

# 11 Social Entrepreneurship in the Market System

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## **Learning goals**

Upon completing this chapter, you should be able to accomplish the following:

- Explain the potential role of social entrepreneurship in market economies.
- Recognize the function of social entrepreneurs in addition to commercial entrepreneurs and the state as suppliers of goods and services.
- Explain the scope of activity of social enterprises in relation to their potential for value creation and appropriation.
- Characterize typical areas of activity of social entrepreneurs and provide examples.

## 11.1 Introduction

This chapter aims to propose a wider economic perspective of what social entrepreneurship is and how its role and functioning may be perceived in a market-based economic system. It relates and contrasts social entrepreneurship to concepts of conventional, i.e., commercial, entrepreneurship and to the state as an intervening force into the market system. By doing so, the potential tasks of social entrepreneurship are derived, assuming functions that are beneficial to society and which cannot or are not served by commercial entrepreneurship or by the government. It is therefore considered as a complementary economic agent to the other actors in the market system. To this avail, this chapter discusses when social entrepreneurship may be seen as legitimate, how legitimacy may be acquired by social entrepreneurs and what types of legitimacy need to be addressed. Furthermore, deliberations on the potential scope of its domain will be undertaken.

In the context of this book, this chapter therefore provides a classification for social entrepreneurship within the wider framework of economic theory, a task that is currently neglected in the literature on this topic (Santos 2009). Based on a market-system perspective it specifically addresses the economic and social functions of social entrepreneurship. The selected economic view perceives economic action as embedded into a wider social environment and as a part of social relations and institutions (Granovetter 1985).

To achieve these goals, the chapter proceeds as follows: section 2 presents a perspective on the function of social entrepreneurship in the market system, relying on traditional approaches to commercial entrepreneurship, specifically those of Schumpeter and Kirzner. It moreover deliberates the role of social entrepreneurship from a welfare economic perspective based on Pareto's concept of efficiency. With respect to the embeddedness assumption mentioned above, section 3 then positions social entrepreneurship within the social economic context, whereby two distinctive aspects will be discussed: The necessity of legitimacy for the social entrepreneur's purpose in order to gain acceptance and acquire resources on the one hand, and the potential domain of the concept in a market system when compared to commercial entrepreneurship and governmental action on the other. The final section introduces the social enterprise case of the "Committee for Democracy in Information Technology" established by Rodrigo Baggio.

## 11.2 The Function of Social Entrepreneurship in the Market System

As a first approach to the topic it might be worthwhile to distinguish between the function social entrepreneurship has in a market system when compared to its conventional counterpart. Such a comparison may be necessary as definitions and indeed beliefs about what social entrepreneurship is and what it amounts to differ considerably (Dacin et al., 2010; Zahra et al., 2009). This chapter is thus limited to a functional view of entrepreneurship (see Saßmannshausen, 2010) and will not regard other issues of entrepreneurship research and theory such as behavioural- or traits-based approaches. We will hence concentrate on the effects of the social entrepreneur's endeavours on a (free) market system, and are therefore not interested in specific traits that social entrepreneurs might share in their everyday actions.

Starting with the conventional entrepreneur the three main lines of thinking regarding his or her function were developed by Knight (1921), Kirzner (e.g. 1973, 2009), and Schumpeter (e.g. 1928, 1934). While Knight emphasizes risk-taking as the significant contribution of entrepreneurs to the market system, Kirzner and Schumpeter concentrate on innovative effects. To Kirzner the "alert entrepreneur" discovers price gaps between markets which he then exploits by ways of arbitrage. In doing so, he functions as an "equilibrator" to the markets since his actions will ultimately lead to a price-equilibrium between the originating and the target market (Kirzner, 2009). Schumpeter on the other hand sees the entrepreneur as a "disequilibrating"; in his view the function of the entrepreneur lies in the introduction of new combinations to markets which eventually disrupt or even destroy old market structures (Schumpeter, 1934; 1950). His conceptualization of the entrepreneur is hence one of an innovator who introduces new products, ways of production or organization, utilizes new resources for production or conquers new markets. One may note that the entrepreneur did not stand at the beginning of research for any of these three authors. They were all rather interested in specific phenomena observable in the market (risk-taking, equilibration, development) and found the entrepreneur to be the acting person behind them. Since they address different issues and potential functions, all three approaches stand next to each other in entrepreneurship theory as accepted concepts of the entrepreneur's role in a market system. Moreover, newer approaches exist, that try to combine two or more of these older approaches, especially the ideas of Schumpeter and Kirzner (e.g., Shane, 2003).<sup>22</sup>

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<sup>22</sup> There have already been attempts to frame the social entrepreneur within these approaches, most notably by Swedberg (2011), who meticulously deduces a Schumpeter-based understanding of the social entrepreneur, and by Zahra et al. (2009) where three models based on Hayek<sup>22</sup> ("The Social Bricoleur"), Kirzner ("The Social Constructionist"), and finally Schumpeter ("The Social Engineer") are devised.

