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by

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Abstract:

I propose a theory aimed at advancing scholarly research in social entrepreneurship. By highlighting the key trade-off between value creation and value appropriation and explaining when situations of simultaneous market and government failure may arise, I suggest that social entrepreneurship is the pursuit of sustainable solutions to problems of neglected positive externalities. I further discuss when positive externalities are likely to be neglected and derive the central goal and logic of action of social entrepreneurship

Social entrepreneurship, commonly defined as "entrepreneurial activity with an embedded social purpose" (Austin, Stevenson, & Wei-Skillern, 2006), has become an important economic phenomenon at a global scale (Mair & Marti, 2006; Zahra, Rawhouser, Bhawe, Neubaum, & Hayton, 2008). Some of the most striking social entrepreneurship innovations originate from developing countries and involve the deployment of new business models that address basic human needs (Seelos & Mair, 2005), such as the provision of low-cost cataract surgeries to cure blindness or the deployment of sanitation systems in rural villages (Elkington & Hartigan, 2008). Yet, social entrepreneurship is a vibrant phenomenon in developed countries as well. For example, according to the Global Entrepreneurship Monitor 2005 survey, an estimated 1.2M people in the UK (representing 3.2% of the working age population) are social entrepreneurs (defined in the survey as being involved in founding and running a social oriented venture younger than 42 months). Given that the comparable number for commercial entrepreneurship is 6.2%, these data raises the intriguing possibility that social entrepreneurship may be almost as important a phenomenon as commercial entrepreneurship (Harding, 2006).

Although social entrepreneurs usually start with small, local efforts, they often target problems that have a local expression but global relevance, such as access to water, promoting small-business creation, or waste management. The innovative solutions that social entrepreneurs validate in their local context often get replicated in other geographies and can spun new global industries (Zahra et al., 2008). An example is the growth of the microfinance industry throughout the world (Seelos et al., 2005). Social entrepreneurship is thus having profound implications in the economic system: creating new industries, validating new business models, and allocating resources to neglected societal problems.

These developments have started to spark academic interest. Practitioner oriented research and several books focused on social entrepreneurship have been published in the last few years (Dees, Emerson, & Economy, 2001; Elkington et al., 2008; Nichols, 2006). Business schools which, with a few exceptions (Dees, 2001), had largely ignored this phenomenon, have been joining the field in the last six years by creating academic centres and developing new courses and research (Mair et al., 2006).

Yet, and despite the increasing academic interest in social entrepreneurship, the management field still lacks a good conceptual understanding of the economic role and logic of action of social entrepreneurship. Definitions abound - a recent paper summarized twenty of them (Zahra, Gedajlovic, Neubaum, & Shulman, Forthcoming) - but they are usually driven by practice rather than theory (Mair et al., 2006). Current research typically (and tautologically) define social entrepreneurs as entrepreneurs with a social mission (Dees, 2001; Martin & Osberg, 2007) and considers social entrepreneurship as entrepreneurial activity with an embedded social purpose (Austin et al., 2006). Definitions are then derived from the integration of these two concepts – entrepreneurship and social (Mair et al., 2006; Martin et al., 2007). Social entrepreneurship has also been called the simultaneous pursuit of economic, social, and environmental goals by enterprising ventures (Haugh, 2007). One approach offers a more idealized view of social entrepreneurs as change agents in the social sector (Dees, 2001). This approach contrasts with more pragmatic definitions that see social entrepreneurship as the generation of earned income by ventures in the pursuit of social outcomes (Boschee, 2001).

The concept of social entrepreneurship has thus become a large tent (Martin et al., 2007) where many different activities are finding a home under a broad umbrella of "activities and processes to enhance social wealth" (Zahra et al., Forthcoming) or "entrepreneurship with a social purpose" (Austin et al., 2006). As a consequence, the concept of social entrepreneurship is poorly defined and its boundaries with other fields of study remain fuzzy (Mair et al., 2006). Some authors consider this inclusive approach a beneficial situation for the development of the scholarly field of social entrepreneurship (Nichols & Young, 2008). Based on this approach they develop arguments about how social entrepreneurship is connected with and may enrich more established fields of inquiry such as structuration theory, institutional entrepreneurship and social movements (Mair et al., 2006).

In contrast to this inclusive approach, I argue that at the pre-paradigm stage that we are in (Kuhn, 1962) the field is better served if knowledge about social entrepreneurship is developed though the elaboration of sharper, well-bounded theories of social entrepreneurship that can then compete for attention and validation. It may be more effective to start the theory development process in a new field with a well-defined, theoretical core (often appearing restrictive in terms of its assumptions), and then validate that theory in different contexts, elaborate on it and bound it, rather than start with a large umbrella concept that means different things to different people and then trying to make collective sense of it. The history of theory development in organizational studies suggests the power of apparently restrictive theories at inception, such as institutional theory, population ecology, and transaction cost economics, to subsequently shape the field's development. In essence, what is needed to move the field forward are well-defined theories (Pfeffer, 1993) that clarify what is social entrepreneurship, explain its distinctive role in the economic system and inform research and practice. The aim of this paper is to propose one such theory.

The development of a theory of social entrepreneurship is important because this phenomenon is fundamentally distinct from other forms of economic organization. While our economic theories are based on the assumption of self-interested economic actors, social entrepreneurs exhibit economic behaviours that seem inconsistent with this motivation. While our strategy theories suggest how organizations can develop sustainable competitive advantages, often social entrepreneurship does not seem to involve competitive behaviour.

And while organization theory is still centered on the organization as unit of analysis, social entrepreneurship often involves systems of cooperation that transcend formal organizations.

The typical answer for a phenomenon that is not easily classifiable is to call it a hybrid. Social entrepreneurship is commonly seen as a hybrid that combines elements of commercial entrepreneurship and social sector organizations (Dees, 2001). Indeed leading organizations in the field define a social entrepreneur as someone who “combines the characteristics represented by Richard Branson and Mother Teresa” (Schwab, 2009). Researchers follow this approach by defining social entrepreneurship in ways that combine the elements of entrepreneurship with a social mission (Mair et al., 2006; Martin et al., 2007). Yet I argue that social entrepreneurship is best understood as an organizing process distinct from those found in both the business and social sectors.

It is true that modern economies include different types of business organizations with different governance models: publicly-owned corporations, family-owned businesses, partnerships, and cooperatives. Yet, and despite their differences (ownership structure, profit vs. non-profit), all these organizational forms share a commonality – they are run to defend the interests of the dominant organizational coalition, be they shareholders, owner-managers, partners or members. Social entrepreneurship initiatives, in contrast, do not seem to be run for the self-interest of its dominant coalition but, instead, appear to be run for the benefit of specific users or society as a whole. Yet, social entrepreneurs interact in the market for resources and services with other types of economic actors. It is important to understand what their role is and how they operate.

Modern economies also include different types of social sector organizations such as charities, social activists, and philanthropic organizations. These organizations operate in the pursuit of certain societal values such as human rights, economic fairness, equal opportunity, freedom of expression, consumer rights and environmental protection. Social entrepreneurship organizations often work in areas that are closely associated with social sector organizations. Yet, I argue that social entrepreneurship, in its essence, is not about upholding particular “values” but about the creation of value. It thus plays an economic and societal role that is distinct from other types of social sector organizations.

If social entrepreneurship is not a hybrid, then what is it? In order to explain the distinctive role and approach of social entrepreneurship I start by defending a holistic conception of value and proposing the trade-off between value creation and value appropriation as a central dilemma for organizations. Then, I explain the unique role of social entrepreneurship in the current architecture of the modern economic system. Based on this analysis, I define the distinctive domain of social entrepreneurship as addressing neglected positive externalities. From this argument I derive the central institutional goal and logic of action in social entrepreneurship. Finally, I discuss the implications of the proposed theory for our understanding of economic action and for the advancement of the field of social entrepreneurship.

A Holistic Conception of Value

In order to develop a well-bounded theory, I argue that first we need to drop the distinction between economic and social value that is so often associated with definitions of social entrepreneurship. It is commonly argued that social entrepreneurs are entrepreneurs with a social mission as opposed to a profit seeking motivation. Their goal is to create social value. For example, Certo and Miller (2008) argue that “Social value has little to do with profits but instead involves the fulfilment of basic and long standing needs such as providing food, water, shelter, education and medical services to those members of society who are in need”**.** Social entrepreneurship is thus defined as “innovative social value creating activities” (Austin et al., 2006) or as activities related to “opportunities that enhance social wealth” (Zahra et al., Forthcoming). A common problem of these conceptualizations is the tautology of explaining the “social” in social entrepreneurship in reference to some “social” elsewhere in the definition - social value, social wealth, social mission, social change, or social impact.

