12 The Impact of Social Entrepreneurship on Societies

Markus Beckmann

Leuphana University of Lüneburg
Centre for Sustainability Management

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

- Distinguish between an organizational and a societal perspective on social entrepreneurship and social business.
- Discuss social entrepreneurship as an alternative instrument for solving social problems and addressing social needs.
- Explain the difference between a static and a dynamic perspective on impact.
- Compare the contribution of social entrepreneurship with the potential of charitable NGOs and aid, for-profit companies, and government provision.
- Describe the conditions under which governments, aid, and for-profit markets can best deliver static impact.
- Explain the dynamic impact of social entrepreneurship for systemic learning.

C. K. Volkmann (Eds.) et al., *Social Entrepreneurship and Social Business,*
DOI 10.1007/978-3-8349-7093-0_12, © Gabler Verlag | Springer Fachmedien Wiesbaden 2012

12.1 Introduction

Social entrepreneurship has created high expectations. It is welcomed as a new approach to overcoming poverty and social exclusion in the developing world (Seelos and Mair, 2005). It is heralded as a new mechanism for solving social ills and satisfying human and ecological needs in the developed world (Mawson, 2008). And, indeed, there are impressive examples of how social entrepreneurs around the world have come up with innovative and far-reaching solutions to hitherto unmet social and ecological challenges (Bornstein, 2004; Elkington and Hartigan, 2008). For many, social entrepreneurship promises a new "hope for sustainable development" (Seelos and Mair, 2009). Others argue that social entrepreneurship and the concept of social business hold the key to building a new kind of capitalism (Yunus, 2007; 2010).

It is not hard to see how individual social entrepreneurs have created considerable social change in their specific fields, but questions remain as to the overall impact that social entrepreneurship can have on entire economies and societies. What is different about social entrepreneurship compared to other approaches like charitable NGOs, markets, or public government provision? What is it that social entrepreneurship can offer for developing countries and for the future development of capitalism? In short, how does social entrepreneurship impact economies?

To answer these questions, this chapter takes two perspectives on the impact of social entrepreneurship. The first one is a *static* perspective. Seen from this viewpoint, the impact of social entrepreneurship has to do with the solutions, goods, and services that social entrepreneurs themselves deliver at a given point in time. The second perspective is a *dynamic* one. From this vantage point, impact is viewed in light of how social entrepreneurs change their environment so that not only they but also other actors begin to provide solutions and offer much needed goods and services. Static impact is, in other words, about efficiency; dynamic impact focuses on innovation.

Distinguishing between static and dynamic impact allows delineating more rigorously the systematic role and relevance of social entrepreneurship. Social entrepreneurship, according to the central argument developed here, is important both for its static *and* its dynamic impact. Systematically, however, it is particularly the dynamic impact that defines the contribution of social entrepreneurship. Social entrepreneurs are change agents who institute new patterns of value creation that other actors may adopt, ultimately realizing an even higher static impact. The impact of social entrepreneurship is thus, above all, a transformative one.

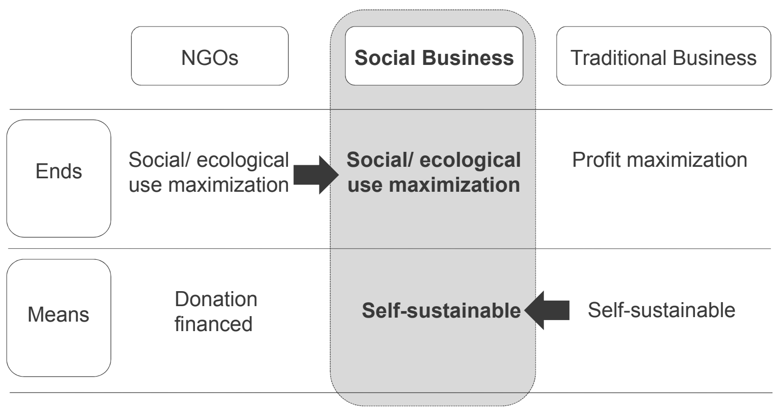
This argument will be developed in five steps. Section 12.2 highlights the need to take a societal perspective when talking about impact. Section 12.3 compares the static impact potential of social entrepreneurship with that of charitable NGOs, for-profit companies, and government provision. By analogy, Section 12.4 develops such a comparison with regard to dynamic impact. Section 12.5 offers a short conclusion, followed by a case study in Section 12.6.

12.2 A Societal Perspective on Impact

In his controversial essay, Milton Friedman (1970) argued that the "social responsibility of business is to increase its profits." According to this perspective, the purpose of business is to maximize profits. In contrast, social entrepreneurship and social business are defined as ventures intended not to maximize profits but social impact. Consequently, the position of social business proponents such as Nobel laureate Muhammad Yunus might be stated as the "social responsibility of business is to address social needs."[27]

These two positions appear to be radically different, at least at first glance, and this difference is sometimes used as a key argument in support of the idea that social business entrepreneurship is in a superior position to achieve social impact. In their presentations on the concept of social business, the Grameen group illustrates this point as shown in **Figure 12.1**. Building on the distinction between ends and means, **Figure 12.1** provides a useful starting point for comparing charitable non-governmental organizations (NGOs), traditional for-profit companies, and the social business approach.[28]

Figure 12.1 The Means and Ends of NGOs, Social Business, and Traditional Business



Own illustration based on Grameen Creative Lab (2010)

---

27 The Grameen Creative Lab, a think tank of the Grameen social business group, puts it this way: "Unlike traditional business, social business operates for the benefit of addressing social needs that enable societies to function more efficiently." See "The Social Business Concept" at http://www.grameencreativelab.com/a-concept-to-eradicate-poverty/the-concept.html. accessed date: 01/11/2011.

