremely well.

I have given several examples of nonprofit franchises to provide a flavor of the way in which franchises manifest themselves in the nonprofit world. In each of these examples, we see the operation of franchises which meet all four criteria we listed earlier. This franchise form is quite distinct from the branch office form. Unlike branch offices, the franchise operations described here retain ultimate rights over and responsibility for their own financial conditions. In most branch offices, on the contrary, all revenues are returned to the center from whence costs are then paid. The delegation of operational and strategic authority is also typically less in the branch office than in the franchise, although here there is clearly more of a continuum.

Some sense the broad scope of franchises in this sector can be found by examining a list of the largest charitable nonprofits, culled from the *Nonprofit Times* (November, 1990) using these lenses. A survey of the organizational structure of the one hundred largest charitable nonprofit organizations yielded 61 responses. Table 1 lists the

Table 1
Examples of franchise and wholly owned operations

Franchised operations	*Wholly owned operations*
United Way	Save the Children
YMCA	Oxfam America
American Red Cross	Christian Children's Fund
UNICEF	Amnesty International
Goodwill Industries	The Humane Society
Boy Scouts of America	Environmental Defense Fund
Girl Scouts of America	Braille Institute
American Cancer Society	Plan International
American Association for Retarded Citizens	Americares Foundation
Catholic Charities	Cousteau Society
Planned Parenthood	United Negro College Fund
United Cerebral Palsy	Children's Aid
American Heart Association	Lutheran World Relief
Volunteers of America	American Friends Service
Boys and Girls Clubs of America	National Trust for Historic Preservation
March of Dimes	Food for the Hungry
American Lung Association	The Wilderness Society
Rotary International	Christian Appalachian Project
National Multiple Sclerosis	World Vision
Big Brothers/Big Sisters	
Arthritis Foundation	
Catholic Relief Services	
Muscular Dystrophy Association	
National Mental Health Association	
Junior Achievement	
American Diabetes Foundation	
National Urban League	
Juvenile Diabetes Foundation	
Girls, Inc.	
National Audobon Society	
Gifts in Kind	
Leukemia Society	
Epilepsy Foundation	
Joslin Diabetes Centers	
National Kidney Foundation	
Armenian General Benevolent Union	
Habitat for Humanity	
National Wildlife Federation	
Cystic Fibrosis	
Nature Conservancy	
Camp Fire Girls and Boys	

Source: Author Survey.

organizations surveyed, dividing them into those which are organized as franchises and those which use the wholly-owned satellite form of organization. Two-thirds of the nonprofits surveyed are franchises. Among the largest twenty nonprofits, the use of the franchise form is even more common, at close to 90% of the total. In the following discussion, I explore some of the reasons for this observed pattern of organizational structure.

3. Accounting for organizational form among nonprofits

Early work on franchising in the corporate sector emphasized its advantages in terms of providing improved access to capital for local operations (Caves and Murphy, 1976). Local franchises and their national partners shared the risks of supplying capital to a particular enterprise. Later work emphasized the role of franchising in reducing agency problems in situations in which monitoring managers was difficult. Thus, corporate franchises would be preferred to wholly owned satellites in operations in remote and dispersed locations (Martin, 1988). In the corporate sector, franchising is thought to be attractive because it is in some sense a compromise form, a kind of halfway house between the free standing entrepreneurial enterprise and the branch office. Even the popular literature in the area recognizes the mixed advantage of the franchise and boosts it as an organization which "weds a knowledgeable big-time operator with an entrepreneurially motivated small time operator" (Foster, 1989). Among nonprofits, as a direct consequence of the nature of production in this sector, this compromise form assumes even greater importance.

Nonprofit organizations face many of the management concerns of the corporate world. Both profits and nonprofits must concern themselves with issues of strategy in a changing environment. Both must worry about creating incentives for managers and developing leadership and vision. In both sectors, there are more mundane operational concerns. But, there are at least five characteristics which distinguish these organizations from standard corporate operations and in many cases complicate the management process: the kind of product or service produced, the use of fund raising as an income source, the inadequate access by nonprofits to capital, the absence of quantitative criteria for managerial performance, and the dependence of nonprofits on volunteers. These five characteristics form the core of almost all the literature on the questions of why the nonprofit form arises and on why nonprofits are sometimes more difficult to manage. I would like to argue that the franchise form perseveres in many nonprofit markets because of its utility in managing these five characteristics.

