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Toward A Positive Theory of Social Entrepreneurship. On Maximizing Versus Satisficing Value Capture

Alejandro Agafonow

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Abstract In a recent issue of the *Journal of Business Ethics*, Filipe M. Santos posits that social entrepreneurs maximize not on value capture, but on value creation, only satisficing on value capture to fuel operations, reinvesting in growth, whatever the specific combination of institutional means is deemed appropriate. No doubt the analytical framework of value creation and value capture casts new light on the phenomenon of social entrepreneurship, but we think Santos is asking too much by advocating a shift in focus away from the organization. On the contrary, we maintain that by refocusing the theory on the organizational level and away from the system it is possible to understand that not all organizational solutions available to social entrepreneurs are able to create value and not all value capture strategies can serve a social goal. Indeed, there is only one form of organization that fulfills the criteria of maximizing on value creation, while satisficing on value capture and that is the social enterprise.

Keywords Social entrepreneurship · Social enterprise · Value creation · Value capture · Value appropriation · Public goods · Market failures

Introduction

The present article addresses a recent contribution of Filipe M. Santos to the *Journal of Business Ethics* in which he breaks fresh ground by looking at social entrepreneurship in the context of value creation and value capture. This allows him to shed new light on the topic, submitting that social entrepreneurs maximize on value creation and only satisfice on value capture to reinvest in growth. His theory is intended to cover a broad combination of institutional means enabling endeavors characterized by neglected positive externalities affecting the poor. It is our contention that there is only one form of organization that fulfills the criteria of maximizing on value creation, while satisficing on value capture, and that is the social enterprise.

Our argument starts by summarizing Santos's thesis. We then move on to explain why his argument may be ill suited to examine types of organization that differ from an enterprise. Next we explain that, contrary to what Santos postulates, there is only a form of organization that fulfills the criteria of maximizing on value creation, while satisficing on value capture; also, that neither all organizational solutions available to social entrepreneurs are able to create value, nor can all value capture strategies serve a social goal. Finally, our argument is summarized in a conclusion.

A. Agafonow (✉)
ESSCA School of Management, LUNAM Université,
1 rue Lakanal, BP 40348, 49003 Angers, France
e-mail: alejandro.agafonow@essca.fr

Santos's Positive Theory of Social Entrepreneurship

The profit that can be rendered out of delivering valuable items for the money customers are willing to pay is the raison d'être of for-profits. The activity is known as value capture or value appropriation, and management sciences have been developed to harness a process of value creation for the sake of value capture in the interest of a residual claimant of profits (see Mizik and Jacobson 2003; Alvarez and Barney 2004; Jacobides et al. 2006; Wagner et al. 2010; King and Slotegraaf 2011). Santos (2012) moved into new territory when putting social entrepreneurship in this analytical framework. Contrary to many scholars in this field, Santos

(2012, p. 339) posits that social entrepreneurs maximize not on value capture, but on value creation, only satisficing on value capture to fuel operations and reinvest in growth.

Filipe Santos's use of "satisficing" is different from the original term coined by Simon (1959), who used it in support of the aim of value capture for the sake of divided distribution under conditions of bounded rationality and incomplete information, intending to build an alternative to the neoclassical construct of "maximizing." Santos does not elaborate much on his novel use of satisficing, implicitly meaning that the difference between revenues and costs is going to be lower than under for-profit maximizing conditions, and carried out for the sake of reinvestment into the social venture rather than distributing dividends to shareholders.