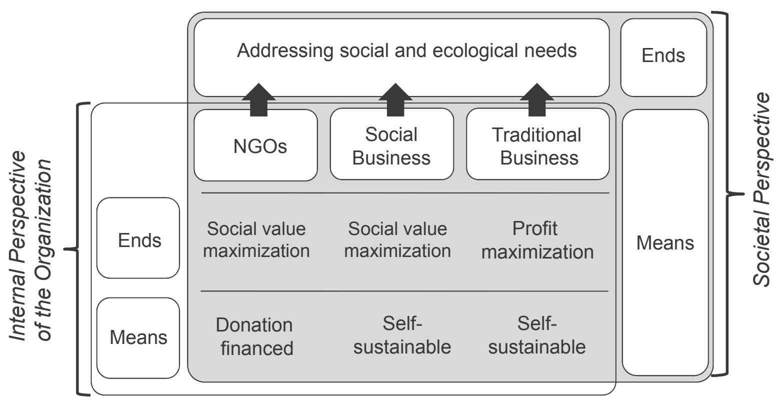
28 The concepts of social business and social entrepreneurship are not exact equivalents, of course, but for the sake of brevity, they will be treated as synonymous here because both have a social mission and both typically try to achieve financial sustainability in the long term.

According to Grameen, social business combines the best of both worlds: it not only seeks to maximize social impact like an NGO; it is also financially self-sustainable like a for-profit company and thus independent of donations. As a result, it links the social ends of NGOs with the means of business and is thus able to have far greater impact than either on their own.

The Grameen illustration helps point out the differences regarding means and ends for NGOs, social enterprises, and for-profit companies, but it is less helpful in assessing the potential and actual impact of these different approaches as it is a purely *internal* perspective of the organizations. Yet, when talking about societal impact, the relevant perspective is a societal one. **Figure 12.2** clarifies this difference.

Looking at things from a societal perspective makes it possible to reconcile the seeming contradiction between the Friedman and Yunus positions. Yunus takes an organizational perspective and then suggests defining a social purpose directly as the organizational end. Friedman takes a societal perspective and argues that the profit-motive as an organizational end can be a powerful means for indirectly achieving diverse societal needs.[29] Thus, Yunus and Friedman are arguing at two different levels (**Figure 12.2**). Yunus highlights the *differences* between NGOs, social business, and for-profit companies; the societal perspective emphasizes a very important *commonality* in that each of the three organizational forms can be an instrument for addressing social needs. When looking at the issue of impact, NGOs, social enterprises, and for-profit companies are thus not competing ends but alternative means for meeting manifold social needs.

Figure 12.2 A Societal Perspective on Means and Ends



Own illustration

[29] Friedman (2005) makes this explicit when he states: "Maximizing profit is an end from the private point of view; it is a means from the social point of view."

A societal perspective on the issue of impact reveals two insights. First, just because a social entrepreneurship venture has a social purpose does not mean that it automatically has a stronger social impact than a comparable for-profit business. Second, just because a social enterprise actually earns money does not necessarily mean that it is a better solution to a problem than a charitable NGO financed by donations. The societal perspective highlights that each organizational approach uses a different instrument—a specific tool—for addressing societal needs. A tool, however, does not have an intrinsic impact nor is it intrinsically superior to another type of tool. What is the intrinsic impact or superiority of a hammer? The answer depends on the problem: Do you want to nail something to the wall or do you want to cut a piece of cloth? It also depends on other circumstances or conditions of use, for example, on whether you have nails or only screws. Finally, it depends on the alternatives. If you want to cut a piece of cloth, a pair of scissors is probably better than a knife; however, a knife would be superior to a hammer, if those were the only tools available.

This analogy illustrates that social entrepreneurship can be seen as a "tool" to address social needs. How powerful the impact of this tool is will depend on

- the problem to be solved,
- the conditions under which it will be used, and
- the alternatives.

The next section compares charitable NGOs, for-profit companies, government provision, and social entrepreneurship as alternative tools for addressing social needs. By looking at different problems and different boundary conditions, the discussion provides a better understanding of the potential static impact of social entrepreneurship on economies and society at large.

12.3 Static Impact and Social Entrepreneurship

In this section, the static impact of social entrepreneurship is explored by focusing on a given point in time and discovering what social entrepreneurship can contribute in different problem settings. To this end, a rough and generic overview of the potential impact of other problem-solving approaches serves as a benchmark against which to compare the specific static impact that social entrepreneurship can have. Comparing social entrepreneurship with the idealized solutions of charitable NGOs, the state, and for-profit companies, the key claim is that social entrepreneurship is often an important second-best solution in areas where first-best solutions fail.

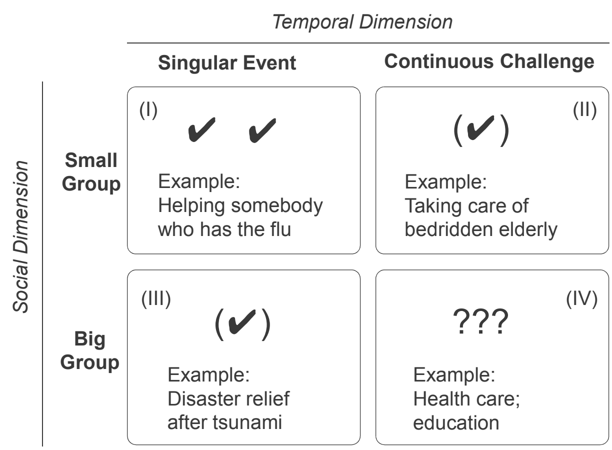
12.3.1 Static Impact of Charitable NGOs and Aid vs. Social Entrepreneurship

As illustrated by **Figure 12.1**, a major difference between traditional NGOs and social entrepreneurship is financing. Many social entrepreneurship ventures try to achieve financial sustainability over time; many NGOs rely systematically on donations. Depending on the problem context, both have certain advantages.