Table 2 summarizes the advantages of the branch office versus the franchise in terms of its survival ability in environments with these five traits. Consider first the kinds of goods

Table 2
Advantages of two alternative organizational forms for nonprofit activities

Type of organization	Prevent reputational externalities	Coordinate fund raising efforts	Improve access to capital	Reduce managerial shirking	Encourage volunteer efforts
Wholly-owned satellites	Good	Good	Poor	Poor	Poor
Franchises	Fair	Fair	Good	Good	Good

and services produced in the nonprofit sector. It is by now well accepted that one reason we see nonprofit organizations forming in many sectors is that such organizations engender trust in supplying goods and services for which more palpable bases for trust are lacking (Nelson and Krashinksy, 1973, Hansmann, 1980). In service organizations in which donors contribute in the hope of helping others, in organizations serving the elderly or children, in organizations in which output is hard to measure and quality hard to monitor, people use an organization's nonprofit status and its concomitant inability to redistribute profits as a measure of its trustworthiness. In much the same way, individuals use an organization's reputation as a way to develop trust in these areas. For organizations operating in these sectors, reputation is the central strategic asset and it is this asset, as embodied in their names, that these organizations are franchising. But, precisely because of the unobservability of the products and services being produced, the reputation of the whole is quite vulnerable to malpractice by particular local affiliates. In some ways, the importance of the reputation creates the potential for local externalities, the potential for one local affiliate to affect its neighbor. Thus, one axis along which we can judge the survival properties of a particular organizational structure is its ability to manage reputational externalities.

The importance of maintaining some control over local affiliates as a way to protect the reputation of the whole is a theme which runs through the literature of the various nonprofits. Consider the following excerpt from a position paper written for the National United Way, arguably one of the least controlling of the nonprofit franchisees:

> In the public mind all United Ways are alike. The United Way in Portland, Maine is no different from the one in Portland, Oregon – just as a Sears establishment in Portland, Oregon is like the one in Maine. Thus, the performance and behavior of one United Way – good, bad, or indifferent – has an impact on the public perceptions of all United Ways. (United Way, 1990)

Clearly the wholly-owned operation is better able to counter problems of reputational externalities than the franchise. Franchises achieve coordination only imperfectly using mechanisms described in Section 4 of this paper.

Nonprofit organizations serving the same purpose are also subject to competition in the fund raising function that makes some national control important. Suppose we have a number of different organizations, each of which is licensed to raise funds under the name of the American Heart Association. Each of these organizations has an incentive to solicit contributions for that fund as long as its marginal cost of solicitation is less than its expected marginal contribution. But if each of these organizations is soliciting from more or less the same donor pool, its fund raising efforts will reduce the productivity of neighboring operations. Thus, new solicitations by one organization will increase the marginal costs of solicitation to the remaining funds. Without some form of control, fund raising competition among the local licensees will deplete the net profits associated with fund raising in that pool. The problem here is precisely analogous to the issue of over grazing associated with the common pool problem, seen in the agriculture and fishing areas (Hardin, 1968, Rose-Ackerman, 1982, Steinberg, 1986).

The problem of the commons in fund raising is well appreciated by nonprofits. Indeed, the United Way can be seen as an organizational response to the commons problem among a set of quite diverse nonprofits. Within the system of local franchises, organizations have developed a number of mechanisms to reduce commons problems, some of which we will explore in a later section of this paper. But these mechanisms are typically imperfect and, in some settings can be contractually burdensome. Thus, on this dimension, too, the branch office form dominates

The third managerial problem of nonprofits involves the difficulty of raising adequate capital. Nonprofit operations in general, have considerably less access to capital markets than they do for profits. (Hansmann, 1981). Since these organizations are subject to nondistribution constraints, they are precluded from issuing equity, since equity is simply the right to a share of the residual revenues of an operation. Even debt is often harder for the nonprofit to raise, since many of its assets may be quite specific to the enterprise and thus worthless as collateral. Yale College buildings are extraordinarily valuable in their current use, but their value in alternative use is quite small. Bennington College which several years ago faced a major financial crisis found that the credit market placed a very low value indeed on their buildings (Dees, 1985).

The advantages of the franchise system over branch offices in getting access to local capital in the for-profit section are well known. These advantages are accentuated among nonprofits. Under the typical franchise contract in the nonprofit sector, the raising of capital involves a form of partnership. The national organization raises capital from either national government or large corporate donors. The local affiliate is typically responsible for raising local capital to build the requisite local operating facilities. Local affiliates are better able to tap local resources to fund their operations because their localness makes them easier to observe. Moreover, evidence suggests that donations are complementary with volunteering which typically occurs at the local level (Callan, 1994). For the rights to use the organizational name and logo, the franchisee pays an ongoing variable fee, thus reducing the initial capital the local affiliate needs to raise.[2] But, if the national organization must – because of scarcity of venture capital in the sector – use an ongoing variable fee payment, then it retains an interest in the financial viability of its local affiliates and it will wish to retain some control in order to protect that interest. Capital scarcity leads to an ongoing fee payment and that fee payment leads to the need for some control which the franchise provides.