Another discussion circles around the question whether social entrepreneurship takes place in an economic setting or if it is part of non-economic activities. Swedberg (2011) for example distinguishes the non-economic entrepreneurial side of social entrepreneurship from the economic one (see also Neck, Brush and Allen, 2009). The former takes place when a person focuses on initiating social change through the introduction of social innovations. Economic social entrepreneurship on the other side is described as taking place when innovative economic entrepreneurship – in the fashion suggested by Schumpeter – serves a social cause. The entrepreneur's venture yields a capitalist and a social profit, wherein the capitalist profit may serve to further the venture's social impact. This view is consistent with Zahra et al.'s (2009) concept of "total wealth" produced by economically orientated social entrepreneurship. Here, the total performance of social entrepreneurship is differentiated into the creation of social wealth and economic wealth which combined make up for the "total wealth" produced by the enterprise. Zahra et al. (ibid.) propose that entrepreneurial entities may appear on a broad spectrum between the production of social and economic wealth but should express both variables in some gradation to be considered social entrepreneurs. Some scholars find this problematic, since profit maximization and concentration is not necessarily the sole interest of conventional entrepreneurs (e.g., Schramm, 2010) and many conventional enterprises have contributed tremendously to social progress without being referred to as social ventures – Schramm specifically highlights corporations and entrepreneurs that provide all parts of society with affordable and healthy nourishment (ibid.). With regard to this discussion, we will focus on the economic function that entrepreneurship incorporates, as we are interested in the role of the social entrepreneur within a market system. In our approach entrepreneurship will hence be seen as social if it leads to innovation in the social realm through market based operations. Literature on social entrepreneurship often demands that the entrepreneurs pursue major social causes and therein cause considerable social change (e.g., Bornstein, 2004; Dart, 2004; Roberts and Woods, 2005; see also Light, 2006; as well as Dacin et al., 2010 on the subject). However, there is little explanation why this has to be and what social change exactly refers to. Moreover, there is no quantification of what major change is and, consequently, when induced change is large enough to be considered the outcome of social entrepreneurship. Specifically, one question that is raised by this discussion is when exactly a social cause is addressed and if social entrepreneurship only refers to efforts in which the positions of every market participant are embellished, or if it suffices if only some parties profit from the effort and others do not. To elaborate on the latter point, social entrepreneurship is considered in the light of *Pareto-efficiency*. Pareto-efficiency denotes a state where the welfare of no entity can be improved without reducing the welfare state of another entity (Arrow/Debreu, 1954, see also Dean/McMullen, 2007). However, such a state does not indicate that every person is sufficiently amended by the economic status quo, it only postulates that the situation of one person cannot be enhanced without reducing the economic status of a different person (Zahra et al., 2008). Assuming a state of Pareto efficiency in which some actors are in an unfavourable welfare position while others are affluent, entrepreneurial action that favours the former and reduces the income of the latter might well be seen as

social entrepreneurship as described above although some market participants are worse off (cf. Martin/Osberg, 2007).<sup>23</sup> From this point of view, social entrepreneurship and the changing of economic and market structures through economic actions does not necessarily foster the welfare of every participant in an economy in a positive way. If one takes a Schumpeterian approach and assumes that entrepreneurial action may indeed lead to considerable destruction of existing structures through innovation, it is rather likely that social entrepreneurship may lead to disadvantages for some members of that economy. Ideally of course, social entrepreneurship leads to *Pareto-superior* states where the disadvantaged are navigated into better positions without affecting anyone else negatively. As an example, such outcomes occur when initiating economic growth from which all parties profit.

A functional microeconomic approach naturally focuses on the entity of the social enterprise. Relying on the traditional approaches to entrepreneurship, a dynamic perspective is preferable. Social entrepreneurship is defined as business models that aim to address a social benefit by *combining* economic market-based operations with a social aim to alleviate the welfare state of a certain target group (Santos, 2009). This approach has several advantages: First, it solves the assumed trade-off relationship between economic and social goals of entrepreneurship proposed in many contributions to social entrepreneurship (cf. Zahra et al., 2009). Social and economic actions are then seen as potentially complimentary rather than conflicting (also see Santos, 2009).<sup>24</sup> Organizations that follow a fair trade approach are a good example here. Disadvantaged farmers in Third World countries benefit from marketing and distribution efforts of trade organizations in the developed world based on a “fair” pricing of their products in contrast to the often exploitive behaviour of other trade organizations. The economic and social aims of fair trade are complimentary because the more successful the fair trade organizations are, the more the farmers profit and the more their social disadvantage is alleviated. Moreover, the proposed understanding allows a clear differentiation between social businesses and charity on one hand and corporate social responsibility (CSR) on the other. As charities do not follow a (market-based) business model by definition, and CSR is not part of a company’s original business model, neither concept is included in this understanding of social entrepreneurship. Secondly, from a functional perspective both the Kirznerian and the Schumpeterian approach are commensurable to this view. The Kirznerian entrepreneur alleviates social disadvantage through equilibration within the market system. He or she uses market imperfections to solve perceived deficits in welfare through arbitrage. The aforementioned fair trade concept falls exactly into this category. The Schumpeterian entrepreneur aims to solve perceived social problems through concepts that disrupt existing equilibriums (states that are Pareto-efficient but perceived as socially disadvantageous, also see Santos, 2009) through innovative business models. He or she creatively destroys an existing market system to erect a new one. Mohammad Yunus’ Grameen bank falls into this category. Microlending

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<sup>23</sup> While other scholars, especially Santos (2009) also argue from a Pareto-based perspective, the reader will see that our argumentation in some parts differs from his conclusions.

<sup>24</sup> Santos is unclear in this point as he both mentions a traded-off relationship and a mere distinction between value creation and appropriation (see Santos 2009, p. 14). Our view is closer the latter concept.

as an innovative banking concept and credit product revolutionised the debt market system of Bangladesh in more than one way: It provided debt capital at lower interest rates (new quality of an existing product), addressed a different target group (women from disadvantaged families) and also introduced a novel concept of securing returns (through peer groups). At the same time, it obliterated the former lending concept which was based on very high interest rates (also see Dowla, 2006 for a more detailed account).

