

Social Entrepreneurship: Beyond the Hype

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Abstract

While social entrepreneurship has been attracting increasing attention, it is not clear what it really is. I argue that the term ‘social entrepreneurship’ is too ambiguous to be useful. It is more appropriate to characterize a particular organization, be it public, for-profit or not-for-profit, by how entrepreneurial it is and how much social value it creates. This article discusses the distinct characteristics of the three types of organizations. I then argue that the boundaries between these three sectors are not getting blurred; more importantly, it is better to sustain these boundaries.

Keywords: Social entrepreneurship; civil society; social value; market failures.

Social entrepreneurship has been attracting increasing attention from philanthropists, donor organizations, not-for-profit sector, international organizations, academia, the media, and the public at large. Business schools in particular find the concept of social entrepreneurship very appealing given its combination of social virtue and business approach. Several business schools have set up centers dedicated to social entrepreneurship (perhaps using alternative names, such as social innovation): Stanford, Harvard, University of California Berkeley, Duke, University of British Columbia, INSEAD, Oxford, National University of Singapore, and the list goes on. The list of business schools offering research or teaching on social entrepreneurship, without a dedicated center, is much longer.¹ All this popularity has brought significant and growing resources to social entrepreneurship: talent and money.

But it is not clear what is social entrepreneurship. Gregory Dees, a prominent scholar in this field, wrote in 1998 “though the concept of ‘social entrepreneurship’ is gaining in popularity, it means different things to different people. This can be confusing.”² Ten year later, in spite of even more popularity, the definitional disputes continue, and have taken a toll. After an in-depth and extensive survey, The Center for Advancement of Social Entrepreneurship reports “even our most knowledgeable informants did not agree on a definition of social entrepreneurship. “*Definition is one of the biggest problems in the field*”” (emphasis in the original).³ Proponents of social entrepreneurship disagree about issues such as whether it includes only not-for-profit or also for-profit ventures, whether the focus should be on individuals or on organizations, whether the change involved has to be systemic or can be just incremental, whether to include only successful

ventures or also failed attempts; some argue about the term itself and suggest ‘social innovation’ is the better choice.⁴ One way to avoid the disputes is to have a definition that is all encompassing, but ends up not being useful: "Social entrepreneurship, therefore, represents an umbrella term for a considerable range of innovative and dynamic international praxis and discourse in the social and environmental sectors."⁵ This lack of consensus on the definition hinders the development of social entrepreneurship as a field of teaching, research and practice. It creates challenges for social entrepreneurship involving issues of legitimacy, sustainability and effectiveness, and makes it harder to attract resources and partners.

The biggest disagreement about social entrepreneurship is whether it includes only not-for-profit or also for-profit ventures – that is the focus of this article. Gregory Dees confines social entrepreneurship to the not-for-profit sector when he writes “social entrepreneurs rely on subsidies, donations, and volunteers.”⁶ Roger Martin and Sally Osberg, both affiliated with the Skoll Foundation, similarly distinguish between social entrepreneurship and business entrepreneurship.⁷ Paul Light argues for a broader view of social entrepreneurship that spans across governments, not-for-profits and businesses.⁸ However, social entrepreneurship is rooted in the not-for-profit sector, and the domain implicitly or explicitly excludes public and for-profit organizations in practice, as reflected in the composition of affinity groups and funders choices. Martin and Osberg support this claim based on their own “analysis showing that the composition of grantees/award winners of notable networks, including Ashoka, Fast Company Social

Capitalists, The Schwab Foundation for Social Entrepreneurship, and the Skoll Foundation, are predominantly not-for-profits.”⁹

I argue in this article that the term ‘social entrepreneurship’ is too ambiguous to be useful. It is more appropriate to characterize a particular organization, be it public, for-profit or not-for-profit, by how entrepreneurial it is and how much social value it creates. Entrepreneurship and social value are two independent dimensions; meaning that a more entrepreneurial organization does not automatically create more social value than a less entrepreneurial organization, and vice versa. However, the two dimensions are probably correlated, meaning that a more entrepreneurial organization probably creates more social value than a less entrepreneurial organization. (As an analogy, a person's height and gender are two independent dimensions, but men are usually taller than women.)

Society uses three types of organizations to manage resources to meet its social needs: public, for-profit and not-for-profit (see Table 1). I shall use the term 'not-for-profit' organizations to be synonymous with nonprofit, voluntary, civil society, NGO, charitable sector, and citizen sector. A not-for-profit organization can address a social need by directly providing a service, such as health care or education. Or, it can address the need indirectly by playing an advocacy role by identifying social problems and unfulfilled needs and rallying support for a particular solution, thus giving voice to a wide variety of social, political, environmental, and community interests. Social entrepreneurship usually refers to these two functions: service and advocacy; this paper too focuses on not-for-profits that perform these two functions. This article does not deal with not-for-

profits that perform an expressive function, such as religious congregations and fraternal societies. This distinction, of course, is not so clear-cut in practice. Many not-for-profits do serve more than one function, and often all three functions.

Insert Table 1 about here

In recent times there has been a growing dissatisfaction with both the market and the state as mechanisms to serve social needs, and to solve the interrelated social, economic and environmental crises. In the popular stereotype, public organizations are unresponsive, bureaucratic, inefficient, and corrupt. For-profit businesses are criticized for being exploitative, rewarding greed, lacking in humane compassion, and producing socially unjust outcomes. This has led to an increasingly passionate search for a new approach, and a proliferation of new buzzwords: 'Third Way,' 'New Middle,' 'social innovation' and 'social entrepreneurship.' It is essentially a hope that not-for-profit organizations will occupy the social space between the market and the state, and offer an effective combination of private structure and public purpose.¹⁰ A vast array of not-for-profits -- hospitals, universities, professional organizations, development organizations, environmental groups, community associations, soup kitchens, and many more -- do try to fulfill this hope.