Donations are a fairly pure form of unilateral solidarity and altruism. The donor gives money or other inputs without receiving a material payment in return. How well does this principle work in different problem contexts?

Figure 12.3 presents a typology that illustrates under which conditions the solidarity principle can be particularly effective and where it is less so. The vertical dimension distinguishes between one-time problems that can be solved more or less at one given point in time and permanent problems that require continuous contributions. The horizontal dimension differentiates between problems that occur in small groups where people have strong face-to-face relations and problems that arise in complex and anonymous societies. This typology shows how the principle of solidarity has more potential to solve some problems than others.

Figure 12.3 The Impact of Solidarity



Own illustration inspired by a presentation by Andreas Suchanek

Box I of **Figure 12.3** illustrates a one-time problem in a small group: a friend or a neighbor who has the flu and needs help. In this situation, many people will be willing to go grocery shopping or walk the dog for a day or two. The situation in Box II, however, is more difficult. Again, someone is ill, but permanently—perhaps an elderly person who is bedridden after a stroke and needs care continuously. In a small group with strong social ties, such as a family, it might still be possible to meet this challenge, but it will grow increasingly difficult and stressful with time, and in some cases there will be no family or volunteers willing to provide long-term help. Box III looks at one-time, singular problems that affect people outside their personal world, maybe even abroad. In these exceptional cases, many people are willing to make a one-time donation. Take the example of the tsunami disaster in Indonesia or the devastating earthquake in Haiti: millions of North Americans and Europeans willingly gave billions of dollars to help. In such cases, solidarity can be a powerful motive. The situation changes, however, in Box IV. This box also contains problems that affect other people outside one's personal realm or even in faraway places, but these problems require a continuous solution. In this situation, spontaneous solidarity is rarely sustainable. Some people might be willing to give some money, but it will be hard to mobilize many people to make long-term financial commitments to people they do not know, especially when the results of their generosity will be a long time coming.

The typology in **Figure 12.3** highlights an important difference between the potential static impact of social entrepreneurship compared to that of charitable NGOs. Donation-based NGOs can be particularly powerful in the case of single-event or highly specific problems. In cases like the tsunami disaster, for example, NGOs provided the organizational infrastructure for large-scale solidarity. Without their mediation, individual donors in, say, Germany, would have found it very difficult to help the people suffering that crisis. In contrast, for that particular point in time, a social entrepreneurship venture built on a complex business model probably would not have had the same impact in terms of providing immediate short-term relief.

Compared with charitable NGOs, therefore, social entrepreneurship might have less of a static impact when it comes to providing short-term relief. Yet, this is not what the genuine domain of social entrepreneurship is about. Social entrepreneurship is about innovating self-sustainable solutions to large-scale social problems. Put differently, social entrepreneurship is about long-term solutions with the potential to have an impact on big social groups. The systematic domain of social entrepreneurship is thus found in Box IV.

Box IV of **Figure 12.3** contains problems that require a continuous, or at least long-term, solution. Consider the case of providing education or fundamental health services. Similar to the problems in Box III, an organizational infrastructure will be necessary to effectively provide these, but an organized one-time intervention such as erecting a school building or a donation-based solution that depends on outside inputs would simply be neither sufficient nor sustainable. The permanent character of such challenges requires a *systemic* solution that can be self-sustaining.

Despite some efforts by charitable NGOs to solve the sort of problems found in Box IV of **Figure 12.3**, the static delivery of systemic solutions is a domain where the relevant alternatives for social entrepreneurship are the public provision of goods and services as well as the market delivery by for-profit firms. To further assess the static impact of social entrepreneurship, the next two sections look at these alternative problem-solving arrangements.

12.3.2 Static Impact of For-Profit Companies vs. Social Entrepreneurship

As illustrated by **Figure 12.2**, for-profit firms can be instruments for addressing important social needs. Indeed, the growth of capitalist markets over the last 150 years shows that a functional institutional framework can harness the pursuit of profit and self-interest for highly desirable social results, such as innovation, new jobs, growth, and better and cheaper products and services (Baumol, 2002). In fact, under appropriate institutions, profits signal that a company has successfully created value. That is, in a functioning market system, a company can make a profit only if customers are willing to pay more for its product than it spent to produce it. Profits are then an epiphenomenon of successful value creation, a signal that the firm is giving more to society than it is taking from it. Seen this way, profits motivate companies to fulfill their raison d'être as societal actors: to organize the creation of value (Jensen, 2002). Given appropriate institutions and functioning markets, there are a number of reasons why traditional for-profit ventures can have a stronger societal impact in terms of delivering much-needed goods and services than mission-driven social entrepreneurship ventures.

First, if (and only if!) profits are an indicator of value creation, they send a strong signal as to whether a company is fulfilling its societal purpose by rewarding successful value creators and punishing those companies that realize losses, meaning that they actually destroy societal value because they consume resources of more value than what they produce. Second, from an internal firm perspective, profit expectations provide a way of deciding between alternative investments and strategies. Third, profits show investors the areas with the largest potential for value creation and thus direct scarce resources into a more valuable use. Social investors and social entrepreneurs have begun to develop methods for performance measurement, but to date these indicators are highly ambiguous and hard to understand compared to a simple profit measure.