Note that until now the scale of entrepreneurial activity has been ignored. Social entrepreneurship emerges simply by fulfilling the proposed function – this is as another advantage of the approach. Moreover, the concentration on a functional perspective lets the social entrepreneur share a theoretical trait with all other entrepreneurial concepts: The possibility of failure (Dacin et al., 2010). Empirically, an entrepreneur may aim to close a social gap through arbitrage or innovation but this does not mean that he or she succeeds in the endeavour (see also Santos, 2009). Failure however, has two very different forms in social entrepreneurship: Failure in economic performance or failure to address the social need as planned. The first case is the same as for the conventional entrepreneur: The inability to secure sufficient returns and/or to realise sufficient profit leads to a termination of the venture. The second form of failure is more interesting as it is a distinct feature of social enterprises. Indeed, a social venture may not succeed to fulfill its aspired mission, even when it is economically successful. A major reason for this may lie in imperfect markets, which may lack transparency or suffer from bounded rationality, for example. Both economic and/or social failure may be largely caused by the market participants' imperfect information. When a market evolves, participants are not (entirely) able to plan and conduct their actions with perfect forethought; they are – at least partially – “blind” to the outcomes and impacts of their actions (Campbell, 1974). This suggests that the social entrepreneur may err on the perceived problem, on the way a problem has to be mitigated, and on the consequences of impact on the target group. He or she may fail to accomplish their desired goals. The chosen perspective on social entrepreneurship avoids limiting analysis to successful entrepreneurs.<sup>25</sup> A final advantage of the perspective is a possible deviance of (sustainable) success and venture survival (see e.g. Santos, 2009). Like conventional entrepreneurship the view proposed here stresses the act entrepreneurship and the incurred effects. It is hence not necessary for a social enterprise to remain on the market forever or be sustainable for a long time. What is important is the impact of economic entrepreneurial action on social welfare, i.e., the creation of a new or changed system structure.

It is suggested that social entrepreneurship may also be analysed on a more aggregated level. In that case, the outcomes of social entrepreneurship are observed. This approach is based upon Santos' (2009) idea of a holistic value concept. Santos states that the domain of social entrepreneurship lies in value creation processes where value appropriation by the creator – or his or her shareholders respectively – is difficult or impossible. Linking to the approach described above, on an aggregate level, social entrepreneurship occurs when

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<sup>25</sup> A normative theory for successful social entrepreneurship is of course still useful to the individual and a worthy pursuit. However we would suggest that such a theory would also profit from analyzing failed efforts (Dacin et al. 2010).

activities improve total welfare, meaning that *Pareto-superior* effects occur. Taking a market perspective, this may be observed when social entrepreneurship adds resources (in whichever form) to the market without appropriating – or being able to appropriate for that matter – those additional resources. For example, business models that improve the human capital basis of an economy by training the poor and disadvantaged fall into this category, as do ventures that broaden the capital basis without appropriating this surplus.

A further matter to discuss is the relationship between government intervention, social entrepreneurship and the market system. It is often proposed that the government should intervene where market operations lead to misallocation or unwanted externalities. However, the state is sometimes unable to address specific problems through lack of money, insight, and/or interest, etc. (Santos, 2009). One may thus assume that the simple inability of a government to detect every social gap or deficit could result in need social entrepreneurship and hence be a triggering factor. Here, the Hayekian perspective concerning the advantages of dispersed knowledge in a market based economy comes into bearing (Hayek, 1945). It is the closer proximity of the (local) entrepreneur that allows him or her to act upon a perceived social drawback through entrepreneurial activity. In other cases the state may refrain from action if it does not consider the topics to be of high relevance or fears that addressing them would result in even further problems. A social entrepreneur's deviating perception of the same case may lead to entrepreneurial activities. This is clearly the realm of the Schumpeterian social entrepreneur. And again, it is irrelevant which of the actors is correct. What matters for the social entrepreneur in the market system is that she or he utilizes this system to alleviate a situation that is perceived as socially negative.

### 11.3 The Socio-Institutional Context of Social Entrepreneurship

As described above, outputs of a social enterprise address social drawbacks or problems, meaning that “the purpose of the social enterprise extends beyond simply revenue generation or profit maximization to include producing goods and services in response to the needs of a community” (Di Domenico et al., 2010, p. 682). Such problems may impair socially-excluded groups of society such as the poor, disabled, discriminated or long-term unemployed (Seelos et al., 2005). Social entrepreneurship fills the gap left by societal institutions failing to address the issues, e.g., state failures to provide welfare to these groups (Aiken, 2006; Bovaird, 2006). Social entrepreneurship thus seems to engage in activities “to provide goods and services..., to develop skills, to create employment, and to foster pathways to integrate socially excluded people...which the market or public sector is either unwilling or unable to provide” (Nicholls, 2006, p.14). This begs the question as to which role the activities of social entrepreneurs have within the market system which, in the above quote, appears to encapsulate first and foremost commercial business activity.

This section argues that it is essential to take a perspective on *the market system* in terms of its *social, cultural, and regulatory embeddedness*, and that it is in this broader context of market economies where the social enterprise has its place in creating social values with economic means (cf. Dart, 2004 for this broad context of social entrepreneurship and Granovetter, 1985 for the general socio-cultural embeddedness of economic action). Within the market system and its wider social environment we address:

- the demand for legitimacy of social enterprises to be able to gain acceptance and obtain resources from societal stakeholders for their activities (11.3.1)
- the perceived scope for social entrepreneurship in market economies and the challenge of scaling novel solutions to social problems by social entrepreneurs (11.3.2).

