

Chu, Rosalind

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Social Entrepreneurship and Social Business

While social entrepreneurship historically has been in practice, it has recently become an emerging field. In this paper, I am going to examine social entrepreneurship and the model and application of social business. More specifically, I will investigate the potential for poverty alleviation through social businesses serving the “bottom of the pyramid” (BOP) as a market.

Social entrepreneurs are social innovators. They are people “who [locate] the interface between a social goal and building a consumer base for the service that delivers that goal: value-centered market economics” (Frances). David Bornstein presents a different description of a social entrepreneur. While he acknowledges the trend of for-profit social businesses, he describes social entrepreneurs as not just those who create social businesses, but as individuals who are *transformative* – people “with new ideas to address major problems [and]... are relentless in the pursuit of their visions” (Bornstein 1). Thus, social entrepreneurship as a field is not *just* social businesses – it includes the various nonprofits and organizations that address social issues and bring about social change. In this paper, however, I am going to more specifically examine for-profit social businesses and how they bring about change.

Nonprofits are undoubtedly essential to addressing social problems. However, as Muhammad Yunus, 2006 Nobel laureate and founder of Grameen Bank, mentions in his book *Creating a World Without Poverty*, most nonprofits do not recover their costs. Nonprofits must rely on donations and spend a substantial amount of time and energy to obtain funding. In this sense, nonprofits are not sustainable. Some argue that nonprofits utilize resources and operate

more efficiently because they are forced to do so, which is a valid point. However, money and funding is *always* a problem for nonprofits. When I was in the grassroots student group California Students Public Interest Research Group (CalPIRG), we spent a total of over 100 hours each semester “pledging” students to donate money and fund our work. Not only is canvassing for money time-consuming, it is also morale-draining.

The nonprofit-charity model can be considered as inefficient. Organizations and projects that have to “rely on subsidies and donations to cover its losses...[remain] in the category of a charity” (Yunus 23). A nonprofit or project’s financial dependence limits it from reaching its full potential. Furthermore, nonprofits that work to alleviate poverty fundamentally operate under the context that poor people need aid and assistance. While this traditional approach to poverty alleviation is valid and has been undeniably vital to those receiving aid, there is another side of the debate: a market-based approach. Rather than focus on the very poor as people who are unable to help themselves and thus need aid, the market-based approach “starts from the recognition that being poor does not eliminate commerce and market processes,...[and] focuses on people as consumers and producers.” By viewing the poor as such, the market-based approach focuses on solutions that “make markets more efficient, competitive, and inclusive” to create benefit for the poor (Hammond, Kramer and Tran 6).

Social businesses exemplify the market-based approach to social problems. Yunus distinguishes between the two types of businesses – the traditional “profit-maximizing” businesses (PMBs) and *non-loss, non-dividend* social businesses. According to Yunus’ model of social business, profits made must be used to reinvest in the business, rather than being passed on to investors (Yunus 24). The profits for social businesses, then, lead to a self-sustaining, self-perpetuating cycle of expansion.

Social businesses will compete in the same marketplace as PMBs. Therefore, some consumers may buy from a social business, and the social benefits offered by the social business may merely be an additional reason consumers choose to purchase from the business. Social investors who invest in social businesses would then evaluate the businesses based on the amount of social impact. Just as most investors will choose to invest in businesses that they believe will generate the most profit, social investors will invest in the social businesses they believe will result in the greatest social impact.

Yunus' concept of a "social investor" who looks for maximum social benefit achieved deviates from the traditional investor who looks for returns and dividends on their investments. In a sense, a social investor is like a donor, except they receive the money back, just with no returns. Just as there are major foundations and individual contributors who donate to charities, there can also be social investors who invest money in social businesses. Yunus even suggest that bilateral and multilateral donors can create "Social Business Funds" in each recipient country, or even create new kinds of financial institutions, both of which would serve social businesses. In addition, commercial lending institutions – just as they are for PMBs – are also a source of funding for social businesses (Yunus 168-169).

While the creation of new financial institutions and "Social Business Funds" may be ideal, it may not be the most efficient way to obtain investment. I think that the concept of "social investors" is one that holds and does work (as there are multiple social investment firms, including Omidyar Network and Good Capital), finding funding this way once again relies on the good will of others. An alternative – and a much more efficient, sensible route – is creating profitable partnerships in which "business and values are aligned by incentives" (Hartman, Werhane and Moberg). In other words, investors of social businesses should want to invest

because they will get returns on their investments. They may be even more inclined to invest in social businesses because they will not only receive dividends, but also have the satisfaction of knowing the positive social impact achieved from his/her investment.