In short, when looking at the efficiency of social entrepreneurship in achieving static impact, it might often be only a *second-best solution*. For-profit firms may very well be the first-best-solution in certain cases because they can deliver needed goods and services more efficiently, can take advantage of economies of scale, and are more sustainable financially. However, the potential superiority of profit-driven companies hinges on a number of critical conditions. If and only if markets have a perfect institutional framework with no market failure will the profit-driven invisible hand lead to the first-best solution with a necessarily stronger static impact than the visible hand of the social entrepreneur. Under such idealized conditions, there are no negative or positive externalities, property rights are perfectly defined, complete private contracts are possible and can be sanctioned by functioning institutions of the rule of law, and, finally, there is no exclusion of underprivileged groups so that everybody has free access to markets, capital, education, and legal justice.

Real life is often far from ideal, however, and in the presence of market failures or shortcomings, for-profits may fail to realize their potential as first-best solutions. In these situations, social entrepreneurship can be an important second-best solution by providing much needed goods and services that internalize externalities, by providing access for the excluded, and by creating value where for-profits cannot or do not (Santos, 2009). Compared to the real-life alternatives, social entrepreneurship is the best "tool" for the job; however, compared to ideal and properly functioning for-profit markets, social entrepreneurship remains a second-best solution.

12.3.3 Static Impact of Government Provision vs. Social Entrepreneurship

Markets are a powerful instrument for providing private goods and services, but there are important social needs that markets do not meet as well. Most importantly, markets are not very suitable for providing public goods. In economics, public goods are defined as goods that are non-rival and non-excludable. Non-rivalry means that if someone consumes a public good, it does not mean that no one else can. Non-excludability means that everyone can enjoy the good. Take the case of eradicating malaria, which is an example of both. The fact that one person benefits from this public health good does not reduce the availability of "eradication of malaria" for somebody else (non-rivalry). At the same time, it is hardly possible to exclude somebody who lives in this country from enjoying the benefits of eradicating malaria (non-excludability).

Non-rivalry and non-excludability appear to be excellent characteristics: everybody benefits from the public good and nobody can be excluded. However, the problem is that these two characteristics render the market provision of public goods difficult, if not impossible. If no one can be excluded from enjoying the benefits of a public good, nobody will be willing to pay for it. As a consequence, functioning markets for these products will not evolve.

Many of the most pressing problems in Box IV of **Figure 12.3** involve the challenge of providing such public goods, including providing communities with infrastructure, education, public health services, basic research, a functioning legal system, peace, stability, to name just a few.

The arguably most powerful instrument that societies have developed for systematically organizing the provision of such public goods is the state, its government, and related public-sector institutions.

First, the state is a powerful means of overcoming the problem of free-riding. Providing public goods for a community requires effective collective action. Only if everybody contributes their share, can the optimal level of public goods be provided. Yet, every individual has an incentive to free-ride on the contributions of others. In this situation, the state can be used to make contributions to the public good mandatory. For example, the state can tax citizens to collect those resources necessary to finance socially desirable public goods. Note that this does not necessarily mean that the state itself needs to *produce* these goods; instead, it can also regulate and finance an arrangement that delegates this task to other actors (e.g., private firms, NGOs).

Second, given functioning and efficient public bureaucracies, the state can draw on a sophisticated infrastructure that already exists and that allows realizing economies of scale and scope. Take, for example, the field of public health. Once there is an infrastructure to organize and finance the vaccination of children against, say, polio, in one place, the same publicly financed agency can take this service to many other places and can also be used to carry out other health-related services, such as vaccinations against measles or providing medical checkups.

Third, in democratic states, the citizens can hold the government accountable for its success, or lack thereof, in delivering public goods. People can vote ineffective governments out of office and let the public authorities know which public goods are actually needed. The democratic process provides feedback that directs scarce resources into their best usage from a societal perspective.

Thus, given a functioning state with efficient institutions and democratic accountability, government can have a much stronger impact in terms of providing public goods than can social entrepreneurship. Compared to a functioning state, social entrepreneurs do not have systematic means to organize collective action for an entire society, they cannot easily draw on a comparable existing and sophisticated infrastructure, and they do not necessarily have well-established feedback-mechanisms for democratic accountability.

In short, when looking at the efficiency of social entrepreneurship for delivering public goods and services at a given point in time, social entrepreneurship may well be only a *second-best solution*. Ideally, a functioning public sector has the most potential to be the first-best solution. Yet, just as in the case of for-profit markets, this potential superiority of the public sector as an instrument for providing public goods hinges on a set of demanding and critical conditions. To start with, there must be a well-functioning state, a fair and effective tax system, and no corruption. Furthermore, for democratic accountability to work as intended, the majority should not be allowed to ignore the needs of a minority, and all citizens must be well informed and have full political rights.

In many countries, not only but particularly in the developing world, these idealized conditions are far from being realized. In these situations, social entrepreneurship can be an important second-best solution. In the face of government failure, social entrepreneurs can create alternative solutions that generate awareness of unaddressed needs, organize collective action to bring together critical resources, and actually provide the much-needed goods and services. Compared to the relevant alternatives at that given point in time, this static impact of social entrepreneurship is highly important, if not critical, for the lives of many. Compared to the idealized potential of a functioning systemic public-sector solution, however, social entrepreneurship often remains a second-best solution.