Such articulations are problematic for theory development because they require subjective assessments about who is in need of “social help” and they suggest that profit cannot or should not be an outcome of fulfilling those needs. They also assume that there is some metric or set of values that make certain types of value creation “social” and others not. This distinction is thus relative to the observer and requires normative judgments. A positive theory of social entrepreneurship should not be built on such a basis. Rather, one should be able to define social entrepreneurship without using the word “social” and without having to make normative assessments about values or needs.

Moreover, the dichotomy between economic and social value poses additional problems for theory development. First, all economic value creation is inherently social in the sense that actions that create economic value also improve society’s welfare through a better allocation of resources. Second, some may argue that economic value is narrower than social value and only applies to benefits that can be measured monetarily, while social value includes intangible benefits that defy measurement. This argument, however, creates a methodological dead-end because its logical implication is the need to develop a theory based on elements that, by definition, are not easily measurable.

I thus argue for the rejection of the dichotomy between economic and social outcomes. It is more effective for theory development to focus on a generic concept of value as defined in terms of the increase in the utility of society’s members. This is consistent with the treatment of the concept of value in economic theory, for which social welfare is defined by the aggregation of individual utility functions. It is also consistent with more applied notions such as blended value (Emerson, 2003).

If we adopt a holistic concept of value what is then the most relevant distinction to explain the diversity of organizations that we observe in modern societies? I argue that the most relevant distinction is the one between *value creation* and *value appropriation*.

Value Creation versus Value Appropriation

Value creation from an activity happens when the utility of society's members increases after accounting for the resources used in that activity. Value appropriation from an activity happens when the focal actor is able to capture a portion of the value created by the activity (Mizik & Jacobson, 2003). It is clear that value creation is a necessary condition for sustainable value appropriation. Activities that allow value appropriation without value creation will either be short-lived (e.g., price arbitrage opportunities in financial markets) or will be seen as illegitimate and probably soon outlawed due to the cost to society (e.g. Enron trading in electricity markets based on price manipulations; or industrial activities that heavily contaminate the environment). It is also clear that some level of value appropriation is important to ensure the growth and sustainability of the organization whose activities create value (this explains for example the fast growth of microfinance organizations that are able to develop a financially viable business model).

Yet, these two dimensions are not perfectly correlated. Some activities that create value do not easily allow for value appropriation because of significant spillovers due to positive externalities (Rangan, Samii, & Van Wassenhove, 2006) or because of the inability to pay of the target customers despite a willingness to pay if funds would be available (Seelos et al., 2005). Moreover, some organizational actions may increase the potential for value appropriation in detriment of value creation (e.g., a price increase that lowers the sales level thus reducing total surplus). This suggests that economic actors need to make trade-offs between value creation and value appropriation.

The importance of these trade-offs are well established in the field of strategy. For example, work on strategic alliances argues that alliance activities by firms have distinct value creation and a value appropriation mechanisms (Lavie, 2007). Work on strategic marketing recognizes that managers, when allocating attention and resources in organizations, have to make trade-offs in terms of the emphasis they place on value creation versus value appropriation (Mizik et al., 2003). Moreover, these choices have consequences in terms of how the organization is perceived by its stakeholders valued by the market. For example, the stock market has been shown to react favorably when firms shift emphasis from value creation to value appropriation strategies (Mizik et al., 2003).

I argue that organizations need to choose if their predominant focus is value creation or value appropriation. This choice is so central to the organizational identity that any perceived shift or ambiguity causes upheaval on stakeholders and may lead to a loss of legitimacy. For example, the Mexican bank Compartamos operated for many years as a typical microfinance institution - maximizing on value creation by lending to the poor and charging an interest rate that allowed it to cover costs and reinvest in growth (Rosenberg, 2007). In the 1990s the managers of the bank were forced to significantly raise their interest rates to cover their costs during a period of high inflation in Mexico. After the inflation suddenly came down, they found that their business model was highly profitable and decided to maximize profits to increase their growth potential - instead of lowering their rates, they kept them at close to 80% and re-invested the profits in an aggressive growth strategy with a view for an IPO. The managers and initial investors cashed out in the 2007 IPO with extremely high rates of return on their initial investment. The bank was valued at more than 1 Billion US$ given the level of growth and profits promised at the IPO. Naturally, the new shareholders will demand a continuation of this value appropriation strategy. In the meanwhile, the bank lost legitimacy in the microfinance field because of its perceived shift from value creation to value appropriation (Pache & Santos, 2009). Microfinance opinion leaders, such as Muhammad Yunus the founder of Grameen Bank and Nobel prize winner, challenged Compartamos actions saying that Microfinance risked losing its soul. Compartamos leader hadd to publish a public letter in defense of their actions, arguing that a strategy of value appropriation was the most effective approach to develop the microfinance industry (The_Economist, 2008).

This example suggests that maximizing both value creation and value appropriation in the same organizational unit is difficult. Although they can seem aligned, trade-offs will eventually emerge and path-dependencies created. A central argument for the theory proposed in this paper is that organizations need to choose one or the other and be clear in communicating their choice. This choice then has important consequences for organizational actions. An organization that is predominantly focused on value creation would typically set the price of its service at the point that would maximize the utility for its users and clients (subject to the organization's sustainability). In contrast, as the Compartamos example illustrates, an organization focused on value appropriation would set the price of its product at the point that maximizes its profit potential.

More importantly, the value creation versus appropriation trade-off is central to the choice of actual activities to be performed by the organization (and not just their price level or quantity). For example a pharmaceutical company focused on value appropriation would not invest in vaccines for diseases that plague developing countries due to the lack of ability to pay by its potential clients. In contrast, a pharmaceutical company focused on value creation would have a motivation to invest in that activity, independent of the amount of value that it would be able to appropriate, given the strong and measurable impact for society of disease eradication. An example is OneWorld Health, a not-for profit pharmaceutical firm launched in the US in 2000 (Seelos et al., 2005). Given the constraints caused by the dominant focus of the pharmaceutical industry on value appropriation, the value creation focus of OneWorld Health allowed it to engage with stakeholders in novel ways and re-design the pharmaceutical value chain to deliver effective drugs to fight the most prevalent (and often neglected) diseases in developing countries.

These arguments suggest that organizations (or at least their sub-units) need to be clear about their central goal being value appropriation or value creation. In most situations, organizations will maximize one of the dimensions and satisfice on the other dimension. For-profit corporations usually have a clear goal of maximizing value appropriation and satisficing on value creation by following legal requirements and socially responsible actions. Social-mission organizations usually maximize on value creation and satisfice on value appropriation by aiming to capturing just enough value to sustain operations and re-invest in growth. For example, Bridges Ventures is a U.K. venture capital firm that was set up in 2002 to invest in economically deprived areas of the UK. It raised a fund that set a high standard of value creation by choosing geographical areas for investment where entrepreneurial activity would have a strong societal impact and then set the goal of maximizing the financial returns to investors within that constraint. Yet, its managers realized that many opportunities for value creation through social investment went unexplored because of their mandate to maximize financial returns. Thus, in 2008 Bridges Ventures raised a social entrepreneurs' fund that satisfices on financial returns by aiming to ensure a rate of return equivalent to bank deposits, but then makes investments in social entrepreneurship initiatives with the goal of maximizing social impact. Naturally this fund attracted a different set of investors who were motivated by social impact not financial returns.

In contrast to my arguments, proponents of concepts such as the triple bottom line (social, financial, environmental) call for organizations to develop strategies that maximize on different variables (Elkington, 1998). Although in some instances it may be possible to temporarily develop win-win scenarios and combine goals, conflicts will inevitably arise when the trade-offs between value creation and value appropriation surface. An example is Grameen Phone, the partnership between Telenor (the Norwegian Telecom company) and Grameen Telecom (the telecom subsidiary of Grameen Bank). The goal of Grameen Phone, established in 1996 was to deploy low-cost mobile phone access in Bangladesh. The astounding success of this initiative made it the largest and most profitable telecom company in Bangladesh and a significant growth driver in Telenor's mature portfolio of businesses. This success led to a clash of interests between the partners since Telenor reneged on an earlier promise to cede majority ownership of the joint-venture to Grameen Telecom, so that the social venture could share the value created with the users. Telenor argued that its promise was just "an intention" and that its current strategy required keeping majority control of all foreign subsidiaries. In addition, the management of Grameen Phone, controlled by Telenor, was plagued with ethical and legal problems, some caused by a desire to increase its margins. Yunus threatened to file a lawsuit against Telenor if the situation was not resolved. He argued that *"the agenda of Telenor to maximize returns for the benefit of its owners is, however, in conflict with the social and non-profit agenda of Grameen Telecom"*(Yunus, 2008).