Consistent with past literature, I argue that all three types of organizations, public, for-profit and not-for-profit, can be entrepreneurial. More importantly, and contrary to much of the past literature on social entrepreneurship, I argue that all three types of

organizations can and usually do serve a social purpose, and are therefore ‘social’.

However, being ‘social’ is not an either-or proposition; it is more useful to think of how much social value the organization creates. There is, of course, no objective measure of the social value created by an organization. Even more problematic, it depends on the ‘values’ of the person making the judgment. It is not true that not-for-profit organizations automatically create more social value than business or public organizations. For example, given my value beliefs, a not-for-profit school that teaches ‘intelligent design’ creates less social value than a for-profit school that teaches the theory of evolution. Many people, of course, would disagree with my conclusion largely because of different values.

One of the most frequently mentioned examples of social entrepreneurship is the Grameen Bank in Bangladesh. This clearly has been an entrepreneurial venture: it is a creative and innovative approach to reducing poverty involving microloans, poor women as clients, no collateral or credit checks, and group liability. Many people believe that microcredit has created much social value; Grameen Bank and its founder Muhammad Yunus were awarded the Nobel Peace Prize in 2006. But it is debatable how much value has been created, which must consider to what extent microcredit has succeeded at actually reducing poverty, especially considering the vast amount of resources (financial and human) devoted to it. In the last few years there has been a growing concern that microcredit has not had a significant impact on reducing poverty.¹¹ In March 2009 the World Bank published *Moving out of Poverty*, one of the most thorough field studies of the dynamics of poverty – how people fall into and rise out of poverty – based on

narratives from 60,000 poor or formerly poor people in 15 countries of Asia, Africa, and Latin America. An “important insight” from this study is that “the tiny loans usually provided under microcredit schemes do not seem to lift large numbers of people out of poverty.”

After a brief discussion of entrepreneurship, I analyze the components of social value: economic profits and consumer surplus. This leads to a discussion of how market failures and concern for equity impact social value. This sets the stage for analyzing the distinct characteristics of the three types of organizations: for-profit, public and not-for-profit, summarized in Table 1. I then argue that the boundaries between these three sectors are not getting blurred; more importantly, it is better to sustain these boundaries. Finally, using the example of higher education, I illustrate that it is possible for these three types of organizations to co-exist for the same social need.

Entrepreneurship

Entrepreneurship can characterize a person or an organization and results in a successful innovation that creates value. Entrepreneurship is the engine of Joseph Schumpeter’s dynamism of ‘creative destruction,’ and involves converting a new idea into a successful innovation; this requires skills, vision, creativity, persistence and risk-taking. The most obvious form of entrepreneurship is starting new businesses that create economic value. In recent years, the term entrepreneurship has been extended, especially by Peter Drucker, to include social and political activities that create social value.¹² Drucker argues that one of the best examples of entrepreneurship is the modern university, and

especially the modern American university (which is a public or a not-for-profit organization). Drucker also cites the example of Girl Scouts which introduced innovations affecting membership, programs and volunteers and reversed the downward trend in enrollment of both children and volunteers. Economist Petrin argues that while the popular stereotype is that decision-making in public organizations is rigid and bureaucratic, there still is room for flexibility and entrepreneurship.¹³ Several case studies demonstrate that government agencies and departments can, in fact, be creative in addressing problems.¹⁴ Any organization, public, for-profit, and not-for-profit can be entrepreneurial.

Entrepreneurship is not an either-or proposition; it is more useful to think of entrepreneurship as a matter of degrees. There is no objective measure of entrepreneurship; even in business organizations, profit alone is not a good measure of entrepreneurship. Reasonable people may well make different judgments on how entrepreneurial a particular organization (or person) is. The extent of entrepreneurship is a matter of judgment; but, most people agree, at least broadly, on what characterizes entrepreneurship.

Social Value

An organization, be it for-profit, public or not-for-profit, consumes resources – labor, materials and capital – to provide goods to its clients.¹⁵ The social value created by the organization is equal to the value of the output as determined by the clients minus the value of the inputs. The goods are sold to the clients at a certain price. If this is a

business organization, the market determines the price of the goods traded. When public and not-for-profit organizations provide the goods, they determine the price for the goods; this price is usually lower than what the market price would have been if this were a for-profit firm.

As Figure 1 illustrates, the value of outputs minus the firm's revenues is 'consumer surplus', and the revenues minus the cost of inputs is profits (or, what the economists call, producer surplus). Social value created is equal to consumer surplus plus profits. Profits accrue to individuals, yet they are part of the social value created – individuals, after all, are part of society. In a public or not-for-profit organization, the revenues are usually not adequate to cover costs and the economic loss has to be subsidized by taxes or philanthropy.