In the nonprofit area, managerial performance is often extraordinarily difficult to monitor. (Brinkerhoff and Kanter, 1990, Dimaggio, 1988). The small optimal scale of nonprofit operations also complicates the monitoring problem, as it increases the number of operations which the national organization will have to oversee. Thus, creating ownership claims for the local manager of the nonprofit via a franchise has clear advantages in mitigating the agency problems we might expect to see when monitoring is difficult. On the other hand, in the nonprofit sector, tax rules prevent the organization from creating managerial claims over the *financial* residual of the organization, as one might do in parallel corporate cases. Instead, the national nonprofit organization will use local ownership to motivate managers by giving them *managerial* control over the use of any surplus generated by operations or making them responsible for their losses.

[2]In some instances the national organization also loans the affiliate a portion of the capital needed for facilities.

Managers of local nonprofit affiliates have the incentive to work hard to raise funds and manage costs because they have considerable control over how those funds are spent; they have been, through the use of the organizational form, turned into nonprofit entrepreneurs. Creation of these ownership claims is valuable precisely because managerial performance is hard to measure.

Nonprofit organizations themselves recognize the importance of local autonomy to encourage managerial enterprise. The National Urban League, for example, argues in its affiliation manual, "Because the achievement of Urban League objectives depends upon the quality of leadership available in each community and because that quality is highest where self initiative is most encouraged a certain degree of autonomy must be maintained in the conduct of affiliate affairs."

The final distinguishing feature of nonprofits is their reliance on volunteers. Organizations like the American Red Cross and the scouting programs rely almost entirely on volunteers. But research investigating why people volunteer has found that a major determinant of voluntary effort is the volunteer's perception of influence over the composition and allocation of the organization's output (Mueller, 1975, Menchik and Weisbrod, 1987). This local influence by volunteers is very difficult in an organization with strong central control. Thus, wholly owned satellite operations will be less suitable for those nonprofits which heavily use volunteers and franchises will come to dominate.

In the for-profit sector, capital access and agency problems in management induce franchising. Among nonprofits, these factors are magnified and thus franchising becomes even more important. In addition, the dependence of nonprofit organizations on volunteers further supports franchising. Indeed, the franchise structure seems an almost ideal form for the nonprofit enterprise.

4. The empirical results

I have argued that franchising is particularly attractive for nonprofits with large capital needs, serious managerial agency problems and large volunteer needs. On the other hand, problems of local competition in fund raising and needs to control reputational externalities encourage organizations to exert more control over their local operations and institute branch offices. This model of nonprofit franchising was tested on a sample of large charitable nonprofits in the US. In general, the results are quite supportive of the model.

Much of the data used to test the hypotheses just developed on the determinants of the propensity to franchise among nonprofits were collected from a survey by the author of major charitable nonprofits. Additional data on organizational characteristics came from the *Nonprofit Times* survey (Sterne, 1990).

All organizations were classified as franchises (1) or branch offices (0) based on the author's survey. Independent variables were identified to correspond to four of the five forces identified in Table 2, capital needs, agency problems, volunteer use and dependence on fund raising. It was not possible to identify a proxy for the fifth factor, the extent of reputational externalities in the system. A logit regression was estimated,

Table 3
Logit estimates of the probability of franchising

Independent variable	Expected sign	Regression coefficient
Constant	?	−1.726 (−1.07)
Use of public fund raising	—	−0.046 ** (−2.05)
Size of organization	+	0.007 (1.38)
Number of local operations	+	0.039 ** (2.83)
Labor intensity	+	7.072 * (1.75)
Log likelihood −14.24		

Number of observations=55.
+ Statistics are in parentheses.
** Signficant at the 0.05 level.
* Significant at the 0.10 level.
Variable measures and means
Number of local operations: units: 258
Size of organization: income, in millions of dollors: $227.
Use of public fund raising: percent of income from public funds: 61%
Labor intensity: fraction of expenses spent on employees: 0.33

predicting the likelihood of franchising by an organization based on the characteristics of those organizations. Results are presented in Table 3 and in general are supportive of the hypothesis generated earlier.