12.3.4 Social Entrepreneurship as a Second-Best Solution in Terms of Static Impact

In his books on social business, Muhammad Yunus (2007, 2010) proposes a distinction between two types of social business that social entrepreneurs can build to address pressing societal needs. This distinction allows substantiating the claim made in this chapter that social entrepreneurship is an important second-best alternative to the ideal first-best solutions of for-profit markets and government provision. Yunus's social business Type I can be seen as a substitute for a functioning market solution; the Type II social business is a second-best alternative to an idealized government solution.

According to Yunus, a *Type I social business* focuses on providing a product with a specific social, ethical, or environmental goal. Profits the social business generates are then used to scale and improve delivery of this product. A prominent example is Grameen Danone, a joint venture started in 2006 in Bangladesh that distributes Shakti doi, a yogurt fortified with many of the key nutrients typically absent in the diet of children in rural communities.

The Type I social business model can be interpreted as a substitute for fully developed for-profit markets. In the Shakti doi case, there are a number of reasons why for-profit markets fail to provide products that satisfy poor people's nutritional needs, including the low purchasing power of the villagers as well as their limited knowledge about the benefits of enriched nutrition. Consequently, social entrepreneurship can have an important social impact. Grameen Danone increases nutritional quality, consequently improves children's health, and thus enhances their future chances. All good, but how does this social business solution fare from a static impact perspective? If the status quo continues, does this solution really offer the most efficient and effective impact possible? This is of course a question of relevant alternatives. Since high-quality foods are a private good, the systematic benchmark is fully developed for profit-markets. The alternative scenario is that all villagers know and appreciate the value of enriched nutrition as well as have purchasing power and thus access to these markets. Given competitive markets, a diversity of for-profit firms could then enter this market, bring in the resources to scale a systemic solution countrywide, and compete both in terms of lower prices and better quality. In the absence of such fully developed markets, however, a social business approach can provide a valuable second-best alternative.

Let us now turn to Yunus's concept of a *Type II social business*. A Type II social business does not aim to achieve impact primarily through its products. Rather, it is a profit-maximizing business that uses all its net profits to address important social needs in a local community. Profits are thus not issued as private dividends but are directed into local development activity.

A prominent example of a Type II social business is Otto Grameen, a joint venture between the German retailer Otto and the Bangladeshi Grameen group. The idea behind Otto Grameen is to establish textile factories in Bangladeshi villages that produce T-shirts and other garments for the lucrative European market. The profits of this textile company go to the

Otto Grameen Trust, which uses them to provide social services to the local poor, such as access to health care or basic education (Yunus, 2010). The idea is that, ultimately, "each Otto Grameen factory might anchor an 'Otto Grameen village' in which everyone enjoys a higher standard of living thanks to the company's presence in the community" (Yunus, 2010, p. 185).

This Type II social business model can be interpreted as a second-best alternative to a functioning government provision of public goods. As the local governments cannot provide public goods such as health care or education, Otto Grameen, as a social entrepreneurship venture, takes over and provides these services. With regard to this public good challenge, the paradigmatic benchmark is a functioning local government that provides access to education, health services, and other infrastructure. If such efficient, effective, and democratically accountable local government institutions existed, this solution could very well have a much higher social impact than that of Otto Grameen. Note the relevant alternative here: if Otto Grameen realized and issued private profits, they could be taxed by the local government and thus contribute to publicly funding the provision of social services. Yet, in the absence of such an ideal, functioning public sector, Type II social businesses like Otto Grameen may offer a much-needed and effective second-best alternative.

12.4 Dynamic Impact and Social Entrepreneurship

The previous section looked at the comparative potential of social entrepreneurship for having a static impact on society, with "static" meaning that the analysis looked at a given problem setting, treated the situation as fixed without considering potential dynamic effects changing the situation over time, and then asked about the direct impact that social entrepreneurs had on their immediate beneficiaries in that given moment.

We now shift from a static perspective to a dynamic one, focusing on how social entrepreneurship affects the dynamic evolution of how societies deal with social challenges. Instead of merely emphasizing direct effects of activities on immediate beneficiaries in a given moment, dynamic impact also involves the indirect effects that derive from changing the entire field and leading other actors to adopt new solutions over time. Static impact focuses on efficiency; dynamic impact highlights the importance of innovation.

The key claim of this section is that social entrepreneurship has often a systematic and important comparative advantage for creating a dynamic impact. To substantiate this claim, we again compare the potential of charitable NGOs, for-profit companies, and government provision to solve problems with the transformative capacity of social entrepreneurship.

12.4.1 Dynamic Impact of Charitable NGOs and Aid vs. Social Entrepreneurship

Section 12.3.1 argued that—from a static perspective—philanthropic NGOs are particularly well equipped to organize issue-specific solidarity for a relatively short time period. Of course, they can, and do, also start processes of systemic social change. In fact, many long-term aid projects are based on the idea of "helping others to help themselves" and often have an important dynamic impact on their environment.

Social entrepreneurship, however, offers a number of systematic comparative advantages when it comes to innovative and sustainable solutions to societal problems. This argument applies to the charitable NGO approach generally, but this section highlights these advantages by comparing social entrepreneurship to the more specific case of philanthropic NGOs that work as aid organizations in developing countries.

First, a scalable and systemic solution to a persistent problem requires a sustainable basis. It needs to be self-sufficient and independent in the long run. The very concept of aid, however, implies a certain degree of dependence. Development aid, in particular, tends to rely on outside inputs to solve a local problem. To be sure, transfer-based aid projects might well be able to develop a solution that is ultimately self-sustainable, but the obstacles that must be overcome to accomplish this are formidable.