An approach to address the “social investment” problem would be for multinational corporations (MNCs) to create profitable partnerships with communities at the “bottom of the pyramid” (BOP). The BOP consists of the 4 billion individuals – 80% of the global population – who live on less than \$2 per day (Prahalad 61). The BOP as a market can be further defined as countries whose people are extremely poor, and “where doing business may also leverage an opportunity to serve people at multiple income levels concurrently” (Seelos and Mair). Those in the BOP are often unable to participate in the formal economy. Companies must engage the BOP in the formal economy as a “critical part of any wealth-generating and inclusive growth strategy” (Hammond, Kramer and Tran 17). The common perception of the BOP holds that this market is very difficult to access, which discourages large firms or MNCs from entering. A major challenge in BOP markets is income constraints: those at the BOP are willing to pay, but are often not able to. Thus, companies and MNCs “need to strive for new levels of efficiency by radically rethinking the whole supply chain” (Seelos and Mair) and must reevaluate their strategies, as well as develop new resources and capabilities.

MNCs will have an incentive to enter BOP markets because like all other markets, financial metrics are still important and will allow corporations to grow profitably. Thus, traditional business strategies and insights do still apply. On the surface, multinational corporations may want to enter BOP markets and partner with other local businesses as part of corporate social responsibility initiatives. However, profit cannot be the only incentive; instead, recognition is the incentive. Bill Gates defines recognition as “[enhancing] a company’s

reputation and [appealing] to its customers...that triggers a market-based reward for good behavior” (Hartman, Werhane and Moberg). Moreover, MNCs have every incentive to want to enter BOP markets: assuming the goal of MNCs is economic sustainability over time, MNCs *must* enter markets at the bottom of the pyramid. If MNCs remain at the top of the pyramid, “global economic growth will be impeded” and they will have foregone valuable market opportunity.

A major impediment for MNC’s to enter BOP markets is the lack of knowledge and information about BOP markets themselves. To overcome resource and information constraints, Seelos and Mair suggest that MNCs should forge partnerships with local BOP partners. These partnerships will not be “one-shot market transactions” nor “isolated connections” but instead a “system of interactions with customers, local communities, the government, and other stakeholders” (Hartman, Werhane and Moberg). Thus, creating profitable partnerships with local BOP communities leads to long-run sustainability and thus *long-run* profit maximization, which addresses the shareholder/investor concern.

Some critics may claim that social businesses that give dividends to its investors is paradoxical and misaligned with a social business’ mission of poverty reduction. While such claims are valid, I think that in the current marketplace and business environment, the most efficient way – as of now – is to work *with* the markets and the established system. Of course, if in the future when BOP markets are much more understood and more widely targeted, investors may be willing to become Yunus’ version of “social investors.” However, because there is still limited information and connection to BOP markets, I think the most efficient model for social businesses is one that yields dividends for its investors.

The perception of a “social business” is that it exists solely to address poverty and social problems while making profits that are fully reinvested back into the business. However, returning dividends to its investors and creating social benefit do not have to be mutually exclusive. Yunus would argue that by giving dividends to investors, social businesses are not receiving the maximum amount of reinvestment back into themselves and thus are not generating the greatest possible social benefit. However, social businesses are still businesses in that all major stakeholders in the business (investors, beneficiaries, and employees) should benefit from the business. When all major stakeholders benefit, that in itself is also self-sustaining and self-perpetuating.

I believe that adopting the *dividend-yielding* social business model is the most efficient (and perhaps effective) method for poverty alleviation. To me, social business is an innovative and re-inventive way of utilizing existing (or in the case of the BOP, untapped) markets to address poverty. The dividend-yielding social business would likewise utilize an already-existing investment model to ensure efficiency and effectiveness of a social business: if social businesses are constantly looking for funding, they can never get started.

A successful three-way alliance between entrepreneurial BOP business WasteConcern, large fertilizer company Map Agro, and the Bangladeshi government solved a waste buildup problem in Dhaka, Bangladesh. In short, WasteConcern identified the market opportunity to convert the majority of the waste generated – food – into compost for rural agriculture businesses to use as organic fertilizer to produce more food, generating a mutually beneficial and sustainable cycle. In order to implement the project, Waste Concern approached Map Agro, the largest fertilizer company in Bangladesh that had the resources and capital to transform and

produce the organic compost. Significant funding for this project, however, came from the Bangladeshi government and UNICEF.