Let us recall that an important part of the scholarship on social entrepreneurship chooses the profit aim as a starting point—that is, satisficing on value capture for the sake of reinvestment is deemed inefficient and the product of an atavistic bias against earning profits, a viewpoint explicitly upheld by Dees and Anderson (2003, p. 12–13). It is also upheld that it is not a fertile line of reasoning to curtail profit making in the realm of social entrepreneurship (e.g., Drucker 1994; Dees 1998; Seelos and Mair 2004; and Martin and Osberg 2007). For instance, Peredo and McLean (2006, p. 64) maintain it is unwarranted to exclude for-profits from advancing social entrepreneurship and achieving social objectives. Martin and Osberg (2007, p. 35) submit that as long as social entrepreneurs' value propositions target a disadvantaged population there is no problem with aiming at turning a profit. Mair and Martí (2006) advocate the advantages of mixing social ventures and profit aims, while Porter and Kramer (2011; also Driver 2012) maintain that profit coupled with societal benefit is a higher form of profit.

Filipe Santos recognizes that there is a tension between value creation and value capture. The emphasis on either one or the other draws from the specific identity of an organization that allows for the differentiation of entrepreneurial activities. Hence, referring to this dichotomy, Santos (2012, p. 339) argues that: "what distinguishes social entrepreneurship from commercial entrepreneurship is a predominant focus on value creation as opposed to value capture." The agent's motivation for economic action thus becomes an important element in distinguishing the two kinds of entrepreneur. Most importantly, an entrepreneur's particular domain of action would be revealed by the forces of a capitalist-driven society because an emphasis on value creation in a market with high potential for value capture will always give the edge to commercial, for-profit entrepreneurs able to scale their ventures faster than social entrepreneurs.

Hence, social entrepreneurs will be displaced in the long term to domains where the market does not perform well, and the potential for value capture is limited. In response to the question of what kinds of areas are likely to see social entrepreneurs thrive, Santos posits:

> "The answer is in areas with strong externalities, particularly positive externalities, where the potential for value capture is lower than the potential for value creation because the benefits for society of the activity go much beyond the benefits accrued to the entrepreneurs" (Santos 2012, p. 342).

Although numerous definitions of social entrepreneurship have been proposed,[1] Santos articulates a new and—in our view—compelling one based on a deep understanding of how market failures prevent value capture. Thus, Santos proposes defining social entrepreneurs as:

> "economic agents who, due to their motivation to create value without concern for the amount they capture, will enter areas of activity where the more severe market and government failures occur [...] these are usually areas with neglected positive externalities affecting disadvantaged populations" (Santos 2012, p. 344).

The contrast between social entrepreneurship and commercial entrepreneurship constitutes an appropriate starting point to consider more concrete organizational features of the strategies and actions preferred by social entrepreneurs as opposed to their for-profit peers. If the latter drive their ventures through for-profit enterprises, we are confronted with the question of what kinds of organization are most suitable for promoting social entrepreneurs' goals. Santos (2012, p. 345–346) suggests: "social entrepreneurship is not specifically about creating market mechanisms or securing government subsidies or creating a social enterprise, it is about crafting effective and sustainable solutions using whatever combination of institutional means is deemed effective." This is indeed compatible with the view of social entrepreneurship as an umbrella concept with plenty of room for different sorts of initiative tackling social problems.

Santos (2012, p. 346), however, moves further in this direction by submitting that the organization is not the focal unit of analysis when it comes to social entrepreneurship because the end is not value capture and, according to him, only value capture is best conceptualized at the level of the organization. An emphasis on value creation, he maintains, requires a move to the level of the system, requiring a shift from the organization as unit of

[1] For a detailed account of these numerous definitions see: Roberts and Woods (2005); Peredo and McLean (2006); Short et al. (2009); Zahra et al. (2009); Dacin et al. (2010); Defourny and Nyssens (2010); Hoogendoorn et al. (2010); OECD (2010); Bacq and Janssen (2011).

analysis. This is what we find highly problematic in Santos's theory, for the reasons that follow.

On organizational Entities and Institutional Means

Since social just as much as commercial entrepreneurs need organizations to achieve their ends, it is not clear what Santos means when he advocates a shift away from the organization and focusing instead on the level of the system. We find Santos's theory compelling precisely because he chose the level of the organization when using the analytical framework of value creation versus value capture—that is, these analytical categories in their present state of development are tailored to the organization as the focal unit of analysis. Furthermore, they may even be ill suited to examine certain kinds of organization that differ from an enterprise, let alone the fuzzy concept of "the system." We now proceed to flesh out this contention.