In contrast to the problems plaguing the Grameen Phone partnership, the more recent partnership between Grameen and the French dairy multinational Danone has been less contentious (Yunus, 2007). The goal of Grameen Danone is to reduce malnutrition of Bangladeshi children through the local production and sale of low-cost yoghurts enriched with vitamins. Danone's CEO created a separate governance structure called Danone Communities for the partnership and made clear that Grameen Danone is a social business that needs to be financially sustainable (thus satisficing on value appropriation) but has the goal of maximizing on value creation for society. To secure this arrangement for the long-term, Danone's leadership cannot change the partnership structure at a later date.

In summary, organizational entities will have a predominant focus on either value creation or value appropriation and any change in the main driver or ambiguity about the positioning on this issue will be identity challenging (Tripsas, 2009).

Building on this central trade-off, I argue that <u>what distinguishes social entrepreneurship from commercial entrepreneurship is a predominant focus on value creation as opposed to a predominant focus on value appropriation</u>. Although there are many accounts of entrepreneurial actors driven by a desire to create value, entrepreneurs need to make choices about whom they bring on as partners and investors. Often they build organizations and engage other stakeholders (co-founders and employees who receive shares, investors such as business angels and venture capitalists) who wish in the end to appropriate value to compensate for their resource commitments. So, even if the founders are driven equally by value creation and appropriation, their early choices will lead to a certain path for the organization. One can argue, for example, that when Jeff Skoll joined Pierre Omidyar as co-founder of eBay, the venture had a good balance between value creation and value appropriation given the focus of the founders on fairness and the good of society. Yet, once the founders accepted venture capital to speed up growth and the VC investors brought Meg Whitman on board as CEO, eBay clearly moved into a path of focusing on value appropriation. The fact that the eBay founders later donated most of the value they appropriated for philanthropic activities (including endowing the Skoll Foundation to support the growth of social entrepreneurship throughout the world) actually reinforces the argument. It suggests that although individual may have multiple goals, organizations need clarity of purpose in order to engage with their environments in coherent ways. They need to choose either value creation or value appropriation as their dominant focus.

Naturally, actual value created and appropriated can only be known ex-post and it depends on the quality of execution of organizational activities. Thus, what drives economic action is the potential for value creation and value appropriation as perceived by economic actors, not their eventual success or failure in creating and/or appropriating value. An activity may be perceived by economic actors as having high potential for vale creation and a high potential for value appropriation. This usually becomes the domain of corporations and commercial entrepreneurs. Activities with low potential for value creation but high potential for value appropriation are usually based on arbitrage opportunities (Alvarez & Barney, 2004) or imply hidden costs to society. Activities with a low perceived value for both value creation and value appropriation are not interesting as a domain for economic activity. The more interesting case for the theory proposed in this paper is when there is a high perceived potential for value creation but a low perceived potential for value appropriation. This is the domain where economic actors predominantly driven by value creation, such as social entrepreneurs, will operate. These four domains of activity are illustrated in figure 1.

Insert figure1 about here

Interestingly, these arguments relate to the arguments of Ghoshal and Moran (2005) who reject the focus on value appropriation that exists in economics and strategy theories and call for value creation to be the "raison d'etre" of the modern corporation. Although I agree on the fundamental choice between value creation and value appropriation, the approach I adopt in this paper is positive not normative. Instead of calling for all business organizations to focus on value creation, I acknowledge that different behavioral motivations may lead to distinct organizational emphasis within the value creation / appropriation trade-off.

This distinction between value creation and value appropriation allows developing a theory of social entrepreneurship that is rooted in established paradigms in economic organization and does not tautologically use the concept "social". Next I use this distinction to discuss the role of social entrepreneurship in the context of the modern economic system.

THE ARCHITECTURE OF THE ECONOMIC SYSTEM

I argued in the prior section that the management field lacks a conceptual foundation that can clarify the distinctive role of social entrepreneurship in society and explain the unique attributes of a social entrepreneurship approach when compared to commercial entrepreneurship, charity work and government provision (Austin et al., 2006). In the modern economic system, characterized by market-based capitalism with a varying level of government sponsored services and an active social sector, what is the role and distinctive domain of social entrepreneurship? To answer this question we need to probe deeper into the architecture of the modern economic system and discuss the different institutional roles.

Economic theory suggests that, in perfect market conditions[1], economic agents pursuing their own self-interest (usually narrowly defined as profit maximization but associated here with the broader concept of value appropriation) will lead the economy to a Pareto optimal outcome in which resources are put to the best possible use and individuals will consume the services that they most value. This outcome will in turn maximize welfare since there can be no re-allocation of resources that will make someone better off without making someone else worse off. This is the fundamental insight of the invisible hand suggested by Adam Smith and later demonstrated by the economist Vilfredo Pareto.

Naturally, economies are not static. New needs, new technologies and new information arise, enabling new opportunities for improvement in the organization of resources and delivery of services. However, profit-oriented companies often invest resources and skills in becoming efficient in certain areas of activity. They may then be unable to identify new opportunities or, even if they do, they may not have incentives to invest in new resources, structures or services given the underlying ambiguity of new areas compared to the clarity of their current business (Santos & Eisenhardt, Forthcoming). Thus, managers and their

[1] Which it its most extreme form requires perfect competition (no increasing returns to scale, multiple buyers and sellers), complete information available to all economic actors, and no transaction costs and externalities.

corporations may become locked into increasingly erroneous views of the world (Hodgkinson), their core capabilities become core rigidities (Leonard-Barton, 1992), and the business model that made them successful may no longer constitute a good fit with the environment (Zott & Amit, 2008).

It thus falls upon commercial entrepreneurs to pursue new opportunities for value appropriation, often creating a new market niches in the process (Santos et al., Forthcoming) or developing an improved service or changing operating procedures to reduce the costs of activities. Competition from entrepreneurs then forces established corporations to either adapt their business processes to remain competitive or risk losing their ability to compete. This often means adopting the innovations introduced by entrepreneurs or acquiring the innovative firms (Markides & Gerosky, 2005). Commercial entrepreneurship is thus the dynamic mechanism that keeps economies evolving towards a state in which resources are allocated and organized in the best way possible to benefit society (Schumpeter, 1934).

Yet, economic activity cannot happen in an institutional vacuum. There is the need for a central actor, such as the government and its institutions, to establish the legal infrastructure of the system and enforce it. This infrastructure includes elements such as property rights and the rule of law. Moreover, in their pursuit of value appropriation, corporations may often push their mandate to maximize profits beyond what is socially acceptable, abusing their dominant position or developing anti-competitive tactics that reduce the value for society. Thus the government also has a crucial regulatory function, setting the legal and monitoring framework that guarantees that competitive market conditions are maintained.

While self-interested competition in regulated market conditions may be an optimal system from an economic efficiency point of view, this system may not lead to equitable economic outcomes since initial endowments and differences in capabilities often generate inequalities in the distribution of resources and welfare. Governments then also assume a re-distributive function, through the tax system and social coverage, to try to raise every individual in society beyond a minimum accepted level of individual welfare. Yet, it can be argued that governments often do not have the means or capabilities to perform this re-distribution function, particularly when action is needed at a local level. The visible hand of the government is blunt and favors general solutions not customized actions. Here enter charitable organizations, which are groups of citizens concerned about a particular social inequality who create an organization that re-distributes resources to reduce that inequality. Charities usually source funds from governments, philanthropic organizations such as foundations, and wealthy individuals to pursue their mission for the benefit of disadvantaged populations. Charities represent the dynamic and distributed mechanism that makes economies move towards a more just distribution of resources and economic outcomes.

Unfortunately, the simple and appealing architecture of the economic system outlined above is spoiled by the presence of externalities. Externalities exist when economic activity creates an impact, positive or negative, that lies beyond the objective function of the agents developing the activity (Rangan et al., 2006). When this happens, the decisions of self-interested actors are no longer optimal for society since actors are ignoring in their decisions the positive or negative impact of their activities on others. In the case of negative externalities, the consequences are usually the adoption of harmful practices (e.g., pollution) or the over-production or over-consumption of activities that bring negative consequences (e.g., excessive car usage leading to road congestion). In the case of positive externalities, the consequence is usually the under-provision of goods that would create value for society (e.g., education, vaccination). In order to achieve an optimal economic outcome, these externalities need to be internalized by economic actors in their decisions, with the government taking up a key role. How this internalization is accomplished depends on the type of externality.

The Case of Negative Externalities. There are three main government mechanisms to correct for negative externalities – regulation, taxation, and market creation. Either the government introduces regulations forbidding the behaviors that lead to negative externalities (e.g., recycling directives; law forbidding production and consumption of narcotics), or it introduces incentives to reduce activities with negative externalities (e.g., gasoline and tobacco taxes), or it creates market-based mechanisms that price these negative externalities and incorporate them in the agents' decisions (e.g., the carbon-emission trading system).

