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Social Entrepreneurship: Beyond the Hype

Social entrepreneurship has been attracting increasing attention from philanthropists, donor organizations, the not-for-profit sector, international organizations, academia, the media, and the public at large. Business schools in particular find the concept of social entrepreneurship very appealing, given its combination of social virtue and business acumen. Numerous business schools have established centers dedicated to social entrepreneurship, including the University of California, Berkeley, Stanford, Harvard, Duke, the University of British Columbia, INSEAD, Oxford, and the National University of Singapore. The list of business schools offering research or teaching on social entrepreneurship without having created a center specifically dedicated to the topic is much longer.[1] This popularity has brought significant resources to social entrepreneurship in the form of both talent and money.

However, it is not clear precisely what social entrepreneurship is. Gregory Dees, a prominent scholar in this field, wrote in 1998, "Though the concept of 'social entrepreneurship' is gaining in popularity, it means different things to different people. This can be confusing."[2] Ten years later the definitional dispute continues, and it has taken a toll. After an extensive in-depth survey in 2008, the Center for Advancement of Social Entrepreneurship reports, "Even our most knowledgeable informants did not agree on a definition of social entrepreneurship. *Definition is one of the biggest problems in the field*" (emphasis in the original).[3] Proponents of social entrepreneurship disagree about issues such as whether it includes only not-for-profit or also for-profit ventures, whether the focus should be on individuals or on organizations, whether the change involved must be systemic or can be incremental, and whether to include only successful ventures or also failed attempts. Some argue about the term itself and suggest that "social innovation" is a better choice.[4] One way to avoid the disputes would be to have a defi-

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nition that is all encompassing, but that ends up not being useful. As Alex Nichols writes, "Social entrepreneurship, therefore, represents an umbrella term for a considerable range of innovative and dynamic international praxis and discourse in the social and environmental sectors."[5] This lack of consensus about the definition hinders the development of social entrepreneurship as a field of teaching, research, and practice. It also creates challenges for the field in terms of legitimacy, sustainability, and effectiveness, and makes it harder to attract resources and partners.

The biggest disagreement about social entrepreneurship is whether it includes only not-for-profit or also for-profit ventures, which is the focus of this article. Dees confines social entrepreneurship to the not-for-profit sector when he writes, "Social entrepreneurs rely on subsidies, donations, and volunteers."[6] Roger Martin and Sally Osberg, both affiliated with the Skoll Foundation, similarly distinguish between social entrepreneurship and business entrepreneurship.[7] Paul Light argues for a broader view of social entrepreneurship that includes governments, not-for-profit organizations, and businesses.[8] However, social entrepreneurship is rooted in the not-for-profit sector, and thus in practice implicitly or explicitly excludes public and for-profit organizations, as reflected in the composition of affinity groups and funders' choices. Martin and Osberg support this claim, based on their own "analysis showing that the composition of grantees/award winners of notable networks, including Ashoka, Fast Company Social Capitalists, The Schwab Foundation for Social Entrepreneurship, and the Skoll Foundation, are predominantly not-for-profits."[9]

Entrepreneurship and social value are two independent dimensions, meaning that a more entrepreneurial organization does not automatically create more social value than a less entrepreneurial organization, and vice versa.

I argue in this article that the term "social entrepreneurship" is too ambiguous to be useful. It is more appropriate to characterize a particular organization, be it public, for-profit, or not-for-profit, by how entrepreneurial it is and how much social value it creates. Entrepreneurship and social value are two independent dimensions, meaning that a more entrepreneurial organization does not automatically create more social value than a less entrepreneurial organization, and vice versa. However, the two dimensions are probably correlated, meaning that a more entrepreneurial organization probably creates more social value than a less entrepreneurial organization.

Society uses three types of organizations to manage the resources that help meet its social needs: public, for-profit, and not-for-profit (see table 1). I use the

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

Figure 1. Characteristics of the three sectors.

term "not-for-profit" organizations to be synonymous with nonprofit, voluntary, civil society, NGO, charitable sector, and citizen sector. A not-for-profit organization can address a social need by directly providing a service, such as health care or education, or it can address the need indirectly by playing an advocacy role in which it identifies social problems and unfulfilled needs and rallies support for a particular solution, thus giving voice to a wide variety of social, political, environmental, and community interests. Social entrepreneurship usually refers to these two functions, service and advocacy, and this paper focuses on not-for-profits that perform these two functions. It does not deal with not-for-profits that perform an expressive function, such as religious congregations and fraternal societies. This distinction, of course, is not so clear cut in practice, as many not-for-profits serve more than one function, and often all three functions.