If social entrepreneurship is about crafting solutions to tackle social problems using effective combinations of institutional means, we are soon confronted with the fact that not all solutions fit the analytical framework adopted by Santos—that is, that social entrepreneurs maximize on value creation, only satisficing on value capture to fuel operations. The problem when applying the latter to a broad array of solutions is that an important part of these lies within the traditional redistributive and advocacy camp of donative nonprofits—that is, charities, NGOs, foundations, and associations that redistribute resources created elsewhere. We do not normally think of these organizations as creating value in the sense of the terminology adopted here, but more indirectly as spin-offs in the provision of public goods that cannot be marketed.

These organizations have traditionally performed a redistributive function, in which social objectives take precedence over profit motives. Their goal is to tilt the balance in favor of a greater redistribution of resources created elsewhere toward the least advantaged. Therefore, when weighing the aggregate economic sacrifice against the aggregate economic output, the third sector has traditionally meant to operate without concerns with financial sustainability. That is, the limit to the softening of the budget constraint of the target population relies on donors' judgments about how much their activity in the private sector can fuel charitable objectives. Although these organizations do a great deal of good for society, it is untenable to maintain that they maximize on value creation unless we blur the boundaries of sectors to make room for a very broad definition of value creation. Still, in Santos's theory, value creation is instrumental in fueling operations for scaling up, which requires the possibility of value capture—that is to say, appropriating part of the value created, normally in the form of money, to further finance the social venture.

Here we reach the bottom line of Santos's theory, because even if we grant that donative nonprofits create value in a broad sense, we cannot capture it, for it remains in the nonmonetized form of positive externalities. Let us recall that in order to capture value—to fuel the goal of either dividend distribution or reinvestment in growth—a firm must create value producing goods, the nature of which allows an individualized rationing through selling in the market. But this is normally impossible or prohibitive in the case of goods that economists have termed *public*. The crucial part is how the market can produce public goods—for instance, national defense, scenic beauty, or oxygen—with the certainty that every person will pay according to the subjective well-being that each one gets from consuming them? To obtain a subjective satisfaction above the subjective marginal cost of paying for these goods, individuals will seek to hide or distort their true preferences so that others stand the burden of paying these goods. This is why the market is made to fail by producing too little or nothing at all of public goods.[2]

The analytical framework of value creation and value capture casts new light on the phenomenon of social entrepreneurship, but Santos is probably going too far in advocating a shift away from the organization because, on the one hand, traditional philanthropy and the public sector are not thought of as creating value—at least in the economic sense of the term—and, on the other hand, it is the economic sense of value creation the one that Santos assumes when acknowledging that social entrepreneurs satisfy on value capture. If the latter were not possible because of nonmonetized positive externalities, social entrepreneurs would not be able to reinvest in growth at all, which is the case for those engaged in the production of public goods that cannot be marketed.

A Holistic Conception of Value?

It has been suggested to us that Filipe Santos may have had in mind a holistic conception of value. Although, it was not made explicit in his paper, this is probably what Santos (2012, p. 346) intended when submitting the following definition: "value creation from an activity happens when the aggregate utility of society's members increases after accounting for the opportunity cost of all the resources used in that activity." According to this conception, social entrepreneurs' actions have the effect of increasing society's aggregate utility, but unlike commercial entrepreneurs, the

[2] This was an issue originally raised by Samuelson (1954, 1955) and Musgrave (1959)

former are not concerned so much with the potential for value capture because what motivates them is the positive externalities their activities trigger, increasing the aggregate utility of society.