### 11.3.1 The Legitimacy of Social Enterprises

In an economic market system the *efficient allocation of resources in face of scarcity* is a pivotal mechanism to produce wealth, for example by supplying needed goods and services to society. And social entrepreneurship has implications on the economic market system particularly through “allocating resources to neglected societal problems” (Santos, 2009, p. 2; Mair and Marti, 2006). However, the Schumpeterian combination of resources (see above) to solve social problems in novel ways will – like any entrepreneurial endeavour – require to obtain these resources from society in the first place (Brush et al., 2001); in particular, for social enterprises to acquire the resources to roll out and scale their social goods and services to other geographies will require them to validate their business models (Santos, 2009). And often on this path social entrepreneurs may face unfavourable normative and regulatory environments for creating social and economic value under resource scarcity (Di Domenico et al., 2010) as external stakeholders will require efforts to be convinced to offer support (Desa, 2011; Dacin et al., 2010).

The *imperative for gaining as well as maintaining acceptance and legitimacy* stem from a number of aspects associated with emerging and young social enterprises: the requirement to assemble and employ external resources to establish and develop the enterprise, the need for acceptance to acquire these resources in face of uncertain future performance of the venture and the request for conforming to societal norms and institutions (for an overview of the legitimacy of social entrepreneurship see Dart, 2004 and Nicholls, 2010):

- First of all, legitimacy will be required in order to attract resources from society (and the market system within it) in competition to alternative uses of resources. In this respect Parsons (1960, pp. 175) clarified that “the utilization of resources from a larger social system, that could be allocated elsewhere, must be accepted as legitimate by members of that larger system”.
- In social as well as in general entrepreneurship obtaining acceptance is critical because of concerns about future performance of new entrepreneurial organizations (Brush et al., 2001), in particular when the products and services offered are novel (for example social innovation). The demand for legitimacy in entrepreneurship exists because of the



risk of failing to achieve the desired social and economic outcomes (for the issue of social entrepreneurial failure also see Massarsky and Beinhacker, 2002). Social entrepreneurs may feel “resource-based pressures to extant sector- or society-level normative frames of reference in order to survive and prosper” (Nicholls, 2010, pp. 613). For example, consider the introduction of micro-lending in Bangladesh and the offers of micro-loans from the Grameen Bank. They were faced with (and perhaps there still are) questions about the general efficiency and impact of microfinance and, even put unintended pressure of the communities on the women obtaining loans, contradicting the idea of empowering them (Phills et al., 2008). Apparently, the initial loans were not in line with local culture and norms, resulting in adverse effects that had to be remedied over time by adjusting the loan packages.

- The need for entrepreneurs and organizations to demonstrate institutional conformity will be stakeholder- and domain-specific (Suchman, 1995) and there may be social as well as economic demands regarding both the accountability of social entrepreneurs as well as social enterprises as emergent organizations (Nicholls and Cho, 2006). Members of society may only want to offer resources like money or their work (be it as employees or volunteers) if they value the social vision and goals of the enterprise. Moreover, there may be questions about the accountability of social entrepreneurs and the quality of products and service. In particular, it has to be kept in mind that social entrepreneurs will not be the only suppliers. Namely, the goods offered by social entrepreneurs may also be provided alternatively by the state or regular for-profit businesses. In this respect, the business model of social entrepreneurs competes with alternative modes of supply (Zahra et al., 2009). Economically, in view of competing forms of goods’ supply social entrepreneurs may need to address concerns about the “efficiency of the allocation process they use in creating the public good” (ibid., p.12). In their pursuit to create economic and social wealth, social enterprises need acceptance to acquire resource support in competition to state welfare production and traditional for-profit business models. Section 3.2 below will sketch out the room for and purpose of social entrepreneurship in a market economy in the context of other forms of supply of goods and services. Before this, the remainder of this section will develop a differentiated understanding of organizational legitimacy of social enterprises. In particular, different forms of legitimacy will be addressed.

Within organizational sociology and institutional theory *organizational legitimacy* has been defined as “a generalized perception or assumption that the actions of an entity are socially desirable, proper or appropriate within some socially constructed system of norms, value, beliefs and definitions” (Suchman, 1995, p. 574). The legitimacy of new enterprises rests in the views of society based on existing societal normative rules and thus “ultimately exists in the eye of the beholder” (Zimmerman and Zeitz, 2002, p. 415). In other words, it will be society members themselves who hold beliefs and views about a new enterprise organization as to whether it is useful and proper. For example, a social enterprise that offers elementary education to the young may be considered as valuable and legitimate because the state does not provide that education in an adequate manner. Even though legitimacy constitutes a generalized perception across audiences, there are different dimensions and *forms*

of *legitimacy* social enterprises may establish. As depicted in table 1 below, there are different categorisations based on regulatory, normative, and cognitive frames of reference. This chapter follows the seminal differentiation in Suchman (1995), which is the most widely used in sociology and economics, distinguishing between the *cognitive, pragmatic, and moral legitimacy* of organizations. The latter forms of legitimacy are more evaluative while the former, i.e. cognitive acceptance, refers to the comprehensibility and taken-for-grantedness of an organization in society. *Cognitive legitimacy* is important primarily in the early stages of a social enterprise which offers novel products or services to cater for social needs which may be difficult to grasp in the first place. Consider the example of “Dialogue in the Dark” founded in 1988 by the (later) Ashoka Fellow Andreas Heinecke (see the case in this book) or the early days of micro-lending. Today, these concepts and the social ideas behind them are universally known, but in the beginning it might have been not so clear what these concepts actually are and how they function to address neglected social needs (i.e., suffering from an initial liability of newness; originally Stinchcombe, 1965, in contemporary entrepreneurship and non-profit organizations see, e.g., Hager et al., 2004). In addition to merely achieving comprehensibility of what they do and offer, social enterprises will also need to be evaluated positively in terms of the immediate interests of their potential stakeholders and in consonance with the social, regulatory and cultural norms of the societies they operate in.