In contrast, as illustrated in **Figure 12.1**, a key idea of social entrepreneurship, and social business in particular, is to aim for self-sufficiency. Social entrepreneurs seek innovative solutions or business models that mobilize the needed resources from within the system. Instead of relying on outside inputs such as aid transfers, social entrepreneurs activate and empower their constituents to contribute diverse resources that sustain the enterprise. As a result, such self-sustainable solutions are much easier to scale onto a systemic level—be it through for-profit companies copying innovative approaches to value creation or through government institutions that adopt successful social entrepreneurial solutions.

Second, innovative and transformative solutions do not just fall out of the sky; they are the result of constant processes of trial and error. These learning processes are only fully effective if they build on rich feedback to analyze what works well and what can be improved. Aid projects that hand out transfers can find it difficult to obtain such feedback. Of course, many aid organizations try to evaluate their work through feedback, but if the aid beneficiaries are receiving help completely for free, they have very little incentive to complain or make suggestions for improvement. In short, comprehensive and unbiased feedback is a rare commodity for aid organizations.

Social entrepreneurs are not immune from the problem of receiving rich feedback. In fact, measuring impact is one of the most demanding challenges faced by both social entrepreneurship researchers and practitioners. Nevertheless, the social entrepreneurship approach can draw on feedback channels that are closed to traditional aid organizations. Social entrepreneurs often manage to empower their stakeholders and integrate them into the process of value creation. In social enterprises such as Dialogue in the Dark (www.dialogue-in-the-dark.com) or Specialisterne (specialisterne.com), differently abled people, for example, the blind or autistic, contribute as valuable experts. Thus, if people provide important resources—be it a price they pay, their labor or expertise, their activism or community support—they are likely to experience a higher degree of involvement and ownership and be more willing to provide valuable feedback. The cooperation at arm's length between a social entrepreneur and its stakeholders is an important feedback channel.

Third, providing aid runs the risk of crowding out desirable systemic solutions that local governments or the market could provide. Take the case of an NGO that delivers basic health services in a developing country. If foreign aid finances these services, the local government might have fewer incentives to build a functioning health system itself. Even worse, aid transfers can create perverse incentives. If corrupt governments benefit from outside aid monies, it creates an incentive to prolong or even create crisis situations. Similarly, aid can destroy local markets. If charitable NGOs hand out, say, food for free, local farmers may be forced out of business. In all these instances, aid runs the risk of providing a short-term cure for the symptoms of a social problem while actually perpetuating or even exacerbating its causes.

Again, social entrepreneurs are not immune from these problems. However, a number of social entrepreneurship characteristics reduce the risks significantly. To start with, social entrepreneurship tries to mobilize resources within a system instead of relying primarily on outside charitable donations, which reduces the problem of corruption. Also, social entrepreneurs often seek to activate new market mechanisms, thus developing markets rather than crowding them out. In effect, they often provide the blueprint for an innovation that for-profit firms later adopt. Finally, social entrepreneurs are in a better position to induce governments to improve their performance. For example, they can provide "proof" that a new approach actually works and need not create additional costs for the public but even net savings. This claim is supported by evidence that half the social entrepreneurs supported by Ashoka report having influenced national legislation within the first five years after creating their organization (Sen, 2007).

12.4.2 Dynamic Impact of For-Profit Companies vs. Social Entrepreneurship

For-profit companies are remarkable at creating shock waves of creative destruction in the economy and in society at large. In fact, their dynamic impact on our lives is immense. Just take the pace of innovation in the fields of mobility, information technology, pharmaceuticals, or communication. Even in failed states like Somalia, poor people have an astonishing degree of access to long-distance telecommunication thanks to cell-phone technology and pre-paid billing mechanisms.

Nonetheless, there are many problems for-profit companies have failed to solve and mission-driven social entrepreneurs often have a comparative advantage for developing inclusive market solutions, for at least three reasons.

First, social change takes time, and so do properly functioning markets. If a new market is the solution to a problem, it is hardly feasible to create one overnight and start making profit immediately. Social entrepreneurs, on the other time, have the luxury of investing over a much longer-term time horizon than do for-profit companies who need to realize a return on their investments in a rather short period of time. Social entrepreneurs can work with "patient capital" that allows them to invest in much riskier, uncertain, and long-term approaches. These new approaches, however, have a high potential to overcome deadlocks, innovate new markets, and achieve a new equilibrium.

Second, social entrepreneurs tend to be stubbornly committed to a specific problem. It is not that for-profit companies never try to address social needs; they can and do choose a social challenge as a starting point for thinking about new business opportunities. And if the company finds a solution to this problem that enables it to create and capture enough value to make a substantial profit, the company will push this development further. If, however, the project disappoints the company's expectations, the firm will sooner or later stop searching for a solution and move on to the next promising challenge. In contrast, social entrepreneurs tend to care deeply about the very specific problem at hand. If one strategy for solving it fails, the social entrepreneur, instead of abandoning the problem, tests a new solution.

Third, thanks to their specific mission, social entrepreneurs have access to critical resources, such as trust, that for-profit companies cannot access as easily. Social entrepreneurs often cooperate with existing NGOs, community networks, or foundations. They can mobilize important non-monetary resources, such as volunteers. But perhaps their most important advantage, as compared to a traditional for-profit firm, is their reputation for being trustworthy, credible, and legitimate. This is important as many markets fail because due information asymmetries. Take a new medicine that is unfamiliar to the people in a community. A for-profit firm might find it hard to develop this new market if it lacks the credibility and trust to explain the benefits of the new medicine. In contrast, a social business will find it much easier to convince the community that its new product is not intended to make a private profit but that it actually benefits the consumer and delivers value. Social business approaches can thus address lack of transparency, reduce information asymmetries, and develop underdeveloped markets. Once transparency has increased and consumers come to understand the value of the novel products and services, other players, such as for-profit firms, can enter the new market and further increase the overall impact of the innovation.