Let us bear in mind, however, that a holistic conception of value has been used in the framework of value creation versus value capture by the literature on relationship marketing, illustrating the limits of business-to-business strategies that underestimate the role of costumers in crafting a value proposition that delivers real value through the final good contributing to a long-lasting commercial relationship. Therefore, holistic value means a thorough understanding of the implications and spillovers of goods being transformed along the value chain that go beyond a short-term concern with profit maximization at the expense of costumers (e.g., Grönroos 1994, 1997; Sheth and Parvatiyar 1995; Christyet al. 1996; Henneberg and Mouzas 2004; Bull and Adam 2011).

No doubt social entrepreneurs are more likely to be concerned with adding more real value to what they produce, except that in the presence of nonmonetized positive externalities it is not possible to reinvest in growth, which makes the use of "value capture" superfluous in the argument of Santos. A holistic conception of value in the sense adopted in relationship marketing is not at odds with the economic sense of value, and it is instrumental in appropriating part of the value created for the sake of shareholders' wealth.

Refocusing the Theory on the Organizational Level

Despite the achievements of Santos's theory, its limits illustrate in general the failure of the scholarly literature to reconcile the social and commercial aspects of social entrepreneurial activities. As the story goes, social entrepreneurs either maximize profits in order to have a chance of impact investment or they prevent mission drift by avoiding profit maximization, along the lines of traditional philanthropy. Put succinctly, the question is whether a social enterprise should aim at value capture to have a chance of impact investment or prevent mission drift by avoiding value capture.

Santos's theory carries the seed of an alternative to the polar opposites of for-profits and nonprofits that currently constitute a gridlock in social entrepreneurship research. Contrary to what was postulated though, by refocusing the theory on the organizational level and away from the system it is possible to understand that not all organizational solutions available to social entrepreneurs are able to create value and concomitantly, that not all value capture strategies can serve a social goal. Indeed, there is only one form of organization that fulfills Santos's criteria of maximizing on value creation, while satisficing on value capture, and that is the social enterprise.

Thus, by refocusing the theory on the organizational level it is possible to expand on social entrepreneurship, acknowledging that neglecting value capture can be either a structural feature of the organizational form that social entrepreneurs choose—like donative nonprofits producing public goods that cannot be marketed—or a matter of strategy in using a firm to advance social goals, for example, a social enterprise that, even producing marketable goods that bear a potential for value capture, serves the goal of reinvesting in growth rather than enriching shareholders. This opens a fertile line of inquiry that suggests a typology of social entrepreneurs based on their preferences for organizational forms to advance social goals as well as their attitudes toward a novel concept: that social entrepreneurs do not have to remain in the camp of advocacy and redistribution, but can experiment with value creation strategies that are not necessarily at odds with the interests of a disadvantaged population.

Conclusion

If social entrepreneurship is about crafting solutions to tackle social problems using effective combinations of institutional means, we are soon confronted with the fact that not all solutions fit the analytical framework adopted by Santos who maintains that social entrepreneurs maximize on value creation and only satisfice on value capture to fuel operations, by whatever combination of institutional means is deemed appropriate.

In fact, an important array of solutions to social problems, represented by charities, NGOs, foundations, and associations, do not create value in the strict economic sense, but rather indirectly as spin-offs via the provision of public goods that cannot be marketed. Santos, however, adopts the economic sense of value creation when acknowledging that social entrepreneurs satisfy on value capture, because in order to capture value to reinvest in growth, as Santos proposes, social entrepreneurs must move away from the production of nonmonetized positive externalities—which describes the behavior of donative nonprofits engaged in the production of public goods that cannot be marketed.

No doubt the analytical framework of value creation and value capture casts new light on the phenomenon of social entrepreneurship, but we believe that Santos is going too far in advocating a shift of the focus away from the organization. Contrary to Santos, we maintain that by refocusing the theory on the organizational level and away from the system it is possible to understand that not all organizational solutions available to social entrepreneurs are able to create value, and not all value capture strategies can serve a social goal. Indeed, there is only one form of organization that fulfills Santos's criteria of maximizing on value creation, while satisficing on value capture and that is the social enterprise.

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