**Table 11.1** Forms of Legitimacy of Social Enterprises

Source	Forms of Legitimacy
Scott (2001)	<i>normative legitimacy</i> : compliance with relevant social expectations <i>regulative legitimacy</i> : conformance with legal rules
Aldrich (1999); Aldrich & Martinez (2003)	<i>socio-political legitimacy</i> : moral conformity with cultural norms and values; regulatory conformance with governmental rules and regulations
Suchman (1995)	<i>pragmatic legitimacy</i> : evaluation of resource efficiency and organizational incentives by direct stakeholders; <i>moral legitimacy</i> : normative evaluation of organizational characteristics and activities <i>cognitive legitimacy</i> : comprehensibility and taken-for-grantedness of organizational features

Own table

*Pragmatic legitimacy* reflects the support of an organization and its actions based on their “expected value to a particular set of constituents” (Suchman, 1995, p. 578) like the state, customers, investors, and employees as immediate stakeholders. In other words it is exchange-based in that pragmatic acceptance “denotes an attribution of social acceptability by stakeholder groups if an activity provides them with anything of value” (Dart, 2004, p. 417). For example, a state institution or foundation might value the initiative of a social enter-

prise because it caters for social problems and groups of society in an innovative way, which would otherwise have to be supported by state aid (*ibid.*). Or consider investors and sponsors of a social enterprise, who – though not striving for maximum return – may still demand for cost recovery or benefits like public attention and publicity. Because of the expectations to receive something in exchange for any support offered, pragmatic acceptance may be fairly fragile (Dart, 2004), in particular when social enterprises fail to produce desired social (and economic) outcomes.

In contrast, *moral legitimacy* is more sociotropic by evaluating the appropriateness of organizational characteristics and actions relative to the norm and value systems of groups of society (Suchman, 1995). This dimension of legitimating an entrepreneurial organization seems easier to achieve for social enterprises because of their focus to achieve the public good. However, as noted by Zahra et al. (2009) social enterprises still need to be considered appropriate in the light of existing public instruments and institutions of social policy-making. With regard to this, Dart (2004, p. 419) supposes that “*given our contemporary social fascination with market-based solutions and mechanisms, social enterprise is likely to both retain and expand its moral legitimacy*” [emphasis added]. From 2004 onwards, the world has evolved in ways which may both moderate and emphasize this prognosis regarding the role of social enterprises in the market system. For example, the recent financial crisis has made people less inclined to bank on market-based solutions to address problems and needs of society. And at the same time the crisis has put substantial pressures on public budgets to continuously fund areas like social security, health care, and education. Overall, this makes alternative modes like social entrepreneurship look more acceptable and welcome by society as social entrepreneurs offer goods in addition to supply by the state and private commercial enterprises. This will be discussed further in the next section (11.3.2).

It is not necessary to go into detail on how social entrepreneurs may go about their legitimizing action to establish their social enterprise and attract resources. It is, however, useful to understand that there are two strands of theory in this regard:

- the *institutional view* which considers legitimacy to be conferred by external members of society and
- an *agency perspective* regarding legitimacy as something to be actively acquired and achieved by organizations (cf. Scott 2001; Dart 2004; Nicholls 2010; Desa 2011).

In the prior view, the legitimating options (Suchman, 1995) need to *conform* to external institutional demands to win support. The latter perspective embraces activities of organizations and entrepreneurs to build legitimacy, e.g., through public relations. They aim at generating organizational legitimating capital and *manipulating* the views society holds about them. Also, social enterprises may actively build relationships and refer to industry legitimacy capital together with other social entrepreneurs and players (see Lounsbury and Glynn, 2001 for these sources of domain-level capital (industry, individual firm) in cultural and social entrepreneurship). For example, in the domain of social entrepreneurship, institutions like the Skoll foundation, fellowship organizations like Ashoka, the Schwab foundation or others, as well as sector-conferences, publications, media events, and competitions

have raised awareness and acceptance of social entrepreneurs and entrepreneurship in the public over the last two decades (more examples may be found in Nicholls, 2010 discussing the legitimacy of the entire field of social entrepreneurship in depth).

A final legitimising option of interest when striving for the dual creation of social and economic value, is the *selection* of specific groups or constituents of society for their support. Here, entrepreneurs turn to those stakeholders which value the offers of the organization. For example, to raise funding, a social enterprise may specifically turn to philanthropic investors instead of commercial investors or banks, because these financiers value the social benefits created by the enterprise (for the range of potential social financiers see chapter 8). Or in the area of personnel, social entrepreneurs may seek volunteers who are committed to the social vision of the organization instead of hiring paid employees.