12.4.3 Dynamic Impact of Government Provision vs. Social Entrepreneurship

Governments and public authorities can certainly have a dynamic impact by innovating new forms of delivering public goods. In comparison, however, social entrepreneurship can build on at least the following three advantages to innovate new approaches and create dynamic impact.

First, dynamic impact is significantly related to successful learning processes. As Douglas North (2005) put it, the "adaptive efficiency" of such learning depends not only on the amount and variety of trial and error experimentation, but also on the feedback loops that allow learning from failure. Unfortunately, governments face substantial barriers to adaptive efficiency. On the one hand, government and public authorities tend to be highly centralized with a unified bureaucracy, which is valuable for diffusing a tested and well-working solution on a broad scale, but is not very conducive to experimentation. On the other hand, simple experimentation—trial and error—even were it possible, is not enough. The results of experimentation and especially the failures need to feed back into the decision-making process. The typical feedback mechanism for governments, however, is rather crude: elections and polls can indicate the population's general approval or disapproval, but can hardly provide specific feedback for any single experiment, much less one that must be repeated over and over again.

In contrast to top-down government provision, the bottom-up concept of social entrepreneurship can increase adaptive efficiency by mobilizing decentralized experimentation and feedback. On the one hand, social entrepreneurs can start many different ventures using different models, that is, they are not constrained by an existing and well-entrenched system for doing things. On the other hand, social entrepreneurs receive more direct feedback from their beneficiaries, who, as discussed above, are often integrated and play an active role in the value creation process.

Second, many societal problems are local or affect only specific minorities. Governments, however, especially at the national level, although capable of providing uniform solutions for the general public, are less able, and very often less willing, to respond to local needs or the needs of minorities, especially when not doing so does not have much of an effect on the outcome of an election. Social entrepreneurship, on the other hand, being not at all dependent on the vote, can be more receptive to minorities, ultimately increasing their visibility. By innovating solutions that show how catering to these minority needs also benefits the majority, they can mainstream new ideas and influence the public sector in the long term.

Third, innovation requires taking risks. The public providers of social services, however, have a tendency to be risk-averse, and for good reason: they are spending the taxpayers' money. In fact, public authorities often only provide funding for a solution that has already been "proved" to work for fear of being criticized for wasting taxpayer money. As a consequence, the public sector has preference for the status quo—solutions already known and tested. Social entrepreneurs, in contrast, are able to test much riskier and innovative approaches. Once these solutions demonstrate their effectiveness and deliver the "proof of concept," other actors, including the public sector, can adopt them. Social entrepreneurship can thus achieve a potentially high dynamic impact over time.

12.5 Conclusion

Social entrepreneurship is often seen as unique because of the specific organizational ends that motivate it and the organizational means it uses. Yet, impact is not about intentions or input but about outcomes. Seen from a societal perspective, the specific organizational approach of social entrepreneurship is therefore not an end in itself, but an alternative means—one instrument among others—to solve social problems. It is the problem itself that determines which of these instruments will most effectively solve it.

Charitable NGOs are particularly powerful in mobilizing altruistic donations to provide relief for short-term, singular problem situations. Long-term, broad-scale problems need a more systemic solution. This is the domain of for-profit markets, government provision, and social entrepreneurship. In an ideal perfectly competitive market, for-profit firms are the first-best solution in terms of providing private goods. Similarly, efficient and well-functioning governments offer a first-best solution for providing public goods. Compared to these idealized solutions, social entrepreneurship is only a second-best solution. Yet, in those areas where the first-best solutions are absent or failing, this second-best choice is highly important. This is especially true in developing countries where social entrepreneurs can play an important role in compensating market and government failures.

While the static impact of social entrepreneurship is important in those areas where first-best systemic solutions are still absent, it has the potential to create an even higher dynamic impact. Compared to charitable aid, for-profit companies, and government provision, social entrepreneurs are in a special position to innovate solutions for a variety of otherwise neglected problems. Once these innovations have proven successful, they can be adopted by other actors, with the eventual result that the innovation has an even higher static impact. Thus, even though social entrepreneurship and social business might not be the future *of* capitalism, they are extremely important *for* the future of capitalism. In light of the complex and manifold challenges facing societies around the world, social entrepreneurship is a powerful transformative force whose static and dynamic impact does create "hope for sustainable development."

12.6 Case Study

Micro-credit programs are an important innovation. They address the problem of credit rationing that leaves many poor people in developing countries without access to the credit that could enable them to make productive investments and rise out of poverty.

Today, both for-profit and social business companies operate in the field of micro finance. In fact, micro finance has become a huge and growing market. Initially, however, this market did not exist due to market failures. Because of their poverty, poor people did not have the collateral that would make them eligible for credit. As a consequence, for-profit banks did not see a prospect for profits and neglected the poor as potential customers. Excluded from the benefits of financial markets, the poor could not participate in many transactions that would actually have been productive for both sides.

Driven by the mission to overcome this sort of exclusion, Muhammad Yunus founded the Grameen Bank in 1983 as a financially sustainable social business that would provide credit to the poor. A key innovation of his micro-credit approach are "credit-rings." Instead of pledging collateral to individual borrowers, groups of borrowers—mainly women—are formed, the members of which are jointly liable and thus have an incentive to monitor each other. Furthermore, because it was a social business, as opposed to a strictly for-profit one, Grameen gained access to rural social networks and thus created understanding and legitimacy for the idea of credit-rings and micro credits.