Another possible correcting mechanism for negative externalities is self-regulation by corporations. One can argue that the trend for Corporate Social Responsibility represents the duty of profit-oriented corporations in accounting for the full cost of their activities to society, even beyond existing legal requirements. In this regard, the implementation of carbon-neutral strategies, for example, can make sense for corporations. In contrast, setting up a foundation to distribute a share of the profits would not make sense for a profit-oriented corporation since it means that it would be taking on a re-distributive function that lies outside its mandate to society (unless it brings such a boost in reputation that it becomes consistent with the value appropriation strategy of the corporation).

However, self-regulation by corporations may not be fully effective given the predominantly self-interested drive in their behavior (being controlled by a coalition of individuals seeking to maximize their self-interest through value appropriation strategies). In addition governments have multiple duties and scarce resources, often failing to pursue their mission of eliminating negative externalities to improve societal welfare.

What is the mechanism that allows for negative externalities to be priced in agents' decisions despite the failure of government and corporations to do so? To perform that role there is a new category of organizations comprising civic movements and pressure groups, that are generally called social activists (e.g., Greenpeace, Consumer Watch organizations, informal social movements). These are groups of citizens that believe the government and corporations are not doing enough to reduce negative externalities in a particular area of life. They then, through formal or informal organizations, develop actions to pressure corporations to comply with existing regulations to better internalize the negative externalities. They also pressure government to change regulations and practices when they are not deemed appropriate. Social activism provides a distributed and dynamic mechanism to systematically correct market failures due to negative externalities, beyond the self-regulation of corporate actors and the heavy hand of governments. Their goal is not to provide solutions to the problems, but rather to develop actions that force or influence other market actors to change their behaviors in ways that reduce the perceived negative externalities. Although this is an important role in the functioning of the economic system, I argue that social activism does not constitute social entrepreneurship, despite being often included in the broad tent that the practice field of social entrepreneurship has become (Sen, 2007).

The Case of Positive Externalities. If the market inefficiency is caused by positive externalities it leads to under-provision or under-consumption of beneficial goods by self-interested actors because they do not perceive a potential for value appropriation, (Rangan et al., 2006). Governments have a key role to play in correcting this market failure and either decide to provide those services directly through governmental organizations since they are considered public goods (which are goods that have the characteristics of being non-rival and non-excludable, such as national defense) and/or create a system of public subsidies that generates an incentive for self-interested actors to increase the provision of these services (e.g., education vouchers; R&D incentives; subsidy for renewable energy production).

Yet, as I argued before, governments have multiple roles and often scarce resources. This suggests that some positive externalities are likely to be neglected by governments. What is the distributed mechanism that ensures that positive externalities are continuously being identified and internalized in economic system? I suggest that this mechanism is social entrepreneurship and that pursuing neglected positive externalities is the distinctive domain of social entrepreneurship. I elaborate this argument in the next section.

The Distinctive Domain of Social Entrepreneurship

As I argued earlier, a central difference between commercial entrepreneurship and social entrepreneurship is that social entrepreneurs are driven primarily by a motivation to create value for society, not to appropriate value for themselves. What legal form an entrepreneurial organization actually adopts (profit vs. non-profit) and whether entrepreneurs eventually appropriate value through their activities or not (they may fail and go bankrupt or their initial perception about the potential for value appropriation may be wrong) is irrelevant for their institutional role since what matters for economic activity is the motivations that drive economic behavior.

I will also assume that, in most activities with a perceived potential for value appropriation, commercial entrepreneurship is a more effective mechanism for action than social entrepreneurship due to the strong influence of market-based incentives in capitalist economies. For example, let us imagine that an activity that has a potential for value appropriation starts to be performed simultaneously by a social entrepreneur and by a commercial entrepreneur. Let us assume that both entrepreneurs are equally effective at developing and validating a new solution for the problem they are addressing. After the initial validation, commercial entrepreneurs are much more likely to be able to acquire the resources needed for growth (skilled employees looking for a high salary, partners looking for an equity revenue share, investors looking for a return on their resource commitments, etc). They will then be able to scale their solution faster than social entrepreneurs, eventually displacing them over the long term. Thus, commercial entrepreneurs will tend to crowd-out social entrepreneurs in capitalist-driven societies.

So the key question becomes: in which situations do commercial entrepreneurs fail to act and social entrepreneurs can play a role? Precisely in areas with strong positive externalities where the potential for value creation is not matched by the potential for value appropriation because the benefits for society go much beyond the benefits accrued to the transacting parties. These market failures, however, should be tackled by governments since the internalization of positive externalities is one of their central roles. Yet, any institutional actor will only perform its role if it has the motivation and ability to do it. So we need to explore further the motivation and ability of governments to address positive externalities.

Motivation. To the extent that citizens value goods with positive externalities, they are likely to reward with their votes governments that deliver them and penalize governments that do not. Thus, democratic governments should have the motivation to provide goods with positive externalities that are valued by society's members (as part of the implicit social contract). In non-democratic regimes, governments are not subject to voting scrutiny and will often try to perpetuate themselves, usually through control mechanisms as opposed to the effective performance of their institutional role. They will thus be less likely to internalize the positive externalities in the economy. In this paper I will focus on the case of democratic governments with a motivation to address positive externalities.

Ability. One can argue that, in democratic regimes, governments may have the motivation but not the ability to address positive externalities due to scarcity of resources, lack of capabilities or shortage of attention. In these cases social entrepreneurs would have to step in to substitute ineffective or resource-constrained governments in addressing positive externalities. While these arguments ring true in the face of the substantial level and powerful examples of social entrepreneurship activities in developing democracies, such as India, the arguments would restrict social entrepreneurship to contexts of poor and/or ineffective governments. This is puzzling given data showing substantial social entrepreneurship activities in developed countries, like the UK (Harding, 2006), where governments should have both the motivation and ability to act to internalize positive externalities. So, while valid, the above argument is not particularly powerful to explain the rise of social entrepreneurship across the world. What we observe is that there are many areas of neglected positive externalities even in the presence of governments that should have the motivation and ability to tackle them. I explore this puzzle in the next section

Neglected Positive Externalities

If there is a wide societal perception of the positive externality, governments will act by either provisioning the activity themselves or creating public subsidies for the private provision of these activities, either through for-profit actors or through established social sector organizations. This is the case for example of the widespread government support for renewable energy production in most European countries or the subsidies for the social integration of long-term unemployed in France. However, in some situations, governments and society may not fully realize the extent of positive externalities in a certain domain. For example, the positive externalities involved with renewable energy production in terms of slowing down climate were invisible a decade ago. Thus, governments often do not have knowledge to act. Profit-oriented entrepreneurs, even if they perceive the externalities, will not act on them given the low likelihood of appropriating value. It then falls to social entrepreneurs to tackle that positive externality by providing a solution to it, while alerting society's members to the importance of these externalities so that they can then be internalized in future actions. This is the distinctive domain of social entrepreneurship.

Proposition 1: addressing problems involving neglected positive externalities is the distinctive domain of action of social entrepreneurship

A micro and a macro example illustrate this proposition. The micro example is the case of Unis-Cité, a French social enterprise founded in 1995 with the purpose of creating a civic service opportunity for young French people (Pache, 2002). The program assembled youngsters from different origins to perform volunteer team work for a period of 1 year in different social projects and programs. Although young French people would benefit in skills and knowledge from this experience, they would not be willing to pay for this opportunity. Instead, many require a stipend to ensure a living wage for the duration of their volunteer service. However the social organizations offering projects did not have ability to pay, even if they valued the services highly. This led the field of civic service to be neglected by both commercial entrepreneurs and government. The government did not even define a legal status for this type of volunteer work, let alone subsidize it. So why would social entrepreneurs develop an offering in this area? The argument was based on a positive externality benefiting society. Given the high unemployment among the youth and the widening societal divisions across religion, race, and residence area (suburbs versus cities; white youngsters versus African emigrants' children) the social entrepreneurs argued that such civic service program would create a sense of cohesion among the youth that would greatly benefit French society.

The social entrepreneurs developed a business model, found support among corporate foundations and local governments, and validated a small scale pilot in Paris in 1998. This pilot was then extended to other French cities in the following years. The value of the initiative was validated by several impact assessments. However funding for the scaling up process was difficult and the national government was not making any progress in the creation of a legal framework. Now, let us fast forward to 2006. French youth from the suburbs revolt against society and provoke widespread riots across France. The national government suddenly realizes the importance of the problem of youth integration, so far neglected. They also realize the value of the positive externalities generated by a civic service program of the kind proposed by Unis-Cité. The government then announces, a few months later, a legal framework and sizable funding to develop a large-scale civic service program among the French youth. This leads to a tenfold increase in Unis-Cité size in 2007 and to the entrance of other providers into this market, both new social ventures and more established social organizations, such as the Red Cross and the Boy/Girl Scouts.