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

Consistent with the existing literature, I argue that all three types of organizations, public, for-profit, and not-for-profit, can be entrepreneurial. More importantly, and contrary to much of the literature on social entrepreneurship, I argue that all three types of organizations can and usually do serve a social purpose and are therefore "social." However, being social is not an either-or proposition; it is more useful to think of how much social value an organization creates. There is, of course, no objective measure of social value, as it depends on the values of the person making the judgment. It is not true that not-for-profit organizations automatically create more social value than businesses or public organizations. For example, according to my values, a not-for-profit school that teaches "intelligent design" creates less social value than a for-profit school that teaches the theory of evolution. Many people, of course, would disagree with my conclusion, largely because of different values.

Even when there is consensus about values, measuring social value can be difficult. One of the most frequently mentioned examples of social entrepreneurship is the Grameen Bank in Bangladesh. This clearly has been an entrepreneurial venture: it takes a creative and innovative approach to reducing poverty that involves making microloans to poor women, with no collateral or credit checks and group liability. Many people believe that microcredit has created a great deal of social value; the Grameen Bank and its founder Muhammad Yunus were awarded the Nobel Peace Prize in 2006. However, it is debatable how much social value this work has created, as any assessment must take into account the extent to which microcredit has actually reduced poverty, especially considering the vast amount of resources, financial and human, devoted to it. In the last few years there has been growing concern that microcredit has not had a significant impact on reducing poverty.[11] In March 2009, the World Bank published *Moving Out of Poverty,* one of the most thorough field studies of the dynamics of poverty—that is, how people fall into and rise out of poverty—based on narratives from 60,000 poor or formerly poor people in 15 countries in Asia, Africa, and Latin America. An "important insight" from this study is that "the tiny loans usually provided under microcredit schemes do not seem to lift large numbers of people out of poverty."

ENTREPRENEURSHIP

Entrepreneurship is the engine of Joseph Schumpeter's dynamism of "creative destruction" and involves converting a new idea into a successful innovation that creates value. It requires skills, vision, creativity, persistence, and risk-taking, and can refer to the work of a person or an organization. The most obvious form of entrepreneurship is starting a new business that creates economic value. In recent years, however, the term has been broadened, especially by Peter Drucker, to include social and political activities that create social value.[12] Drucker argues that one of the best examples of entrepreneurship is the modern university, in particular the modern American university, which is either a public or a not-for-profit organization. Drucker also cites the example of the Girl Scouts, which introduced innovations that affected its membership, programs, and volunteers and reversed a downward trend in the involvement of both children and adults. Economist Amil Petrin argues that while the popular stereotype is that decision-making in public organizations is rigid and bureaucratic, there still is room for flexibility and entrepreneurship.[13] Several case studies demonstrate that government agencies and departments can be creative in addressing problems.[14] In fact, any organization, public, for-profit, or not-for-profit, can be entrepreneurial.

Entrepreneurship is not an either-or proposition; it is more useful to think of it as a matter of degrees. There is no objective measure of entrepreneurship, and profit alone is a not a good measure, even in business organizations. How entrepreneurial a particular organization or person is is a matter of judgment, but most people agree, at least broadly, on what characterizes entrepreneurship: vision, skills, innovation, persistence, flexibility, and risk-taking.

SOCIAL VALUE

Any organization, in order to provide goods to its clients, consumes resources: labor, materials, and capital.[15] The social value created by an organization is equal to the value of its output as determined by its clients, minus the value of the inputs. For example, an organization sells goods to its clients at a certain price. If this is a business organization, the market determines the price of the goods traded. When public and not-for-profit organizations provide the goods, they determine the price, which is usually lower than the market price. As figure 1 illustrates, the value of outputs minus revenues is "consumer surplus," and the revenues minus the cost of inputs are profits—or what economists call "producer surplus." The amount of social value created is equal to consumer surplus plus profits. Although profits accrue to individuals, they are part of the social value created—individuals are, after all, part of society. In a public or not-for-profit organization, the revenues are usually not adequate to cover costs, and the economic loss has to be subsidized by taxes or philanthropy.