Insert Figure 1 about here

In this discussion it is necessary to take into account the cost of capital used by the organization. The logic for determining the cost of capital is the opportunity cost of foregoing other alternative investments, adjusted for risk. The objective of private firms is not just 'accounting profits', but rather 'economic profits', defined as accounting profits minus the opportunity cost of capital. The ability to generate accounting profits is not enough; economic profitability is necessary for long term viability of business. A lot of misunderstanding in the social entrepreneurship literature results from confusing accounting profits with economic profits. An organization that earns accounting profits

but not economic profits still needs philanthropic donors to survive. Muhammad Yunus contributes to this confusion with the notion of ‘social business’ or ‘not-for-loss’ businesses that are viable because they cover their operating costs.¹⁶ But the problem with not-for-loss businesses is that they still do not cover the opportunity cost of capital, and are not economically viable without philanthropic sources of capital. There is no conceptual difference between a not-for-profit that incurs an accounting loss of, say, \$1 per year and needs philanthropic donors to cover this operating loss, versus a not-for-loss organization that covers its operating costs every year but needs \$10 of philanthropic capital, assuming the cost of capital to be 10%. Or, put differently, a philanthropist is indifferent between donating \$1 per year forever and donating \$10 of capital upfront, assuming the cost of capital to be 10%. In the rest of this article I shall refer only to economic profits, not accounting profits.

The key conclusion from the above discussion is that any organization -- for-profit, public or not-for-profit -- can create social value, and does so to the extent that the value of outputs exceeds the cost of resources consumed. If the organization is inefficient, incompetent or corrupt, it is possible that the costs exceed the value of outputs and social value is destroyed.

If markets are working well then private profits and social value are aligned together, and firms acting in their own self-interest will lead to a socially optimal outcome. Adam Smith wrote in his famous book ‘*Wealth of Nations*’ more than two hundred years ago:

Every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it... He intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.¹⁷

The genius of Adam Smith was to understand the harmony between private interest and social value. Adam Smith's 'invisible hand' argument, of course, critically depends on the markets being 'efficient'. If the market is efficient, then private firms provide the goods needed to fulfill the social need. To do so, they raise capital from investors motivated by self-interest: the prospect of economic profits. Consumers who are able and willing to pay the market-determined price buy the goods. The invisible hand ensures that social value is optimized.

Market Failure

If markets worked perfectly for all social needs, there would be no need for public or not-for-profit organizations (leaving aside the issue of equity, which I will address shortly). That is an unrealistically rosy picture. In fact, markets often fail due to externalities, monopoly power, and imperfect information. In that case it is the role of the government to address the market failure. When markets fail, the government is the solution.

A common reason for market failure is externalities, whereby the organization and its clients do not bear all the costs (such as pollution -- negative externalities), or do not capture all the benefits (such as spillovers from R&D – positive externalities) related to the goods produced. In that case, the social value created is equal to consumer surplus plus economic profits minus negative externalities and plus positive externalities. If markets fail there is valid reason for government regulation to try to fix the market failure, essentially by internalizing the externalities. On this logic, governments prohibit or mandate some activities (such as the ban on fluorocarbons or requiring catalytic converters on cars), impose taxes on organizations to compensate for the negative externalities (such as carbon tax), and reward firms for positive externalities (such as subsidize R&D). At times the state chooses to have public organizations directly provide the goods, such as government owned research facilities; this is particularly true for public goods, such as police protection.

In some industries (such as electricity) where scale economies are very large, one or a few firms might dominate the market and could exploit market power to the detriment of social value. The government can address this market failure either through regulation (such as regulated private utilities in the USA) or through public organizations directly providing the goods (such as government owned utilities in most countries).

The third reason for market failure is imperfect information. If consumers are at a disadvantage by virtue of asymmetric information (such as in pharmaceuticals), firms can

exploit consumers and reduce social value created. Governments usually address this market failure through regulation.

Based on some combination of the externalities and monopoly power argument, the government is responsible for providing basic services such as education, public health, water, sanitation, electricity, and infrastructure. The unregulated market is not an effective way to meet these social needs. There is much debate about whether the actual production of these services should be privatized or outsourced. The government does not have to directly provide these services; it can fulfill its role by regulating or financing the services. For example, if water supply is privatized, the government needs to regulate the rates; or the government can choose to finance the water supply but outsource the management. But, few would argue that the state can totally avoid responsibilities for such public services. The governments in almost every country certainly profess to accept responsibility for these traditional functions. There is not much controversy about this, and public organizations are usually the leading providers of these services.

Equity

Even if there is no market failure, society might prefer the government to fulfill a particular social need. Social welfare is determined not just by the total amount of value produced, but also by the 'distribution' of this value. Markets are driven by efficiency and often produce more inequality than society considers desirable. Citizens often desire a more egalitarian society than what free markets produce, and they express this desire for social justice through the political process. For example, there is arguably no market

failure in the case of the food industry, and accordingly the need for food is satisfied largely by for-profit organizations. Yet many poor people, even in affluent countries, cannot afford adequate nutrition. In many countries (especially in affluent countries) there are public agencies to provide food assistance to the needy. The same argument could be made for other social needs such as housing and health care. Many societies consider basic nutrition, health and education to be fundamental human rights, and require the state to be responsible for fulfilling these social needs. This is especially true for services targeted at children. Social justice requires attenuation of the effects of the 'lottery of birth': children born to poor parents tend to grow up to be poor adults and pass on the disadvantage to their children in turn. Social justice and equality of opportunity requires that all children have access to a certain level of education. Even late Milton Friedman advocated the school voucher system, and not for the state to withdraw totally from the field of education.