The resource base of social entrepreneurs is specific and they may not get access to the full scale of resources a market economy has on offer (e.g., in terms of funding sources). Here, social entrepreneurs often make do with those they can persuade, and also improvise with the resources at hand, acting as *bricolageurs* (Zahra et al., 2009; also see the study of Di Domenico et al., 2010 exploring the resource acquisition and management of social enterprises in practice). Compared to commercial entrepreneurship, potential differences in resource composition and access stem from the unique mode of *value creation* and *value appropriation* in social enterprises. In particular their high level of external social value creation but (relatively) low scope for value appropriation might make it more difficult to establish and grow social enterprises. In particular, this may be in terms of finding employees and financial investors who are attracted by salaries and economic returns. It will be difficult for social enterprises to appropriate such returns and, in turn, to offer appropriated proceeds to employees and investors as immediate stakeholders in exchange for their pragmatic support (Santos, 2009, p. 20). These specific forms of *initial legitimising and resource acquisition* and the *process of value generation and distribution through resource allocation* offer a lens for defining the scope for social entrepreneurship in the market system.

### 11.3.2 The Scope for Social Entrepreneurship in the Market Economy

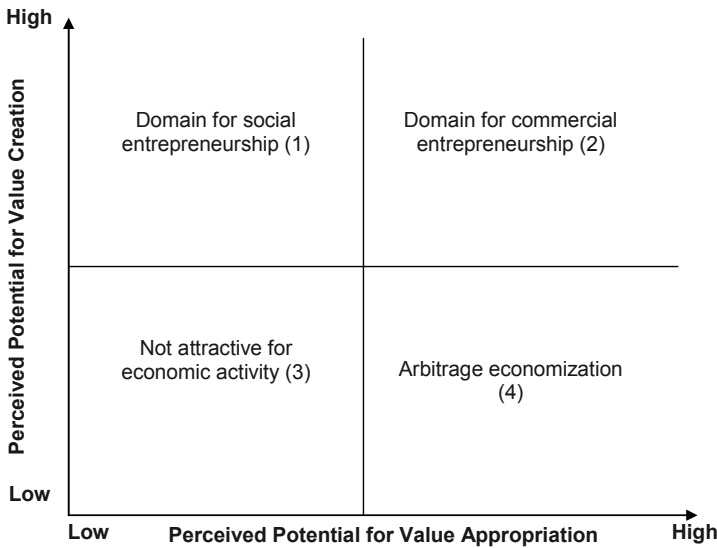
To derive the possible function of social entrepreneurship in a market system which also includes commercial business and state action requires

- differentiating between economic *value creation and value appropriation* and
- discussing events of *market (and state) failure* in producing societal wealth as an opportunity for social enterprises to step in and remedy such failures.

First of all, we follow a holistic notion of value creation (as in Santos, 2009). In this sense value creation constitutes an increase in the aggregate utility of societal actors' individual utility functions. In consonance with the above, this encapsulates both economic *and* social value generation (rather than defining a dichotomy or trade-off between the two). In this sense, economic action increases societal wealth. However, when defining the role of social entrepreneurs in the market place it is useful to concentrate on economic value.

While there does not need to be a dichotomy between final economic and social value creation, a differentiation between the *creation and appropriation of economic value* is critical in understanding what different market actors are able to supply in terms of goods and services to society. Appropriation reflects the share of the created economic value that the enterprise is able to capture for itself, e.g., as a financial return. The extent of value appropriation and creation will vary across different areas of the overall supply of goods and services. This heterogeneity in creating and appropriating value brings about different types of market actions in the market system with social entrepreneurship among them (Figure 11.1; adapted from Santos, 2009):

**Figure 11.1** Economic Value Distribution and Market Activities



Own illustration based on Santos (2009)

The traditional domain for commercial entrepreneurship and business activity in the market place is in areas where there is substantial value creation (as reflected by corresponding consumer demand) and where this value can be appropriated by the business and returned to its owners, for example in markets for consumer products like sportswear or electronics (2). Here, for-profit entrepreneurial businesses will grow and market incentives will drive efficient supply. In contrast, areas with few opportunities for value creation and appropriation are unlikely to attract economic activity (3). And domains with little potential for value creation but high chances for value appropriation may attract speculators seeking arbitrage opportunities which get eliminated over time or are ruled out by state legislation (4); examples are benefits from price inefficiencies in financial markets or profits from negative externalities like environmentally-harmful industrial activities.

Overall, from the viewpoint of society the market functions to supply products and services for private consumers and paying customers. However, there will also be services and products which are in high demand by society – and which would produce substantial societal value – but will be undersupplied by commercial market participants because they perceive a low potential for value appropriation and profit generation through regular business activity (1). In particular, in such situations it will be difficult for business to acquire resources from resource owners who expect an economic return to the production of such goods and services (e.g., financial or strategic investors). The role which social entrepreneurship plays can be defined when addressing why the commercial market may fail to make sufficient offers in this context.