This example of a neglected positive externality being addressed early on by social entrepreneurs and later by the government is not an isolated case, as our macro-example demonstrates. Ashoka, the global organization that identifies and supports close to 2000 high-impact social entrepreneurs, claims that over half of the social entrepreneurs in their network influenced national legislation within five years of launching their organization (Sen, 2007). What this suggests is that social entrepreneurs operate in areas of neglected positive externalities, develop economic action to demonstrate a solution to address the externality, and then often influence governments to create legislation that legitimates and supports their innovation. This facilitates scaling-up and replication of the innovation, thus reducing the market failure of service under-provision in their chosen field. This systematic identification and solution of problems related to neglected positive externalities is the distinctive role of social entrepreneurship in society.

While the above arguments set out the distinctive domain for social entrepreneurship, a theory of social entrepreneurship should go further and clarify which types of positive externalities are likely to be systematically neglected, even by highly effective governments. I argue that positive externalities whose benefits are both localized and favor less powerful segments of the population are likely to remain neglected by governments.

Localized Positive Externalities. As I argued before, the case for government provision is particularly strong in situations where the positive externalities generate goods that are both *non-rival* (the consumption of the good by one individual does not preclude others from consuming – examples are new knowledge or radio broadcasts) and *non-excludable* (once provided there are no mechanisms to prevent individuals from consuming the good – examples are national security or clean air). These are called in economic theory "public goods" and since they benefit society as whole, they are more visible and there are more incentives for governments to intervene. However, beyond the extreme example of public goods lies a spectrum of goods that generate substantial positive externalities but do not qualify as public goods. In some situations, these positive externalities may be invisible or irrelevant to the general public. I argue that this happens in particular when the externalities are localized in the sense that they benefit disproportionally a segment of the population, such as isolated populations, racial minorities, or elderly people. In these situations, governments may have a weaker mandate to intervene since they would be using public funds to support a specific group or constituency. An important variable however is the power of the affected group.

Powerless Segments of the Population. When these localized externalities benefit a powerful segment of the population (defined as having high status, control of resources, ability for collective action, influence in public opinion) the government has an incentive to act and will be pressured to do so by those society members that care about the issues. Note, for example, the sizable subsidies provided to farmers in most developed countries. While an argument can be made about the positive externalities of having an active farming activity, these benefits will mostly accrue locally (unless there are food security concerns at the national level which is often not the case for open market economies). Yet, existing subsidies in developed countries are clearly beyond the level justified by positive externalities because of the high visibility and collective action capacity of farmers.

Let us imagine now that the positive externality accrues mainly to a localized and powerless segment of the population (by powerless we include characteristics such as small in size, low status, low resources, low ability for collective movement, no influence on public opinion). In these situations the government, faced with many priorities and generally scarce resources, may not notice, is not motivated to, or cannot easily justify to society spending resources and efforts in benefiting a specific segment of the population. These will then become areas of severe under-provision compared to the economic optimal level, representing a system failure.

Social entrepreneurs, faced with this failure of both markets and governments and feeling passionate about the needs of that particular group or about the characteristics of the problem, will enter this domain and develop a solution to the problem. At the same time as they try to validate their solution, they often also raise societal awareness about the problem. In summary, these areas of neglected positive externalities are ideal for social entrepreneurs - they offer a high potential for value creation because of the neglect they suffer from government, commercial entrepreneurs and established businesses.

Proposition 2: Social entrepreneurs are more likely to operate in areas with localized positive externalities that benefit a powerless segment of the population

This proposition is supported by substantial evidence that most activities of social entrepreneurs are directed towards offering services to disadvantaged segments of the population (poor, long-term unemployed, disabled, discriminated, socially excluded, etc) (Seelos et al., 2005). However, the proposition also has a very important implication for a theory of social entrepreneurship. Helping disadvantage segments of the population is not, contrary to some definitions (Certo & Miller, 2008), the defining characteristic of social entrepreneurship. Rather, the pursuit of neglected positive externalities is the defining characteristic of social entrepreneurship. It so happens that the most serious problems of neglected positive externalities affect disadvantaged populations. This explains why so many social entrepreneurs operate for the benefit of these populations. This also means that efforts to help <u>advantaged</u> populations may also constitute social entrepreneurship, as long as it involves addressing neglected positive externalities. An example is the development of

Wikipedia, the online encyclopedia. This is a service that benefits mostly advantaged populations - literate audiences with access to computers and internet technologies. Yet this is an excellent example of how the problems caused by positive externalities in the production of knowledge can be tackled by social entrepreneurs who are able to develop an innovative solution that creates value for society.

Searching for and Measuring Positive Externalities

An important implication of the theory proposed in this paper is thus that social entrepreneurs do not need to be defined as "good" or "moral" agents that want to help others. Although helping others is often a motivation for their behavior and an outcome of their activities (Zahra et al., Forthcoming) this is not what defines the role of social entrepreneurs in society. What is distinctive about social entrepreneurs is that they are economic agents who, due to their motivation to create value without concerns to the amount their appropriate, will enter areas of activity where the more severe market and government failures occur. Value creation can be defined here as the sum of the value added to all members of society minus the value of all resources used. The proposed theory can thus be elaborated and tested based on measurable indicators of positive externalities and value creation.

This suggests that the development of the field of social entrepreneurship may require further work on identifying which important spillovers are likely to get neglected by both markets and governments and then measuring them. In particular, industry-based analysis should be developed on the impact of solving certain classes of problems of positive externalities. What is the value for society of curing blindness in one individual? What is the value of eradicating a contagious disease? What is the value of integrating formerly disenfranchised members of society? What is the value of creating a repository of knowledge easily accessible to all? Developing studies and metrics would allow comparing the impact of different social entrepreneurship activities. This, in turn, would enable the allocation of societal resources in more efficient ways to areas of greater impact per unit of resource used.

Venture philanthropy organizations and social venture capital firms are springing up in large numbers[2] to invest societal resources in the social entrepreneurship organizations capable of achieving the greatest impact. Value creation benchmarks would be useful for the allocation of resources since the traditional metric for venture capital investments (the potential for profitability) is not valid for social entrepreneurship. Such benchmarks would also help social enterprises allocate resources to different activities or segments of beneficiaries. If we take seriously the notion that there is no dichotomy between social and economic value, then we need reliable ways of measuring the value to society created by different economic activities.

Although this may seem a challenging task, it is not much different from the need to build detailed actuarial tables to assess risks and costs in the insurance industry or detailed depreciation tables for assets in the accounting profession or detailed methodologies for cost/benefit analysis in investment projects. We have more than a century of work in metrics to support the accounting, insurance and investment fields. We has only recently started to develop an equivalent knowledge infrastructure for social entrepreneurship and social investing. This will be a fundamental area for the field's progress.

The Division of Roles in the Economic System

Some additional implications of the theory concern the distinct role of different institutional actors in the architecture of the economic system. An initial consideration is that helping disadvantaged populations in areas with weak or no positive externalities may be better characterized as charity (defined as the re-distribution of resources from more affluent elements of society to less affluent ones), than social entrepreneurship. A litmus test is to ask

[2] For example, the European Venture Philanthropy Association counts more than 100 members

social entrepreneurs for their theory of value creation – why their activities will benefit society and what are the causal mechanisms and expected impacts (Guclu, Dees, & Anderson, 2002).

Another consideration is that there are many activities for which positive externalities are not neglected but rather appropriately recognized by society's members and subsidized by governments. In that case, those activities can be carried out, depending on their nature, by either commercial or social enterprises, often using well established methods and solutions. This will no longer constitute social entrepreneurship in the way that it is being defined in this paper. For example running a school in a society where the value of education is well recognized and subsidized by the government is not social entrepreneurship, unless the school uses an innovative approach to either focus on a segment of the population for whom schooling is not yet available (e.g., marginalized people) or address a specific area where positive externalities are still neglected (e.g., technology or music education).

Very effective social entrepreneurs often combine both strategies and develop activities for marginalized populations in areas with positive externalities still neglected by society thus creating a multiplier impact effect. An example is CDI, the Brazilian organization founded by Rodrigo Baggio, an award winning social entrepreneur (Kayser & Santos, 2009). Baggio launched the first information technology school in a slum of Rio de Janeiro in 1995 to fight digital exclusion amongst the poor Brazilian youth. The concept was very compelling due to the positive externalities of integrating marginalized youth into society as engaged citizens with valued skills. By 2005 CDI had built a network of 1000 schools across Latin America. The government, influenced by CDI's success, Baggio's activism, and the increased awareness of the benefits of digital inclusion, launched a federal program of digital inclusion in 2005. This led to establishment of 6000 government-based computer centers by 2008.