Three Sectors

The three types of organizations, for-profit, public, and not-for-profit, are very different on several dimensions, as summarized in Table 1. Public and not-for-profit organizations usually incur an economic loss, not because they are inefficient, but because they intervene in cases of market failure or to cater to people who cannot afford market prices. Therefore, these organizations need to find sources of funds to cover this loss.

Governments have the legitimate power of coercion and impose taxes on citizens to fund public activities. Not-for-profit organizations rely on donors motivated by altruism.

Contemporary economic history clearly demonstrates that the market system is the best way to allocate resources and achieve overall growth. The first choice for fulfilling a social need is free markets. The invisible hand ensures that social value is optimized. If there is a market problem – market failure or a concern for equity -- then government should step in and either regulate the market or ensure that public agencies directly or indirectly satisfy the social need. In an ideal world, for-profit and public organizations would fulfill all social needs and there would be no need for non-profits in this context. (We would still need not-for-profits for other reasons, such as fulfilling spiritual needs.) In a well functioning democracy, the political process – the counterpart of the invisible hand in the public context -- ensures that the government creates social value consistent with the values of its citizens.

Unfortunately, like the invisible hand, the political process too is at times flawed, and governments often fail due to inefficiency, incompetence and corruption. When markets are the problem, governments are the solution; the government then must regulate the market or substitute for the market. When governments are the problem, markets are not the solution, since there is a need for government intervention precisely because of market failure. That is when not-for-profit organizations are needed to fill the gap. Not-for-profit organizations cannot substitute for the government intervention: they have neither the legal power to regulate markets, nor adequate resources to substitute for the market or government. Not-for-profit organizations can help the market to function more efficiently and/or the state to fulfill its responsibilities.

Scaling Up

Modern financial markets can provide virtually unlimited quantities of capital provided the venture is expected to earn positive economic profits making it fairly easy for for-profit organizations to scale up. Public organizations enjoy the privilege of access to the government treasury for resources needed to scale up subject to approval from the political process. A major challenge for not-for-profit organizations is how to scale up the activities and satisfy the social needs to a significant extent.¹⁸ With a few exceptions (such as the Gates Foundation), not-for-profits have not been able to attract the capital needed to significantly scale up their activities to directly provide a service. But, not-for-profits can act as catalysts, advocates and watchdogs to prod for-profits and public organizations to better fulfill their responsibilities to satisfy the social needs.

Even though the not-for-profit sector has been attracting increasing attention, there has been a lack of even the most basic information about these organizations. The best source of empirical data is the John Hopkins Comparative Nonprofit Sector Project, which provides a portrait of the sector in 35 countries, including 16 advanced industrial countries, 14 developing countries, and 5 transitional countries of Central and Eastern Europe.¹⁹ The not-for-profit sector (including religious congregations) represents 5.1% of the gross domestic product (GDP) of these countries. The not-for-profit sector in developed countries is proportionally more than three times larger than that in developing countries (7.4% versus 1.9%). By comparison, government revenues account for 27% of the world GDP.²⁰ This data reinforces the view that it is unlikely that not-for-profit organizations can directly satisfy social needs on a large scale. It might be more feasible

for them to be advocates: catalyze, help and prod businesses and governments to live up to their responsibilities. This is even truer in developing countries, where the not-for-profit sector is smaller, and the scale of unfulfilled social needs is much larger.

As an example, in developed countries, some poor people cannot afford adequate nutrition. Government food assistance programs do not cater to all the needy, and various not-for-profits, such as religious and community organizations, do an admirable job of helping the disadvantaged. Not-for-profits are able to fill this gap because it is relatively small. But in India, 230 million people are undernourished; 43% of children under 5 years old are underweight.²¹ It is difficult to imagine that not-for-profits will directly fill this enormous gap. The 'Right to Food Campaign' in India, an advocacy network of not-for-profit organizations and activist individuals, has been gathering momentum.²² "The campaign believes that the primary responsibility for guaranteeing basic entitlements rests with the state," and has been agitating for an act of parliament to increase food assistance to the needy.²³

Allocating the Output

The three types of organizations use very different mechanisms to allocate the goods they produce. For-profit companies allocate goods based on market prices. If there is a shortage of goods, public organizations do not use price to clear the market, and instead allocate the goods on some other basis. In a perfect democracy all citizens are politically equal and public organizations allocate goods on the basis of citizen rights.

Unfortunately, many governments are far from democracies, let alone perfect

democracies; in that case, public organizations often allocate goods on the basis of political power and patronage. For example, personal and property security is a public good and markets cannot fulfill this social need. Therefore, police protection is a public activity. (However, a few rich people in gated communities do hire private guards, and some people organize neighborhood watches as not-for-profits.) On the logic that all citizens are equal, the government claims to provide equal police protection to everybody. However, it is not accidental that rich neighborhoods tend to be better patrolled than poor neighborhoods.

In the case of business firms, free markets allocate resources across different social needs such as food, shelter, and health care. In the case of the government, the political process helps determine the prioritization of different needs. In principle the political process should reflect the collective desires of the citizens. In practice, vested interests and self-interest of public officials also play a large role.

Not-for-profit organizations allocate goods to clients in accordance with the preferences of donors. There is no counterpart of the invisible hand or the political process for not-for-profit organizations to ensure that social value is optimized. We have to rely on the wisdom and competence of philanthropic donors. For example, the Boy Scouts of America is one of the largest youth organizations in the US. Its membership policies exclude atheists, agnostics and avowed homosexuals. These policies are considered unjust by many and have attracted much criticism; at the same time, many individuals

and groups support the Boy Scouts. How much social value is created by the Boy Scouts is clearly a debatable proposition.