The *failure of markets* to allocate resources and, in turn, goods and services efficiently can have a number of reasons, e.g., non-competitiveness, asymmetric information distribution, unaccounted externalities, and public goods (e.g., Stiglitz, 1989 or, in relation to social entrepreneurship, Nicholls, 2006). In the situation in quadrant (1) above markets may not fulfil societal demand because of low potential for value appropriation. There may be an undersupply by for-profit businesses of goods that are non-rival or non-excludable in consumption (i.e., public), e.g., some environmental or information goods (Rangan et al., 2006). Note that – though not completely non-excludable or -rivalrous – goods and services in typical fields of activity of social entrepreneurs like education or health do feature partial non-exclusivity and externalities. On account of such positive externalities where others do benefit (e.g., vaccination or employability programs) full-scale value appropriation is difficult. In addition, there may also be the issue that target groups, who need a product or service, are unable to pay for it, e.g., education or health services (Santos, 2009). It is in these areas where substantial societal values may be generated – but the low ability of appropriation hampers traditional commercial supply – that social entrepreneurs can unfold their activities. Due to their primary focus on generating social value they are able to internalise positive externalities when creating the public good. However, the *government* could also try to foster the internalisation of such externalities in the rationale of for-profit economic agents in sectors like education or healthcare. This may be done for example by offering monetary incentives for businesses so as to stimulate service offers to social target groups who cannot afford to pay for themselves (e.g. through subsidies or a voucher-program). Alternatively, the state could even provide goods and services. However, sometimes the state neither offers incentives for business nor provides goods itself. This may be due funding or other resource constraints, or conflicts with other duties and priorities on the political agenda (Santos, 2009; Dart, 2004; for a broader discussion of government failure versus market failure see, e.g., Winston, 2006).

Having described supply-side gaps by commercial market agents as well as the state, the function of social entrepreneurship in a modern market economy can finally be appreciated in terms of (a) *additional supply*, (b) *innovation* and (c) *welfare extension*.

(a) As described above, in a market economy, social entrepreneurship can produce goods or services to society and create additional value in areas of undersupply by commercial businesses or state (closing the gap in quadrant (1) in figure 1 above). The unwillingness or inability of business and governmental actors to supply may stem from perceived limits for value appropriation (in case of the former) and scarce public resources to tackle neglected externalities (Santos, 2009) (in case of the latter).

(b) However, there is more to the role of social entrepreneurship than merely supplying goods or services. As businesses and state lack activity to address societal needs in some areas, social entrepreneurs take on an innovation function in exploring novel solutions to unmet social needs. Whether social enterprises perform this function efficiently and whether there will be demand for their offers is evaluated by societal resource owners and consumers as described in the discussion of the imperative for legitimacy (cf. 3.1). Note that this is a form of entrepreneurial hypothesis-testing (Kerber, 1997) where social entrepreneurs take on risks and could fail as introduced above. Put it another way, social entrepreneurs will try out whether their new products and services will be valued and demanded by society. This exploration and innovation function is particularly important since state offers to fulfill education, health care and other needs of society will be suboptimal in face of imperfect government knowledge. To propel such innovation by social entrepreneurs at the market level, the state may take on an instrumental support function towards social entrepreneurship in two ways: first, providing a facilitating legislative framework to innovating social entrepreneurs and second, relieving information asymmetries and generating economies of scale.

Flanking social entrepreneurial activities by providing an institutional framework is instrumental because of the need for legitimacy of innovating social entrepreneurs. A good example reported in Santos (2009) is the French social enterprise Unis-Cité. It offers opportunities to the French youth to engage in social projects as a civic service. These opportunities help young people from diverse cultural backgrounds to develop skills and knowledge relevant to the French labour market which suffers from considerable youth unemployment and integration problems. The government started to support the Unis-Cité initiative after the youth revolts in France in 2006, offering a legal basis for this volunteer social work as well as providing substantial funding. This support catalysed the growth of Unis-Cité considerably and fostered the nation-wide roll out beyond small-scale pilot and follow-up projects. Beyond the provision of supportive legislative frameworks by the government, social entrepreneurs themselves may even contribute to alleviate problems arising from (initially) weak institutional frameworks, e.g., in terms of property rights or capital market institutionalisation in the case of micro-lending in developing economies (De Soto, 2000). It may even be that legislation evolves around the positive externalities addressed by social pioneers as institutional entrepreneurs. Government policy-makers can also help to alleviate information asymmetries and resource shortages particularly in novel areas of social entrepreneurship. For example, public institutions can play a role in initiating networks or establishing foundations in the field of social entrepreneurship (see Nicholls, 2010, who discusses a range of governmental contributions to building and legitimating the field). In addition to enabling reciprocal information and resource exchange under the roof of social

foundations or programs, the government itself can provide financial resource support. This can aim at assisting social enterprises in reaching a threshold size or in scaling the geographical presence of their projects. Often, government action will take the form of public-private partnerships. This kind of state intervention to promote entrepreneurship ideally concentrates on cases of market failure, e.g., cases of neglected positive externalities or information asymmetries (cf. Grünhagen, Koch and Saßmannshausen, 2005).

(c) As discussed in section 2. above, social entrepreneurship has a particularly important function when providing Pareto-superior effects in terms of improved overall resource efficiency and welfare. Often, social entrepreneurs will be active in areas where they improve health care, develop skills of people and create employment, or they establish paths to integrate socially-excluded groups of society (cf. Nicholls, 2006); examples are “Dialogue in the Dark” or the case of “CDI Committee for Democracy in Information Technology” in section 4. below. In these to cases the social and economic action of the entrepreneurs particularly helps to add human capital to the production function of economies and create additional wealth. In general, however, there are many ways in which social entrepreneurs can be instrumental in generating welfare. Whether a social entrepreneur identified an efficient way to do so will be evaluated and legitimated by societal resource holders themselves. One example of a social entrepreneur who has sensed social demand from excluded groups of society for a new service is the case of Rodrigo Baggio and his Committee for Democracy in Information Technology (CDI). The mini-case shows how a social enterprise has introduced social service innovation, in this case IT education and access, to a market where other actors – at least initially – did not fulfill demand. At the same time, the case leads to a discussion from a market perspective on what roles CDI as a social enterprise, commercial businesses, and the government may be tasked with.