A final consideration is the distinction between social entrepreneurship and social activism, two roles that are often confused in practice. Part of the confusion is that sometimes negative externalities can be seen as the flip side of positive externalities. For example, trying to prevent companies from polluting (a behavior that generates negative externalities and is often tackled by social activists) may look similar to trying to convince companies to recycle (a behavior with positive externalities). Indeed, sometimes individuals or organizations take the role of both social entrepreneurs and social activists. However the underlying activities and their requirements are different. Influencing behaviors to cancel negative externalities is inherently a political activity. It requires exerting pressure on governments and corporations using political mechanisms (demonstrations, strikes, civil disobedience, data gathering to build arguments, garnering public support). Social entrepreneurship is not about exerting pressure but rather about developing and validating a sustainable solution to problems that often have a local expression but global impact. It is about exploiting opportunities for value creation that were neglected by other institutional actors. It is also about facilitating the dissemination of the solution so that others are compelled to adopt it as well. This process involves innovation and leading by example as opposed to pressuring. Both social activism and social entrepreneurship have important functions in the economic system but they constitute different processes with different institutional goals.

In summary, I have used economic and institutional arguments to identify the unique domain of action of social entrepreneurship – addressing problems involving neglected positive externalities. This is not to say that social entrepreneurs will never operate outside this domain. They probably will, particularly because the practice-based definition of social entrepreneurship is both broad and somewhat ill-defined. What my arguments demonstrate is that social entrepreneurs are an economic agent that performs a unique role in the economic system, which cannot be substituted by any other category of institutional actor.

These arguments provide a conceptual basis to develop a theory of social entrepreneurship that is distinct from other fields, while still drawing from economic and organizational theory arguments. The next step is to build on this conceptual foundation to understand the unique mode of action of social entrepreneurs and why they are effective in addressing neglected positive externalities. Now that I have shown the economic usefulness of social entrepreneurs, I will propose a theory of how they operate as economic actors.

The Distinctive Approach of Social Entrepreneurship

In the prior sections I argued that social entrepreneurship is a process of addressing positive externalities that are neglected simultaneously by self-interested private actors (because of low potential for value appropriation) and by government actors (usually localized externalities benefiting powerless segments of the population). What is then unique about how social entrepreneurs address problems related to neglected positive externalities?

It is commonly argued that social entrepreneurs have to develop practical and innovative solutions, given their lack of resources and the scale of the problems they aim to address. However this is no different from commercial entrepreneurs who, being also resource constrained and aiming to address significant societal problems, also need to be innovative and practical often “creating something from nothing”(Baker & Nelson, 2005) .

It is also sometimes argued that social entrepreneurs operate in the absence of markets for the issue they aim to address and need to develop new market-based mechanisms. However, entrepreneurs who operate in nascent fields also need to construct new markets around their solution (Santos et al., Forthcoming). Moreover it is not clear why social entrepreneurs would have a preference for market-based mechanisms compared to other type of governance arrangements, such as government provision or public-private partnerships

(Rangan et al., 2006). If they are indeed tackling areas of positive externalities, market-based mechanisms may not be the most efficient form of economic organization to address them.

In order to understand the key difference between social entrepreneurship and mainstream business approaches we need to go back to my earlier arguments that the key difference between social entrepreneurs and commercial entrepreneurs is that they seek opportunities for value creation without regard for the potential for value appropriation. This focus on value creation has important implications for how social entrepreneurs act when compared to other economic actors that are focused on value appropriation. First, social entrepreneurs aim to achieve a *sustainable solution* to the problems they address, as opposed to achieving a *sustainable advantage* for their organization. Second, social entrepreneurs adopt a logic of *empowerment* of others, both inside and outside their organization, as opposed to the more traditional logic of *control*. These fundamental distinctions of the social entrepreneurship approach are discussed next.

Sustainable Solution not Sustainable Advantage

Organizations driven by value appropriation are usually concerned with pursuing opportunities for profit and entrenching situations in which their value appropriation capacity is maintained and, preferably, enhanced over time. In fact, the field of strategy is based on exploring of how firms can achieve a sustainable competitive advantage over rivals (Nickerson, Silverman, & Zenger, 2007). Thus, managers are advised to adopt a firm-centric focus and continuously (re)consider the positioning of their organization in the market. Similarly, theories of the entrepreneurial firm place appropriation of rents at the centre of why new entrepreneurial activities are internalized in new ventures (Alvarez et al., 2004). Thus, entrepreneurs, although aware of the fact that they need to innovate and create value, need to construct a market position that will give them a sustainable advantage since they do not want to see the value they create spilling over to other organizations and actors (Santos et al., Forthcoming). This goal of sustainable advantage is deeply ingrained in strategic thinking and embedded in our models. It underlies all theories of strategy, from industry analysis to the resource-based view of the firm and dynamic capabilities approaches.

In contrast, social entrepreneurs are concerned with correcting perceived market and government failures so they aim to provide long-term fixes to these problems - their focus is achieving sustainable solutions instead of achieving sustainable advantage. Sustainable solutions are approaches that either permanently address the root causes of the problem or institutionalize a system that continuously addresses the problem, ideally with minimal intervention from the original innovators.

Addressing the root causes of the problem involves developing a solution that makes the problem disappear permanently. For example, certain tropical diseases in Africa have huge societal costs. The development of an effective vaccine could eradicate viruses completely and eliminate the problem. Institutionalizing a system can either involve the development of a new market mechanism to systematically address the problem (e.g., microfinance) or the establishment of a government sponsored provision model (e.g., free vaccination in public hospitals) or even a combination of the two mechanisms (e.g.; public sponsoring of youth volunteer work as done by Unis-Cité).

Particularly striking is the development by social entrepreneurs of community-based solutions that use neither markets nor governments. An example is Gram Vikas, a rural development organization in India whose mission is to deploy running water and sanitation systems in rural villages with a mandate of covering 100% of the households. Gram Vikas developed a solution that involves providing to the villages the technical skills and building materials for water sourcing, piping and sanitation system, while the villagers provide the labor and guarantee that all the households of the villages, with no exceptions, agree to install and use running water and sanitation in their house. Moreover, each family needs to invest some of their savings into a Village fund that is placed in a bank account. These funds are used to guarantee the maintenance and operation of the sanitation system in perpetuity. Thus, once the system is installed, it is guaranteed to be sustainable. In addition any surplus generated by this capital is used for community development projects. The Gram Vikas staff supports these projects for five years to transfer their skills and approach to the villagers. There are multiple positive spillovers from implementing such a system: a lower level of diseases in the villages, less time spent searching for water, and benefits in building community capacity. Gram Vikas has installed such systems in more than 200 villages so far and is now transferring its methodology and competence to other social organizations.

An implication of these arguments is that social entrepreneurship involves a non-dogmatic approach to problem resolution that takes advantage of the varied institutional mechanisms afforded by society (e.g., markets, social enterprise, community-based efforts and governments). Thus, social entrepreneurship is not specifically about creating market mechanisms or securing government subsidies – it is about crafting effective and sustainable solutions using whatever combination of means is deemed appropriate.

Interestingly, this also suggests that the greatest success for a social entrepreneur would be to tackle an area of positive externality in such a way that the externality is internalized for the benefit of society and the work of the social entrepreneur is no longer necessary. Note that this same outcome would represent a failure for commercial entrepreneurs seeking to maximize value appropriation through sustainable advantage for their venture. Naturally, social entrepreneurs may get emotionally attached to their organizations and risk focusing on sustaining the organization more than solving the problems of society. Yet, true social entrepreneurs should invite competition, not defend from it, since replication of the innovative solutions will increase the value created to society.

Proposition 3: Social entrepreneurs are more likely to seek sustainable solutions than to seek sustainable advantages

An important implication of this proposition for the field of social entrepreneurship concerns the focal unit of analysis. The theory of the firm suggests that the organization is the central unit of analysis because it is the locus of appropriation of rents through residual control rights over resources (Grossman & Hart, 1986). If we take seriously the fact that the motivation of social entrepreneurs is not value appropriation but rather value creation, then a corollary is that the organizations may not be the most important unit of analysis for social entrepreneurship. Sustainable advantages are defined at the level of the firm, which is the unit of accrual of appropriated value. In contrast, sustainable solutions are defined at the level of the system, which is the unit of accrual of the created value.

Thus, a prediction from the theory is that the central unit of analysis for social entrepreneurship research may be the solution and its underlying business model, not the organization. The business model, defined as the interconnected set of activities that create value by addressing a particular need, is a relatively recent area of enquiry in strategy and organization theory (Zott & Amit, 2007). There is much to be gained by understanding what types of business models and strategies can be developed when the main driver of action is not value appropriation. Shifting the focus away from the organization as unit of analysis also brings social entrepreneurship closer to areas that study organizational processes that are not contained in traditional organizations. Research on innovative business models, such as open-source development (O'Mahony, 2007), and innovative organizational forms, such as community-based organizations (O'Mahony & Bechky, 2008), are interesting avenues for development of the social entrepreneurship field.