Governance

Another significant difference across the three types of organizations is the governance mechanism, especially to correct organizational failure. In efficient markets and in well-regulated markets the interests of the shareholders and social welfare are aligned. If a firm does not serve the interests of the shareholders, they can exercise their right to fire the managers. The corporate governance movement in recent years in the US and other countries seeks to strengthen shareholder rights. If public officials do not create social value, the citizen in a democracy can exercise their citizen rights to change the government. In practice, of course, markets and regulation are rarely 'perfect', and the democratic process is often not effective, and at times totally absent. At least in principle, there is a governance mechanism for businesses and governments.

In the case of not-for-profits, the governance mechanism, even in principle, is rather ambiguous. Donors cannot easily change the management or the policies of a not-for-profit. They, of course, can choose not to donate to that organization – but that is not a governance mechanism. Shareholders elect the board of directors, and citizens elect government officials, but donors do not get to elect the managers of a not-for-profit. In practice however, most not-for-profits function quite well given the altruistic idealism of the staff and donors.

Distinct Boundaries

Much of the past literature on social entrepreneurship suggests that the boundaries between the three sectors: public, for-profit and not-for-profit, are blurring. More interestingly, many proponents of social entrepreneurship advocate “dismantling the barriers between the sectors.”²⁴ I argue to the contrary that it is better to sustain clear boundaries between these sectors. The three types of organizations, of course, interact with each other, but that is not the same as blurring the boundaries. The above discussion has demonstrated that public, for-profit and not-for-profit organizations are distinctly different, and more importantly, play different roles in fulfilling social needs. The motives and governance mechanisms of these organizations are not only different, but also incompatible.

Profit and Non-profit Boundary

An individual providing financial resources to a venture and expecting to earn a return lower than the cost of capital is behaving as a philanthropist, not an investor. This individual is, in effect, making a donation equal to the difference between the cost of capital and the expected return. This is not to suggest that philanthropists are irrational; just that there is a critical difference between a philanthropist and an investor. Investors expect to earn more than the cost of capital, and philanthropists expect to earn less than the cost of capital. This is an either-or distinction; there is no blurring of boundaries and no hybrids. Expected returns are, of course, impossible to determine accurately *ex ante*. The actual returns earned *ex post* might, and do differ considerably from the expected returns. The cost of capital is very difficult to calculate accurately in practice -- much

research in the field of finance is devoted to this issue. The fact that both the expected return and the cost of capital are difficult to assess accurately does not invalidate the conceptual distinction between philanthropy and investment.

A parallel distinction can be made between a for-profit organization and a not-for-profit. A for-profit firm attempts to earn returns higher than the cost of capital (that is, positive economic profits), and attracts financial resources by convincing investors that the expected returns are higher than the cost of capital. A not-for-profit organization does not expect to earn returns (even if positive) higher than the cost of capital, and raises financial resources by appealing to the altruistic motives of philanthropists. Once again, this is an either-or distinction; a private organization can be either for-profit or not-for-profit; there is no blurring of boundaries and no middle ground.

Many individuals, of course, invest in for-profit firms and simultaneously donate money to not-for-profits. This is not blurring the boundaries between investing and philanthropy. People play multiple roles and behave differently in the context of each role. Similarly, many for-profit firms make philanthropic donations and some even operate philanthropic organizations. If the for-profit firm is owned by an individual (or by a private partnership), then this is equivalent to the individual (or partners) engaging in both investing and philanthropy.

Many publicly traded for-profit firms make philanthropic donations and some even operate philanthropic organizations. Milton Friedman argued that firms owned by

shareholders should not engage in philanthropy since managers are donating money that belongs to shareholders.²⁵ The primary objective of publicly traded companies is to maximize profits for shareholders; individual citizens have a civic, and arguably moral, responsibility to be philanthropic. Microsoft is not philanthropic and does not give away money belonging to its shareholders; but Bill Gates has been giving away his personal fortune. Companies should do well, citizens should do good. Even if one disagrees with Friedman, these philanthropic activities are always quite small relative to the size of the parent organization, and often isolated into a separate organization, such as Google Foundation. In any case, considering such firms to be hybrid organizations is hyperbole.

Similarly, some not-for-profits operate (usually small) for-profit businesses on the side. For example, many not-for-profit universities run continuing education programs that are intended to, and do make profits. These profits are used to cross-subsidize other unprofitable activities, and the universities are clearly not-for-profit. Once again, such not-for-profits should not be considered to be hybrids in any practical sense.

Profit and not-for-profits organizations, of course, do work together. There is a growing feeling on both sides that not-for-profits working with businesses can achieve more than by attacking from the outside.²⁶ Not-for-profits acting as advocates and catalysts can usefully find common ground with for-profit businesses genuinely interested in solving social problems. But, it is critical for the not-for-profit organizations to maintain their legitimacy by preserving their independence and capacity to criticize. A critical role of not-for-profits is to serve as watchdogs to ensure that businesses and governments fulfill

their responsibilities. While there is common ground, there is also a fundamental conflict between the interests, motives and roles of for-profits and not-for-profits. Effective partnerships are more like project alliances rather than hybrid organizations.

Public and For-profit Boundary

There has been a proliferation, especially in developing countries, of hybrid organizations that blur the line between public and for-profit organizations.²⁷ Many Chinese and Russian companies have complex and somewhat opaque ties to the government. The hybrid company Dubai World, which was at the center of the recent financial crisis in Dubai, was variously described as state-controlled, state-supported, quasi-state, parastatal, without fully clarifying the exact roles and responsibilities of the state and the shareholders.