As of 2007, sales for the organic compost were 10,000 tons per year, and comprised of 25% of Map Agro's overall revenues (Seelos and Mair). Because this business model was so successful, WasteConcern has partnered with Dutch company World Wide Recycling BV to "jointly develop a landfill gas recovery site" that processes organic waste on a much larger scale (Seelos and Mair). Their business received support from the United Nations Framework Convention on Climate Change (in their goal of reducing methane emissions through composting) and investment from two Dutch development banks. Increased investment from the private sector, then, allowed the social business to be expanded and scaled.

Scaling a social entrepreneurial organization depends on the organization's capabilities, which are summed up using the acronym SCALERS: staffing, communicating, alliance building, lobbying, earnings generation, replication, and stimulating market forces (Bloom). Because social businesses are profit-generating, the "earnings generation" and "stimulating market forces" (and also by creating markets for offerings) are necessities. A social business' scaling impact will depend on the particular product or service it provides. Some social businesses seek to scale "deep," largely impacting a limited and local population, while most strive to scale "deep and wide."

Generally, social businesses and social entrepreneurial organizations have more successfully scaled their projects and work at the BOP markets of developing countries. On the other hand, there are few established social businesses that address poverty in the United States. According to the Grameen Foundation, 37 million people (12.6%) live in poverty. However, a

fundamental problem with attempting to address poverty in the United States is that those at the bottom of the pyramid in the US are still near the top or middle of the “global pyramid.” Thus, social entrepreneurs must decide between addressing social problems in developing where the majority live in poverty or in developed countries where government institutions and formal economies are set up to address social issues. Because the standard of living in the U.S. is much higher than those of developing countries, the marginal social impact of social businesses is also much higher in developing countries, which for some social entrepreneurs is more compelling to work on.

Because the United States has formal institutions of healthcare, education, and more accessible information and resource channels, social entrepreneurs should instead focus on creating partnerships with government at the local and/or federal level. Government’s role in promoting social entrepreneurship is to increase scaling impact by “[providing] seed funding to research the feasibility of new approaches, [enacting] policy changes that remove barriers to innovation..., [offering] support for replicating a successful model to additional locations,” and expanding existing information channels for organizations (Wolk). However, the environment for social businesses that address social issues in the United States is not as enabling as it is for social entrepreneurial nonprofits. For example, in May 2009, President Obama asked Congress to provide \$50 million in seed capital for a Social Innovation Fund for *nonprofits* (Office of the Press Secretary).

In the United States, nonprofits are the paradigm for providing welfare and aid to the less fortunate, both domestically and internationally. In order to apply social business concepts and models to the U.S. marketplace, people in the U.S. have to adjust their clear-cut distinction between nonprofits and for-profits. According to Professor Foote from UC Berkeley, the

different between a nonprofit and for-profit is 6%, 6% being “the average profit of the Fortune 500 (at least, before the latest economic unpleasantness)” (Foote). Furthermore, the for-profit U.S. economy is almost \$14 trillion, which is about 20 times larger than the non-profit sector of \$0.7 trillion (Foote). I believe that there is still potential for social businesses that address poverty in the U.S. to thrive, although social businesses will have to adopt even more innovative and strategic models.

One possibility is – especially since there is only a 6% difference – for nonprofits to re-evaluate their current models and experiment with new strategies and models to gradually become a for-profit social business rather than remain a nonprofit dependent on other sources of funding. Nonprofits can even experiment with transforming certain projects (rather than the whole organization) into for-profit social business enterprises, while maintaining their goals, missions, and objectives. Just as WasteConcern and MapAgro formed a partnership to launch a pilot for-profit project aimed at sustainably dealing with waste, nonprofits in the United States can also seek partnerships with already-existing companies. Social business serving the BOP both domestically in the U.S. and globally may have different structures, but fundamentally they remain the same and all share one main goal: poverty alleviation.

The market-based approach of social business is an innovative and sustainable model that can be utilized to address poverty across the globe. I am interested in seeing further developments of social businesses serving the BOP as a market to address social problems in sectors such as health, food, energy, financial, and education. Similarly, I think the social business model is promising and has potential to transform the nonprofit sector into self-sustaining, self-perpetuating social businesses that will enable nonprofits to expand and scale their efforts. Finding solutions to social problems requires effective and efficient means that I

believe social businesses possess. While certain methods of generating the greatest social benefit with the highest efficiency are suggested – dividend-yielding investment model and partnerships with MNCs – they are by no means a definite answer. The social business sector will be continuously changing and evolving to find the most innovative, strategic, and efficient approaches to poverty alleviation. Throughout this process, these businesses and projects will not only be providing the social entrepreneurship field with invaluable insight, but ultimately allow the field – and society – to progress towards a world without poverty.

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