A final point is that since entrepreneurs focus on sustainable solutions not sustainable advantage, they may adopt a different logic of action. I elaborate this argument next.

Empowerment not Control

Corporations and commercial entrepreneurs focus on value appropriation. Although value needs to be created in order to be appropriated, self-interested actors need to ensure they **control** enough of the industry value chain to appropriate a substantial part of the value they create. The five forces strategy framework is an illustration of that approach (Porter, 1980). The organization that better controls key environmental forces can appropriate more value to the extent that the other stakeholders are dependent on the organization and the organization is not dependent on other stakeholders. There is a whole range of work in strategy and organization theory that focuses on issues of organizational power and control. Theories such transaction costs economics and resource dependence have the notion of control at their core. Who controls critical transactions (Williamson, 1991) and resources (Pfeffer & Salancik, 1978) can increase survival chances and appropriate more value.

In contrast, social entrepreneurs are focused on value creation and their key concern is the effectiveness of the overall value system of activities and partners, not their organization. This means that they do not need to use a logic of control ensure value appropriation. Instead, evidence suggests that they use a logic of **empowerment**, which is the opposite of control.

Empowerment, according to the World Bank (2009), is the “process of increasing the assets and capabilities of individuals or groups to make purposive choices and to transform those choices into desired actions and outcomes”. It is symptomatic of the pervasive focus of organization theory on issues of power and control that there is so little management research on empowerment beyond the idea of employee empowerment. In fact, employee empowerment can be seen, cynically, as just another mechanism for value appropriation since the firm controls the rents generated by the employees’ output. Indeed, empowerment schemes are often resisted by employees (Maynard, Mathieu, Marsh, & Ruddy, 2007).

In contrast, a central element of the social entrepreneurship approach is the empowerment of actors outside the organizational boundaries (which are often diffuse), be they beneficiaries, users, or partners. Given that social entrepreneurs face severe resource constraints (due to low value appropriation potential and the lack of societal awareness to the importance of the positive externality that they are addressing) and that they are targeting potentially large scale problems for which they seek sustainable solutions, the best way to achieve their desired outcomes is to empower beneficiaries and potential stakeholders to become an integral part of the solution. Social entrepreneurs thus typically put in place mechanisms and systems that reduce their stakeholders' dependencies on the organization and increase these stakeholders' ability to contribute to the solution and to their own welfare.

A key element for an empowerment approach is the belief that the beneficiaries or users of the system, no matter who they are, are likely to be endowed with resources and skills that are sub-utilized. In the book "The Mystery of Capital", Hernando de Soto documented the vast amounts of wealth that poor populations hold, in savings and in the value of the homes they live in. Yet, these populations cannot use these assets as collateral for investing in their own economic progress due to a lack of institutions and functioning property rights systems (de_Soto, 2000). Likewise de Soto recognizes that poor populations everywhere in the world are as entrepreneurial and resourceful, if not more, as those in the more developed countries.

The solution then is to establish a framework that enables poor populations to deploy these resources and skills. While de Soto advocates macro-institutional reforms in property rights and the rule of law to unlock this hidden capital, social entrepreneurs tend to develop micro-institutional solutions to the same problem. An example is the Gram Vikas perpetual village fund that transforms the savings of rural villagers into an endowment that ensures the operation of the water and sanitation system in perpetuity. Gram Vikas estimates that the villagers funds are five times larger than the capital that Gram Vikas needs to mobilize on it own (Elkington et al., 2008), which creates a six-fold leverage on its efforts. This is just an illustration of the attractiveness of an empowerment approach for social entrepreneurs.

Proposition 4: Social entrepreneurs are more likely to develop a solution built on the logic of empowerment than on the logic of control

A striking example of a solution built on the logic of empowerment is the Barefoot College established in India in 1971 by the social entrepreneur Bunker Roy (Elkington et al., 2008). The founder believes that we have “a gross underestimation of people’s infinite capacity to identify and solve their own problems with their own creativity and skills, and to depend on each other in tackling problems. What I learned is that empowerment is about developing that capacity to solve problems, to make choices, and to have the confidence to act on them” (Roy & Hartigan, 2009). Over 35 years, Barefoot College has used a grass-roots and practical approach to train and develop almost illiterate people into experts in critical areas such as irrigation and water, solar-powered systems, medicine, architecture, mechanics and accounting. These graduates then find work in rural villages or stay at the college campus (which was built by its own graduates and is managed collectively by the rural poor). The College work reaches close to 600 villages in India and its graduates have already achieved impressive technical successes. In addition, 20 colleges were already created across 13 Indian states using the Barefoot college template.

There are also some recent and visible examples of empowerment in management practice, in particular, with the rise of open-source business models, of which the open-source software movement is a prime example. Corporations that are focused on value appropriation have been struggling to understand how best to incorporate these principles into their own organizations in a consistent way (O'Mahony et al., 2008). One of the first and most publicly discussed examples was the empowerment of the community of users at eBay. The community had a strong voice on how the platform was managed and took over important functions in the system (such as rating fellow users). Interestingly, this empowerment approach may have been driven by the ambivalence of the founders between social and commercial entrepreneurship as described earlier in the paper. The innovative design of eBay's business model was a source of strength for the company and allowed it to get traction and grow at a time when powerful competitors in online auctions were already well established, such as the firm Onsale. Yet, when eBay received VC funds and planned an IPO it became focused on value appropriation. Then a permanent tension arose between the power of the user community and the profitability of the organization. Different value appropriation strategies, such as price increases and additional services offered only to the most profitable users met with fierce resistance from the community. Such tension does not exist in business models focused on value creation, such as Wikipedia, in which the users are empowered to contribute with content and improve the quality of the existing content, creating what is in effect a public good: a repository of the world's knowledge that is freely accessible to all.

Overall, exploring how social entrepreneurs use empowerment approaches and embed them in their business models, may not only contribute to the development of social entrepreneurship but also provide compelling ideas about how mainstream organizations and entrepreneurs can use the concept of empowerment to innovate in their business.

Discussion

How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it.

Adam Smith, The Theory of Moral Sentiments 1759

And by directing that industry in such a manner, 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 in his intention. Nor it is always worse for society that it was no part of. By pursuing his own interest he frequently promotes that of society more effectually that when he really intends to promote it.

Adam Smith, The Wealth of Nations 1776

In order to discuss the distinct role of social entrepreneurship I outlined the architecture of the economic system in modern capitalist societies. Each type of economic actor performs a specific institutional role that explains and justifies their existence as a distinct institution. The two central actors are governments, which are focused on the public interest and establish the market infrastructure, and corporations which pursue value appropriation strategies that deliver economic efficient outcomes. Charities then have a re-distributive function to improve the fairness in economic outcomes. However, in dynamic economies these actors are not sufficient to achieve social welfare. There is a role for other institutional actors to function as corrective agents in the economic system, operating in a distributed way. This is the case of commercial entrepreneurial organizations which point society to neglected profit opportunities that improve resource allocation, and social activists which raise awareness to situations of negative externalities. The missing actor in this system is social entrepreneurs. They provide a distributed mechanism to indentify neglected positive externalities, develop innovative solutions to address them and, often, change institutional arrangements so that the externality becomes visible and is internalized by societal actors.

Table 1 summarizes the role of the different actors in the economic system, clarifies the role of social entrepreneurship and lists the four propositions proposed in the paper.

Insert table 1 here

The theory of social entrepreneurship proposed in this paper is entirely consistent with economic arguments except in one aspect – the self-interest of economic actors, a concept first introduced by Adam Smith in his seminal work on “The Wealth of Nations”. Smith argued, among other fundamental economic insights, that the pursuit of self-interest by individuals in free market competition would lead society to more efficient economic outcomes than those provided by the heavy hand of public interest or the benevolence of individuals (Smith, 2003). Since then, from agency theory to transaction costs economics to the economic theories of the firm, the central assumption about human behavior has been that economic action is driven by self-interest. Although work on economic sociology has argued persuasively that individual behavior is influenced by the social and relational context of individuals, economic theory has so far largely failed to integrate other drivers of behavior in mainstream economic models (Rocha & Ghoshal, 2006).

Yet, even Adam Smith, the father of "the invisible hand", acknowledged that human behavior is often driven by a sense of sympathy towards others. In his other seminal book "The Theory of Moral Sentiments" Smith described the mechanisms through which a sense of attachment and desire to help others was an important element for individual action and personal fulfillment (Smith, 1976). Human beings have an ability to imagine themselves in other's situations and thus empathize with their plight as well as take pleasure from their success. This means that the utility of individuals is connected to the well-being of others, even if they have never met them. I call this phenomenon "others-interest".