The social business approach thus played a crucial role in developing the micro-finance market. In effect, it had a remarkable *dynamic* impact. Over the years, thousands of new micro-finance institutions all over the world diffused the idea of micro credits. In Mexico, José Ignacio Avalos Hernández adopted the idea of micro finance in 1990 and transformed his charitable NGO into the micro-finance institution Compartamos, which is aimed at combating widespread poverty. As a non-profit, Compartamos significantly contributed to developing the local market for micro finance. Then, in 2000, it was legally converted into a for-profit bank and grew rapidly. Six years later, in 2006, Compartamos went public and became a privately held for-profit corporation that continued to grow massively. In 2010, Compartamos had annual revenues of about $493 million, with growth rates of about 30%. Grameen's annual revenue, by way of comparison, is about $177 million.

Compartamos's transformation into a for-profit has been harshly criticized by social business proponents. The criticism touches on the general question of whether a for-profit or a social business approach is the superior instrument for providing micro credits. While this question is far too complex to be answered easily, the distinction between dynamic and static impact can perhaps shed some light on the inquiry.

In terms of dynamic impact, social entrepreneurs such as Yunus and the early Avalos Hernández played a critical role in overcoming market failures and creating financial innovations. Once these markets had emerged, however, for-profit banks like Compartamos entered the market. Proponents of the for-profit approach could argue that these for-profits take static impact to a new level. For-profit competition increases efficiency, attracts additional capital, thus making more loans available, and ultimately drives down interest rates, which are still very high in micro finance in general. From this perspective, the fact that Compartamos has tripled its revenues in comparison to Grameen shows that for-profit companies can be powerful engines of static impact.

On the other hand, social business proponents could argue that the for-profit approach is flawed based on remaining market failures in the domain of micro finance. Many poor people are economically illiterate and cannot make fully informed decisions. They are often in situations of dire urgency that easily could be exploited. Also, credit-rings can create social pressure sufficient to drive people to commit suicide when they cannot repay the loans. These problems create the need for further innovations guided by a strong social mission—a challenge social business might be better positioned to address than for-profits.

Questions:

1. Why did for-profit markets fail and lead to credit rationing before the concept of micro credit? Why was social business important in overcoming these problems?
2. What are the benefits of a for-profit micro-finance solution? Under what conditions?
3. What are the benefits for a social business solution? Under what conditions?
4. “In the long run, the poor should not need to rely on social business services but should be able to freely choose between for-profit firms that compete to serve them as valued customers.” Do you agree or disagree? Are the micro credits provided by social businesses the future of financial markets—or a transitory step in economic development?

12.7 Further Reading

[1] Armendáriz, B. and Morduch, J. J. (2007), *The Economics of Microfinance*, MIT Press, Cambridge.
[2] Baumol, W.J. (2002), *The free-Market Innovation Machine. Analyzing the Growth Miracle of Capitalism*, Princeton University Press, Princeton.
[3] Easterly, W.R. (2006), *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*, Oxford University Press, Oxford.
[4] Yunus, M. (2010), *Building Social Business: The New Kind of Capitalism that Serves Humanity's Most Pressing Needs*, Public Affairs, New York.

12.8 Bibliography

[1] Bornstein, D. (2004), *How to Change the World: Social Entrepreneurs and the Power of New Ideas,* Oxford University Press, Oxford, UK.
[2] Elkington, J. and Hartigan, P. (2008), *The Power of Unreasonable People: How Social Entrepreneurs Create Markets and Change the World*, Harvard Business Press, Boston, MA.
[3] Friedman, M. (1970), "The social responsibility of business is to increase its profits", in *New York Times Magazine*, September 13, pp. 32–33, pp. 122–126.
[4] Friedman, M. (2005), Making philanthropy out of obscenity, in *Reason*, October 2005, online: http://www.pitt.edu/~woon/courses/reason.pdf, accessed date: 02/11/2011.
[5] Grameen Creative Lab (2010), Social Business Lab, online: http://desautels-events.mcgill.ca/yunus/Final_ Social_Business_Lab_Program.pdf, accessed date: 02/11/2011.
[6] Jensen, M. C. (2002), Value maximization, stakeholder theory, and the corporate objective function, in *Business Ethics Quarterly*, vol. 12, no. 2, pp. 235–256.
[7] Mawson, A. (2008), *The Social Entrepreneur: Making Communities Work*, Atlantic Books, London.
[8] North, D.C. (2005), *Understanding the Process of Economic Change*, Princeton University Press, Princeton, NJ.
[9] Santos, F. (2009), A positive theory of social entrepreneurship, *INSEAD Working Paper*.
[10] Seelos, C. and Mair, J. (2005), "Social entrepreneurship: Creating new business models to serve the poor", in *Business Horizons,* vol. 48, no. 3, pp. 241–246.
[11] Seelos, C. and Mair, J. (2009), "Hope for sustainable development: How social entrepreneurs make it happen", in Ziegler, R. (ed.), *An Introduction to Social Entrepreneurship: Voices, Preconditions and Contexts*, Edward Elgar, Cheltenham, pp. 228–245.
[12] Sen, P. (2007), "Ashoka's big idea: Transforming the world through social entrepreneurship", in *Futures*, vol. 39, pp. 534–553.
[13] Yunus, M. (2007), *Creating a World Without Poverty: Social Business and the Future of Capitalism*, Public Affairs, New York.
[14] Yunus, M. (2010), *Building Social Business: The New Kind of Capitalism that Serves Humanity's Most Pressing Needs*, Public Affairs, New York.