The results indicate that a 1% increase in the share of public fund raising lowers the probability of franchising by 4.6%. As expected, the coordination required for public fund raising encourages organizations to use the branch office system rather than franchising.

The attractiveness of franchising increases with the need for capital. The size, or income, of the nonprofit was used as a measure of capital needs. The results from the regression are only mildly supportive; the sign on size is positive, as expected, but the coefficient is insignificant.

Both nonprofits and for-profits agency problems lead to franchising. Organizations with a large number of local operations would be expected to have monitoring problems and thus to turn to franchising. The evidence in this paper strongly supports this hypothesis and suggests that increasing the number of local operations by 1 increases the likelihood of franchising by 3.9%. Among nonprofits in the survey using franchises, the average size of the network is 461 affiliates; the average number of branch offices, on the other hand, is only 9.

Finally, I have argued that heavy reliance on volunteers raises the attractiveness of franchising. Unfortunately, U.S. nonprofit organizations do not generally report the value or extent of volunteer use. As a measure of potential volunteer use, I have used the labor intensity of the organization. The more labor intense an organization, the larger the scope is for volunteers. The results in Table 3 support the hypothesis that labor intensity increases the probability of franchising.

5. Mechanisms for controlling the commons

One of the advantages of the branch office over the franchise is its superior ability to coordinate fund raising. Among franchises, however, there are a number of mechanisms which have been developed to reduce commons problems, and thus allows the use of the franchise structure even when some fund raising is needed. This section explores the two most common mechanisms, the franchise fee and fund raising restrictions.

The economics literature on the optimal structure of the franchise fee has largely focused on for-profit organizations (Martin, 1988, Mathewson and Winter, 1984, Rey and Tirole, 1986). Among for-profit franchises, territorial restrictions typically limit competitive overlap among units. Thus, the central concern in designing fees has been to maintain the franchisee's incentive to promote the product. Thus, fees, which vary with either gross revenues of the franchisee or number of service units, have been criticized for their potential for blunting the incentives of franchisees to push their products, even as their advantages in terms of administrative simplicity have been recognized.

Among nonprofits, locational barriers are more permeable. In particular, in fund raising, particularly direct-mail fund raising, franchisees at widely separated sites can compete. In this setting, fees may be used to reduce intra-franchisee competition, as well as to siphon revenues to the center. By basing the franchise fee on gross revenues or membership numbers, the center reduces the marginal revenue from fund raising and thus reduces the commons problem among its affiliates. Here, the gross-fee operates analogously to the license fees used to prevent over-fishing in rivers and lakes. By contrast, a fee set on the basis of net revenues (i.e. revenues after deductions from fund raising costs) would, by simultaneously lowering both cost and revenue, have no effect on fund raising levels. Under circumstances in which one affiliate's fund raising efforts adversely affect the returns to other affiliates, the national organization will wish to "distort" the behavior of its affiliates. When commons problems are large, gross fees, *precisely because they are distortionary,* will be preferred to more complicated fee structures.

It is interesting to look at the franchise fee structure of several nonprofit organizations in the context of the argument just made. Most of the nonprofit organizations I have thus far surveyed base their franchise fees on either a gross revenue or membership basis. This includes, for example, Scouting, all the disease research organizations, Goodwill Industries, United Way, and many others. Franchise fees, however, differ significantly among nonprofits. In the case of the disease research organizations, which depend largely on direct-mail campaigns and have permeable locational barriers, fees tend to be quite high relative to corporate franchise fee levels, to the order of 10–50%. For more service oriented organizations, with higher natural barriers, like Planned Parenthood or the Red Cross, both of which center around the provision of local services, fees are typically under 5% which is more in line with the 4–10% we see in corporate situations. Of course, the higher the franchise fee, the more control national organizations have over externalities, but the less initiative is presented to managers.

A more subtle franchise fee is used by the American Lung Association and does an even better job of balancing externality control and stimulating managerial initiative. The American Lung Association has approximately 130 affiliates. On direct mail or standard solicitation the affiliates pay a fee of 10% based on *gross* receipts. On special events, however, the fee is based on net revenues! This system, which distinguishes sources of revenues, makes good economic sense. In the direct mail solicitation, with its wide geographic reach, commons problems are substantial. So it is here that we wish to "distort" local behavior with a gross fee. For special events, we reach out to a donor pool which is geographically local, but likely to have broader charitable interests; here the commons problem is likely to be less. Moreover, special events typically require more managerial initiative, initiative which we wish to encourage. Therefore, here we use a net fee.