Despite Smith's observations about the multifaceted nature of human behavior, he and the economists that followed his ideas have failed to explore the impact of others-interest as a driver of behavior for economic action. It is as if individuals operated in two distinct spheres: a personal sphere of family and social ties driven by others-interest and an economic sphere of resources and production driven by self-interest. Yet, the growing importance of economic actors that behave as if motivated by an interest for others (creating social enterprises, volunteering in charities, pursuing social oriented goals in their organizations), seems to negate the validity of this partitioning approach to human behavior. Economic theory needs to acknowledge the role that others-interested behavior plays in economic activities, which may be as important for economic outcomes as the role that self-interested behavior plays[3].

To support a theory of social entrepreneurship that reflects observed reality I thus propose a behavioral assumption of "*Heterogeneity of Interests*". Specifically, I argue that within each individual there are two main drivers for behavior:

- self-interest in which individuals derive utility from improving one's welfare (in the words of Adam Smith, the strong human drive for "bettering one's own situation").

- others-interest in which individuals derive utility from improving the welfare of other members of society. This feeling is not based on an abstract notion of public interest, but rather on a desire to help specific others in "bettering their own situation".

The strength of each driver varies among individuals as some people may have more propensity for self-interest while others may have more propensity for others-interest. It is useful to note that these propensities may change over time given contextual factors. One such factor has relates to cultural norms and is often shaped by the theories people espouse (Ferraro, Pfeffer, & Sutton, 2005; Ghoshal, 2005). Others factors are based on individual prior experiences (how people see others behaving) and resource endowments (how much wealth people already have). These factors do not change the central argument that at any given point, individuals will derive their utility from a balance of self-interested and others-interested outcomes. This balance is specific to each individual and shapes the types of activities and organizational behavior in which he/she engages.

At the population level we will thus find heterogeneity of interests, which may account for the heterogeneity of organizational forms that are present in the economic system. Naturally, individuals who have a similar balance of self and others interest will tend to

[3] Indeed, there is increasing empirical evidence that a narrow focus on self-interest does not capture well the motivations and behaviour of economic actors. For example, research on marketing as shown that people are happier when they spend money on others than on themselves (Dunn et al, 2008).

associate together for organized action. This balance will determine the type of activities that they will engage in and the type of organizations that they create. Specifically:

- individuals who place a strong weight on self-interest will tend to associate together in the context of organizations focused on value appropriation - being run to maximize the benefits for their owners, independently of the legal form they exhibit (publicly-traded firms, new enterprises, partnerships, cooperatives).

- individuals who place a strong weight on others-interest will tend to associate together in the context of organizations focused on value creation – being run to maximize the benefits for others in society, independent of the potential for value appropriation. These can typically take the form of social activist organizations or social entrepreneurship organizations. It also includes charities and philanthropic organizations focused on fairness outcomes through resource re-distribution activities[4].

In fact, and going back to Adam Smith's ideas of a benevolent invisible hand that turns self-interested individual behaviors towards socially optimal outcomes, social entrepreneurship can be interpreted as the second invisible hand of the economic system, this one based on others-interest rather than self-interest. By pursuing their specific others-interest and addressing opportunities for value creation in a distributed way, social entrepreneurs drive the economy closer to an efficient outcome by systematically identifying neglected positive externalities and developing mechanisms to incorporate these into the economic system. In this regard, they can do a more effective job than a benevolent central actor such as the government. Government leaders, even if motivated by public interest, may find

[4] It should be noted that I do not include in this definition government organizations. These organizations have a specific mandate to defend the public interest (a general society interest not self or others-interest). They may therefore include a combination of self-interested and others-interested individuals.

impossible to identify social optimal outcomes in a myriad of sometimes incompatible individual (and group) preferences (the paradox of social choice in welfare economics).

Thus, much in the same way as a benevolent central actor is inefficient at allocating resources to the most productive opportunities and needs to harness the invisible hand to generate efficient outcomes from distributed *self-interested* action, central actors also need to harness the power of the invisible hand generate even more efficient outcomes from distributed *others-interested* action.

In the words of Muhammad Yunus, referring to the current inability of modern economies to solve societal problems, “things are going wrong not because of *market failures*. The problem is much deeper than that. Mainstream free-market theory suffers from a *conceptualization failure*, a failure to capture the essence of what it is to be human” (Yunus, 2007). Bringing social entrepreneurship into the fold of economic and strategy theory may allow us to better capture in our theories “the essence of what is to be human”. It is more useful to adjust our theories and assumptions to reflect the world we live in, than to force human nature to follow the assumptions on which we conveniently established our theories.

Conclusion

The phenomenon of social entrepreneurship challenges our assumptions about human behavior and economic action. It also challenges our beliefs about the role of entrepreneurship in society. Social entrepreneurship is a complementary economic approach that is based on value creation and operates by its own rules and logic. Yet, it is an approach that seems able to address some of the most pressing problems in modern society. The goal of this paper is to place social entrepreneurship in the context of the dialogue about economic organization and the functioning of modern economies. I hope to have provided a conceptual framework that can help explain the phenomenon of social entrepreneurship and enable further scholarly research and more effective practice and public policy.

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Table 1: Institutional Actors in Modern Capitalist Economies

Characteristics	Governments	Business	Charity	Commercial Entrepreneurship	Social Activism	Social Entrepreneurship
Distinct Role in Economic System	Centralized mechanism through which the infrastructure of the economic system is created and enforced (and public goods provisioned)	Distributed mechanism through which society's resources and skills are allocated to the most valued activities	Distributed mechanism through which economic outcomes are made more equitable despite uneven resource endowments	Distributed mechanism through which neglected opportunities for profit are explored	Distributed mechanism through which behaviors that bring negative externalities are selected out	Distributed mechanism through which neglected positive externalities are internalized in the economic system
Dominant Institutional Goal	Defend Public interest	Create sustainable advantage	Support disadvantaged populations	Appropriate value for stakeholders	Change social system	Deliver sustainable solution
Dominant Logic of Action	Regulation	Control	Goodwill	Innovation	Political action	Empowerment

A Positive Theory of Social Entrepreneurship - Propositions:

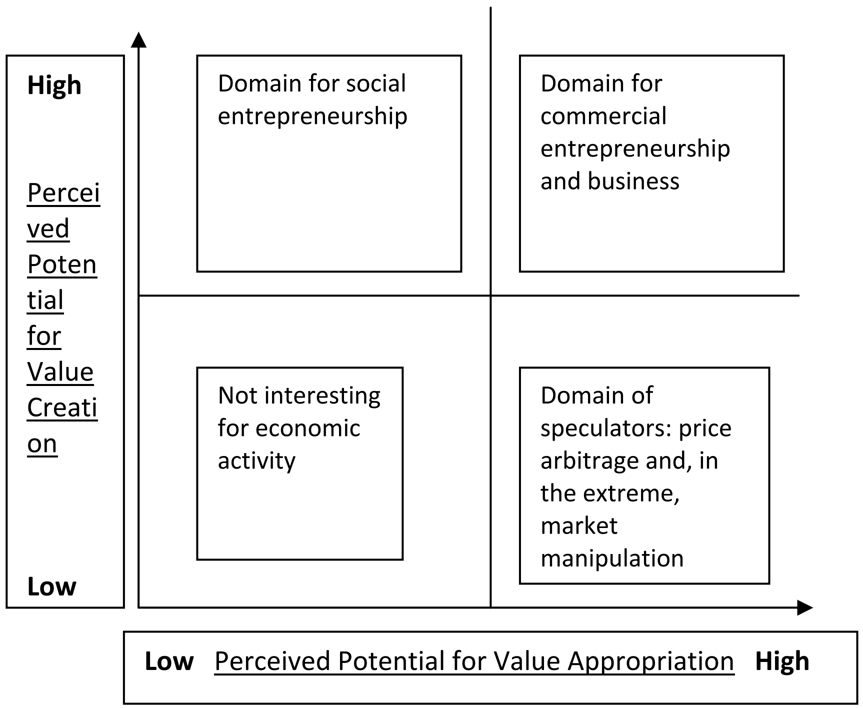
Proposition 1: Addressing problems involving neglected positive externalities is the distinctive domain of action of social entrepreneurship

Proposition 2: Social entrepreneurs are more likely to operate in areas with localized positive externalities that benefit a powerless segment of the population

Proposition 3: Social entrepreneurs are more likely to seek sustainable solutions than to seek sustainable advantages

Proposition 4: Social entrepreneurs are more likely to develop a solution built on the logic of empowerment than on the logic of control

Figure 1: Domains of Action for Economic Activity



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