Blurring the boundaries between public and for-profit organizations can have major negative consequences. For example, Fannie Mae and Freddie Mac in the USA are neither truly private entities since they are publicly chartered and enjoyed ill-defined government guarantees, nor truly public agencies since they are privately owned by shareholders. This resulted in the two organizations accumulating very highly leveraged balance sheets on the strength of inferred government guarantees, and finally cost US taxpayers billions of dollars after enriching the executives who led them to disaster. The problem with such hybrid organizations is the potential for 'privatizing the gains, and socializing the losses' to the detriment of the citizens.

The fact that public and for-profit organizations work together should not be construed as blurring of boundaries. For example, the trucking industry has benefitted tremendously from the national highway system in the US. The public agencies responsible for highway construction and maintenance are very distinct from private trucking companies. Similarly, private airlines are interdependent with public airports and public flight control, yet are distinctly different organizations.

The argument for blurring of lines between for-profit and public organizations is vastly overstated and problematic. Supporters of hybrid organizations have "long argued that they enjoy the best of both worlds: the security of the public sector and the derring-do of the private sector." But this can easily turn into the worst of both worlds. "The biggest problem with hybrid companies is that they are inherently confused organizations."²⁸

Governments have the unique power of legal coercion: the ability to tax their citizens and to regulate markets. Only governments can use taxes to cover the economic losses of public organizations. No private organization enjoys this privilege, not should it have an opaque access to this privilege. This leads to hybrid organizations almost always being very politicized to the detriment of the citizens.

It is necessary to distinguish between these hybrid organizations and old-fashioned state-owned enterprises that do not involve private shareholders. Governments do occasionally manage for-profit organizations, especially in communist, formerly communist and socialist countries, such as China and India. However, with the decline of the communist ideology, the prevailing policy in most countries now is that governments should provide

goods only in case of market failure or political consensus for equitable distribution. When governments go beyond these boundaries they are probably 'crowding out' the private sector to the detriment of social welfare.

Sources of Revenues

The fact that an organization has multiple sources of revenues should not be construed to be a blurring of boundaries. According to the John Hopkins report cited earlier, “private philanthropy accounts for a smaller share of civil society organization revenues than is commonly thought.” In that survey, philanthropy accounted for only 12% of the total revenues of not-for-profit organizations; fees and charges to clients contributed 53% of total revenues, and government funding provided the remaining 35%. In only two fields – international assistance and religion – is private philanthropy the dominant source of income. This reinforces my earlier argument that the not-for-profit sector cannot be a substitute for the government; philanthropy is not an adequate source of capital to satisfy the social needs on a large scale.

The revenue structure of not-for-profits varies considerably across countries. In developing countries client fees account for 62% of revenues compared to 45% in developed countries. By contrast, the government provides only 22% of not-for-profit organizations revenues in the developing countries compared to 48% in the developed countries. This paradoxical result underlines the dual character of the not-profit sector in the developing countries, with a substantial portion of the sector providing services to an affluent clientele willing and able to pay for superior education, health, and related

services. For example, the misnamed ‘public schools’ – which are really private not-for-profit schools – in UK and other Commonwealth countries such as India, are prestigious schools that charge very high fees and cater to the affluent elite. A smaller component of the not-for-profit sector in developing countries, with limited support from the government, provides services to the disadvantaged.

It is not the sources of revenues that determine the nature of the organization: for-profit, public or not-for-profit. The key determinants are the expected economic profits, sources of capital, and the governance mechanism (see Table 1). The fact that a not-for-profit receives revenues from charging fees to its clients or from the government does not imply blurring of boundaries.

Example: Higher Education

The three types of organizations can, and do, co-exist for the same social need. For example, higher education is provided by for-profit, public and private not-for-profit universities/colleges. The market for higher education functions quite well, though it does have significant positive externalities such as a more informed citizenry and higher national productivity. A bigger problem with a market-based approach to education is that many children of less affluent parents would not be able to attend private for-profit universities. This perpetuates inter-generational inequality, and is perceived as socially unjust in many societies. Therefore in most countries the government heavily subsidizes higher education, and public universities have historically have played a dominant role. Not-for-profits often play a role too and fill niches in the market. Given economic

growth and burgeoning demand for tertiary education and training in recent years, for-profits have been growing rapidly in some countries.

A distinctive feature of higher education in the US has been its diversity. Public organizations accounted for 74% of the total enrollment of 18.3 million students in degree-granting institutions in 2007.²⁹ The so-called land-grant universities were started in 1862 to focus on the study of agriculture and engineering. Now all the states in the US subsidize public universities to varying degrees. Some public universities, such as University of Michigan and University of California Berkeley which are considered among the best universities in the world, have clearly been entrepreneurial and value creating organizations. The prominence of public universities is a relatively recent phenomenon. The oldest colleges and universities, such as Harvard, Princeton and Yale, are all not-for-profit institutions founded in the seventeenth and eighteenth centuries, and originally often had a religious affiliation. Now, the not-for-profits are usually secular, enjoy high status and reputation for academic excellence, and charge higher tuition fees. Not-for-profit universities and colleges play a particularly large role in the US probably due to historical reasons and the culture of philanthropic donations. Given the increasing demand for higher education in recent years, private for-profits have been growing rapidly; enrollment in for-profit degree-granting institutions has increased from 0.3 million in 1997 to 1.2 million in 2007.³⁰ The largest of these, the University of Phoenix is expanding rapidly, and increased its enrollment by 22% in 2009 over the previous year, bringing its total number of degree-seeking students to 443,000.³¹ For-profit colleges are still viewed with skepticism by some consumers and policy makers, especially with

regard to their academic standards. For-profit college leaders claim they attract students because they are more nimble and entrepreneurial, and respond to the marketplace more quickly than do not-for-profit and public colleges.