## 11.4 Case Study

### **Baggio and the Committee for Democracy in Information Technology (CDI)**

Around the world computers and the internet are used every second of the day – but not by everybody on the planet.<sup>26</sup> In what is often coined the “digital divide”, there are people who are excluded from the use of information and communication technology, both in developing economies as well as in developed economies, for example immigrants, the disabled and the poor. The Committee for Democracy in Information Technology – CDI – is a social enterprise striving to help and serve such social groups, in particular young people, and their demand for IT infrastructure and skills – but there is more to it. It all began in 1995 when Rodrigo Baggio, a Brazilian IT consultant, founded the first Information Technology and Citizen Rights School of CDI in the Santa Marta favela of Rio de Janeiro. Rodrigo Baggio envisioned the heart of CDI to be in empowering people to become active citizens in their communities through information and communication technology: “One must believe in the power of communities to transform their social reality by mastering new information and communication technologies.” CDI not only provides computer and communication infrastructure, but makes long-lasting efforts to educate and support people in their life.

Since the mission of CDI is not about IT alone, the CDI schools or community centres take steps towards the social inclusion of low-income communities. Correspondingly, every new CDI school is build around solving challenges and developing entrepreneurial ideas in one’s community through information technology, for example by offering a free or low-cost internet access through an internet café or planning a PR campaign against child abuse in the community. As school students develop new competences around IT and communication technologies they engage in economic and entrepreneurial activities, address pressing social problems, and increase their own employability. With CDI providing the computer and other hard- and software, the local community is taken further on board, running and administering the school and providing school buildings and facilities. In its education mission CDI follows a train-the-teacher concept, closely collaborating with local volunteers and educators from the community. The students of the schools take a course to develop computer and software skills and work on a community project at the same time. Today, CDI has a budget of more than 5 million USD per year. Funding is a mix of small, symbolic course fees to pay the teachers and donations from “maintainers” and “supporters” that make contributions in money or materials. Overall, CDI taps multiple funding sources, aiming to include public support and partnering with other foundations which help specific disadvantaged groups like disabled and chronically ill people, prisoners and drug addicts.

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<sup>26</sup> This mini-case has been prepared for class discussion of CDI from an economics perspective. It is not intended to prefer a specific form of supply of IT education to other forms such as public education policy. For preparing the case the authors have used material from earlier works, in particular the CDI cases written by J. Mair and C. Seelos at IESE and O. Kayser and F. Santos at INSEAD, which, however, focus more on issues of the entrepreneurial management of CDI’s expansion. See <http://cdiglobal.org/>.

When establishing the first school, Baggio received requests from other communities inquiring about the concept as well as donations of computers from businesses. Building on the success of opening the first school, he chose a social franchise concept to grow and establish more schools throughout Brazil and, later, internationally. Local communities send proposals for new schools to CDI, making suggestions what kind of community work may be facilitated by information technology. CDI then co-operates with the community in training (both technical and educational), fund raising, and in the formation of a new school. Over time, CDI has established a network of more than 700 information technology and citizen rights schools, operating across Brazil and in several Latin American countries. CDI has created a range of direct and indirect impacts on society, both socially and economically (see the impact section on CDI's global website: <http://cdiglobal.org/>). For example, more than 50,000 students have graduated from the schools, increasing their chances for employment. Moreover, many school teachers and educators have been trained, community projects have been developed, and many communities got access to computers and the internet.

As often is the case with successful pioneering entrepreneurs, the success of Baggio and CDI as a social enterprise also attracted attention and competition in Brazil. In particular, the Brazilian government initiated its own policies to fight digital exclusion among poor people in the first decade of the new millennium. This initiative may have developed because Baggio himself raised awareness towards the drawbacks of the digital divide for the Brazilian society. Most prominently, thousands of computer centres (so called "Telecentros Comunitarios") have been established with public funds. The telecentros offer computer and peripheral equipment free to use, for example to search the internet or to write and print documents, as well as IT training courses similar to CDI. In addition, commercial internet cafes and computer businesses now target low-income households which cannot afford a personal computer at home. While not building computer skills and developing community projects in the way CDI does, these businesses still supply competitive computer and internet access at low cost. The fact, that now both the government and private businesses have entered into the supply function, poses interesting questions with regard to the future role CDI may play as a social enterprise in the market segment of IT training and access provision for low-income households.

**Questions:**

1. Consult the impact section of CDI's website at <http://cdiglobal.org/> and discuss the positive externalities and values created by Rodrigo Baggio and his social enterprise. Try to develop a concept as to how the direct and indirect impact created by CDI may be accounted for. In how far is it difficult for commercial for-profit businesses to create this value and impact on individuals and communities?
2. Sketch out the innovator role played by Rodrigo Baggio and find examples of other social entrepreneurs and their function in addressing social needs in a novel way. How did the government react in these examples?
3. Becoming aware of the problem of digital exclusion in Brazil, the government developed its own policy program to provide low-income and rural households with computer access and IT education through public sources. Do you think that there may be negative crowding-out effect on social and commercial entrepreneurs from the private sector? What could have been alternative paths for the government to combat digital exclusion?
4. Rodrigo Baggio scaled his social entrepreneurial idea through a bottom-up franchise concept. What would have been alternative ways to grow CDI? In the development of alternative expansion concepts, also consider the challenges and approaches to gaining organizational legitimacy for CDI. While demands for moral acceptance may be less difficult to meet, how can pragmatic legitimacy be build in terms of portraying an efficient use of donated money and computers?

## 11.5 Further Reading

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