The mixed system used by the American Lung Association has another advantage over the gross revenue tax. In particular, while a gross revenue tax reduces the inefficiency of over solicitation, it tends to distort the choice of fund raising techniques, moving organizations away from lucrative, but high cost techniques. Special events are a clear example of a high cost but profitable technique. By creating a special category for these fund raising methods, the organization may be better able to limit over solicitation while reducing technique distortion.

The franchise fee serves as one way of reducing the over-grazing problem among affiliates of a particular organization. The problem of excessive competition from other, unrelated organizations remains, in much the same way that a particular industry cartel will remain vulnerable to the entry of new firms producing related products. Inter-organizational externalities appear to be increasing as technology has reduced the costs of reaching large audiences with charitable appeals. We have already seen some organizational responses to this new awareness of the commons problem. In the health area, for example, the Combined Health Appeal represents a consortium of health research organizations, banded together for fund raising purposes. States are beginning – under pressure from larger nonprofits – to investigate licensing restrictions. But these efforts are still just beginning and most of the externality-reducing effort has taken place within organizations.

Nonprofits also use rules to govern intra-organizational competition. In many instances local affiliates are given exclusive territories; that is, they are given the exclusive monopoly right to serve and solicit from a particular area. Often the national organization consults with its existing locals before issuing a new exclusive territory. Territorial restrictions solve the commons problem by fiat rather than through the pricing system represented by the franchise fee. In the case of the United Way, for example, the Middletown Connecticut United Way cannot solicit funds under the United Way logo in a Greenwich Connecticut firm. A Planned Parenthood affiliate is given the right to set up a clinic in a particular area and can do its fund raising only within a local area. The American Red Cross of a particular area is limited in its ability to solicit either funds or volunteers from outside that area. One of the strongest examples of the exclusive territory is the Roman Catholic Church in which parishioners were traditionally prohibited from crossing parish boundaries in their church affiliation.

What are the advantages of using territorial restrictions versus fees as a way to control the fund raising efforts of local affiliates? Territorial restrictions like quotas are easy to administer,clear, and with predictable outcomes. Moreover, these restrictions reduce competition across affiliates, but leave whole the organization's incentives to compete against new entrants from related charities. In this sense, restrictions dominate fees. On the other hand, territorial restrictions can be rigid and provide fewer incentives to organizations to innovate within their own industry. Suppose, for example, an organization has developed a new method of fund raising which considerably lowers its fund raising costs. It might well be socially optimal for that firm to expand its territory over that of its less efficient neighbor. A tax system allows for such efficient reallocations, while a system of exclusive territories does not. Perhaps more important, to the extent that local agencies provide services as well as raise funds, allowing some competition between affiliates in fund raising may increase the incentives of the affiliates to improve the services they provide. Under these circumstances, the fee system will be preferable over the use of exclusive territories. Finally, we also see that territorial restrictions may be infeasible for technological reasons associated with the form of fund raising used. For door-to-door solicitations, or direct mail efforts, territorial restrictions are clearly possible. For mass media solicitations dividing up the solicitation market may be prohibitively expensive. In this case, the taxing strategy will be preferable.

The public television network is an interesting example of the last proposition. The national public television system imposes no fund raising restriction on its affiliates, beyond that naturally imposed by the boundaries of the spectrum. Indeed, in some areas, as a result of cable penetration, public television watchers will be solicited on the several public stations several times, and will make some choice as to which of the public stations they will support. It is possible to argue that allowing a modest amount of fund raising duplication in this setting is useful because it encourages healthy programming competition among stations and this, in turn, increases the donor base as a whole. If this argument is correct, then recent initiatives by the national organization to reduce local programming control should be soon followed by an increase in rules to govern fund raising rivalry.

6. Conclusion and remaining puzzles

This paper has explored the ways in which the franchise system with its incentives for entrepreneurship and its concomitant monitoring and taxing ability acts as an important organizational form for those nonprofits engaged in local activities. Franchises provide a way to balance the control needed to deal with system externalities and still preserve enough autonomy to encourage local managers and volunteers to work productively in a sector noted for its low wages. The empirical work suggests that franchises are particularly prevalent in nonprofits with monitoring problems, strong use of volunteers and large capital needs.

I have also considered in some detail the way in which territorial restrictions and the structure of the franchise fee operate. Some puzzles remain in this area as well. It is clear that, in the nonprofit world, just as in the for-profit world, franchises differ quite significantly from one another in terms of just how much monitoring the national organization does and how that monitoring proceeds. The level and structure of franchise fees also differ substantially among nonprofits. The task of making sense of these differences remains for another day.

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