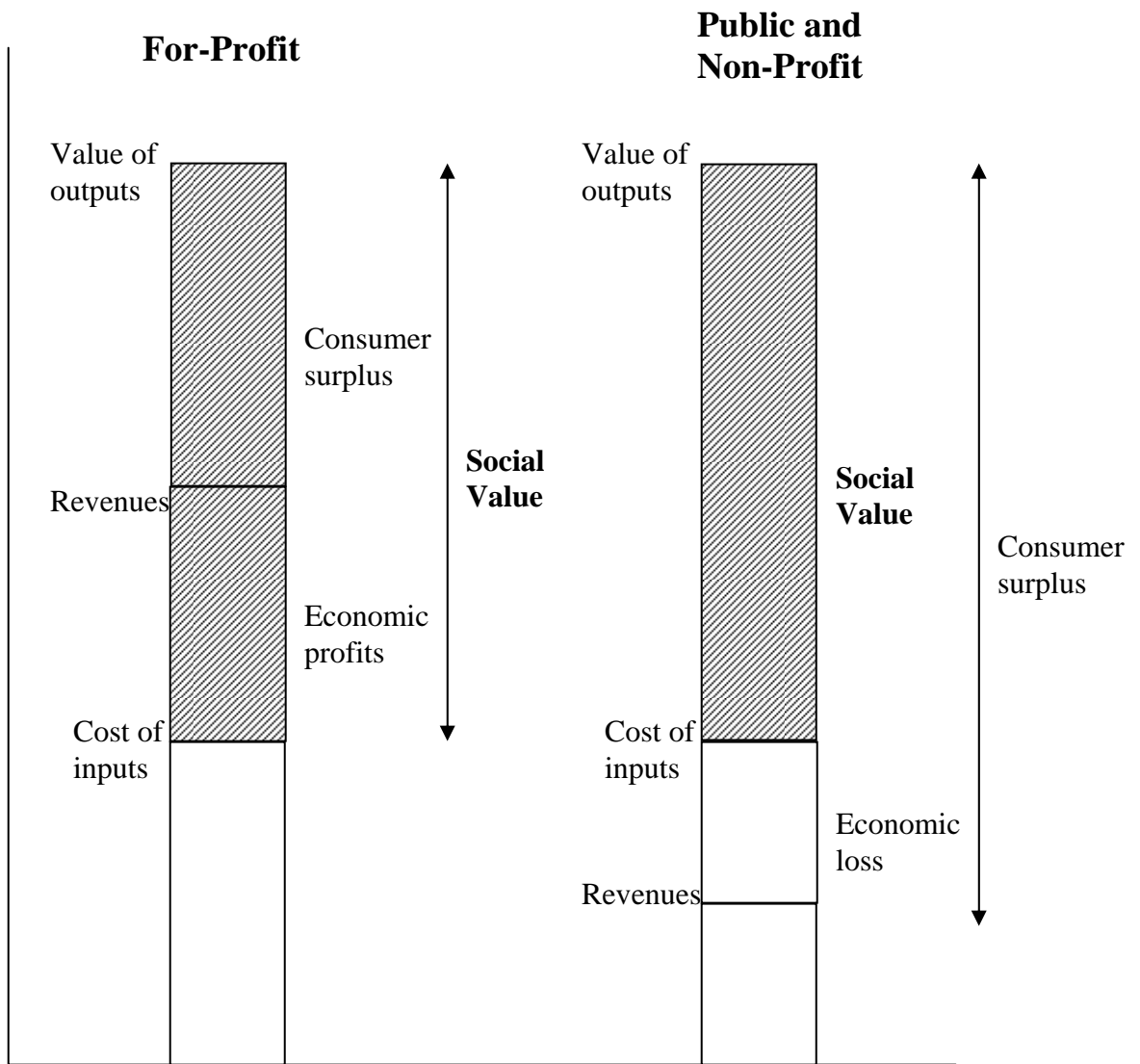
In India higher education is dominated by public organizations of varying quality. The elite Indian Institutes of Technology (IITs) are public organizations that have been very entrepreneurial and had a major positive impact on companies and the economy in spite of their rather limited resources. To promote access on a meritocratic basis, IITs charge tuition of only \$500 per semester, which is inexpensive even taking into account low-income levels in India. As the information technology industry has been expanding rapidly in India since the 1980s, the public educational organizations were unable to meet the growing demand for training. The National Institute of Information Technology, a for-profit training company headquartered in Gurgaon, India, was founded in 1981 by two graduates from IIT Delhi. The company pioneered information technology education in India and has played a significant role in the success of the software industry in India. NIIT provides its services to individuals, enterprises and institutions; its training solutions touch 5 million learners every year in 40 countries. In 2009, NIIT opened a not-for-profit university in Bangalore, India to focus on research and higher education in information technology related fields. Given the growing demand for business education, the elite Indian School of Business was conceived as not-for-profit organization funded by philanthropic donations. The higher education landscape in India is becoming more diverse as for-profit and not-for-profit organizations play an increasing role.

The above discussion of higher education demonstrates that all three types of organizations, for-profit, public and not-for-profit, can be entrepreneurial and create social value. Superior organizations have both characteristics to a significant degree.

Table 1. Characteristics of the three sectors

	For-Profit	Public	Not-for-profit
Mechanism to ensure creation of social value	Invisible hand	Political process	Wisdom of the donors
Products/services allocation driven by	Price mechanism	Citizen rights; political power	Preferences of the donors
Providers of funds driven by	Self interest	Coercion: taxation	Altruism
Governance mechanism	Shareholder rights	Citizen rights	Self-governed
Ability to scale up	High	Varies	Low

Figure 1. Social Value Created



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- ¹ Alex Nicholls, 'Introduction' in *Social Entrepreneurship*, edited by Alex Nicholls, Oxford University Press, 2006, p. 1-35, pages 8-9.
- ² J. Gregory Dees, 'The Meaning of "Social Entrepreneurship,"' Center for the Advancement of Social Entrepreneurship, Duke University, 1998.
- ³ Center for the Advancement of Social Entrepreneurship, 'Developing the Field of Social Entrepreneurship,' Duke University, June 2008, page 3.
- ⁴ James A. Phillips, K. Deiglmeier, and D.T. Miller, 'Rediscovering Social Innovation,' *Stanford Social Innovation Review*, Fall 2008, p. 34-43.
- ⁵ Alex Nicholls, 'Introduction' in *Social Entrepreneurship*, edited by Alex Nicholls, Oxford University Press, 2006, p. 1-35, page 5.
- ⁶ J. Gregory Dees, 'The Meaning of "Social Entrepreneurship,"' Center for the Advancement of Social Entrepreneurship, Duke University, 2001, page 3.
- ⁷ Roger Martin and Sally Osberg, 'Social Entrepreneurship: The case for definition,' *Stanford Social Innovation Review*, Spring 2007, p.28-39.
- ⁸ Paul Light, 'Reshaping Social Entrepreneurship,' *Stanford Social Innovation Review*, Fall 2006, p. 46-51.
- ⁹ James A. Phillips, K. Deiglmeier, and D.T. Miller, 'Rediscovering Social Innovation,' *Stanford Social Innovation Review*, Fall 2008, p. 34-43, page 43.
- ¹⁰ Lester Salamon, S. Wojciech Sokolowski, and Regina List, *Global Civil Society*, Center for Civil Society Studies, The John Hopkins University, 2003.
- ¹¹ Aneel Karnani, 'Microfinance misses its mark,' *Stanford Social Innovation Review*, Vol. 5 (3), p. 34-40, Summer 2007.
- ¹² Peter Drucker. *Innovation and Entrepreneurship*. Harper & Row, New York, 1985.
- ¹³ Tea Petrin. 'Is entrepreneurship possible in public enterprises?' in *Entrepreneurship development in public enterprises*. Edited by Joseph Prokopenko and Igor Pavlin, International Labor Organization, Geneva, 1981.
- ¹⁴ *Innovation and Entrepreneurship in State and Local Government*. Edited by Michael Harris and Rhonda Kinney, Lexington Books, Oxford, 2003.
- ¹⁵ I shall use 'goods' as a generic term to include products and services.
- ¹⁶ Muhammad Yunus, *Creating a world without poverty: Social business and the future of capitalism*, New York: Public Affairs, 2007.
- ¹⁷ Chapter 2. Smith, Adam. *An Inquiry into the Nature and Causes of the Wealth of Nations*. Methuen, London, 1776.
- ¹⁸ Center for Advancement of Social Entrepreneurship, *Developing the Field of Social Entrepreneurship*, Duke University, 2008.
- ¹⁹ Lester Salamon, S. Wojciech Sokolowski, and Regina List, *Global Civil Society*, Center for Civil Society Studies, The John Hopkins University, 2003.
- ²⁰ World Development Indicators, The World Bank.
- ²¹ International Food Policy Research Institute, *Global Hunger Index*, 2009.
- ²² David Ruff, 'India's malnutrition dilemma,' *The New York Times*, 8 October, 2009.
- ²³ See <http://www.righttofoodindia.org/>. [Accessed 3 February 2010]
- ²⁴ James A. Phillips, K. Deiglmeier, and D.T. Miller, 'Rediscovering Social Innovation,' *Stanford Social Innovation Review*, Fall 2008, p. 34-43, page 36.
- ²⁵ Friedman, Milton, 'The social responsibility of business is to increase its profits,' *The New York Times Magazine*, 13 September, 1970.
- ²⁶ Roger Cowe, 'Business/NGO partnerships -- what is the payback?' *Ethical Corporation*, April 2004.
- ²⁷ The Economist, 'The rise of the hybrid company', *The Economist*, 5 December 2009.
- ²⁸ The Economist, 'The rise of the hybrid company', *The Economist*, 5 December 2009.
- ²⁹ National Center for Education Statistics. Available at http://nces.ed.gov/programs/digest/d08/tables/dt08_188.asp?referrer=list. [Accessed 10 February 2010]
- ³⁰ National Center for Education Statistics. Available at http://nces.ed.gov/programs/digest/d08/tables/dt08_188.asp?referrer=list [Accessed 10 February 2010]
- ³¹ Jennifer Gonzalez, 'For-profit colleges, growing fast, say they are key to Obama's degree goals,' *The Chronicle*, 8 November 2009.