In this discussion, it is critical to take into account the cost of capital used by an organization. The logic for determining the cost of capital is the opportunity cost of foregoing other alternative investments, adjusted for risk. The objective of private firms is not just "accounting profits" but rather "economic profits," defined as accounting profits minus the opportunity cost of capital. The ability to generate accounting profits is not enough; economic profitability is necessary for the long-term viability of a business. A lot of misinformation in the social entrepreneurship literature results from confusing accounting profits with economic profits. An organization that earns accounting profits but not economic profits still needs philanthropic donors to survive. Muhammad Yunus contributes to this confusion with the notion of "social business" or "not-for-loss" businesses that are viable because they cover their operating costs.[16] The problem with not-for-loss business-

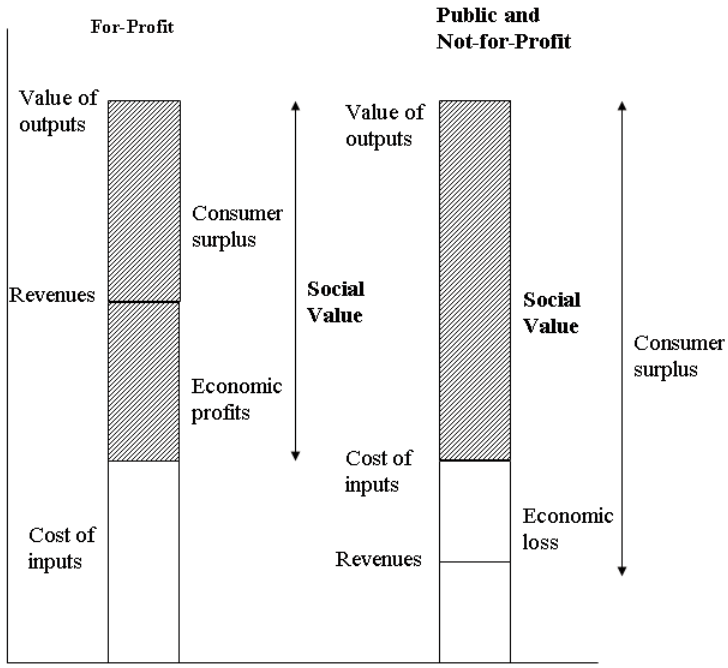

Figure 1

es is that they do not cover the opportunity cost of capital, and they are not economically viable without philanthropic sources of capital. In the rest of this article, I will refer only to economic profits, not accounting profits.

The key conclusion from the above discussion is that any organization—for-profit, public, or not-for-profit—can create social value, and it does so to the extent that the value of outputs exceeds the cost of resources consumed. If the organization is inefficient, incompetent, or corrupt, the costs may exceed the value of outputs and the social value will be destroyed. If markets are working well, private profits and social value will be aligned, and firms acting in their own self-interest will lead to a socially optimal outcome.

More than two hundred years ago, Adam Smith wrote in his famous book, *Wealth of Nations:*

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

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

Market Failure

If the markets worked perfectly to provide for all social needs, there would be no need for public or not-for-profit organizations (leaving aside the issue of equity, which I will address shortly). That is, of course, unrealistic. In fact, markets often fail, and when they do, it is the role of the government to provide a solution.

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

In some industries where scale economies are very large, such as electric utilities, one or a few firms can dominate the market and exploit that power to the detriment of social value. The government can in turn address this market failure, either through regulation (as the U.S. regulates private utilities) or through public organizations that directly provide the goods (as government-owned utilities do in most countries).

The third reason for market failure is imperfect information. If consumers are at a disadvantage by virtue of imperfect information, firms can exploit consumers and reduce the social value created. Governments usually address this market failure through regulation. For example, in the pharmaceutical industry, most patients and even some doctors lack the knowledge and expertise to assess the safety and efficacy of drugs. Therefore, the government of nearly every country requires all prescription drugs to be approved by a public agency (e.g., the U.S. Food and Drug Administration) before they are allowed onto the market.

Based on some combination of the externalities and monopoly power arguments, the government is responsible for providing basic services, such as education, public health, water, sanitation, electricity, and infrastructure. The unregulated market is not an effective way to meet these social needs. There is extensive debate about whether the actual production of these services should be privatized or outsourced. The government does not have to provide these services directly; it can fulfill its role by regulating or financing the services. For example, if the water supply were privatized, the government would need to regulate the rates; alternatively, it could choose to finance the water supply but outsource the management. In any case, few would argue that the state can totally avoid taking responsibility for such public services, and the government of almost every country certainly professes to accept this critical function and provides these services.

Equity

Even if there is no market failure, society might prefer that the government fulfill a particular social need. Social welfare is determined not just by the value produced, but also by the distribution of this value. Markets are driven by efficiency, and citizens often want a more egalitarian society than what free markets produce. They express this desire for social justice through the political process. For example, there is arguably no market failure in the food industry, thus the need for food is satisfied largely by for-profit organizations. Yet many poor people, even in affluent countries, cannot afford an adequately nutritious diet; therefore, many countries have public agencies that provide food assistance to the needy. The same situation applies to other social needs, such as housing and health care. Many societies consider basic nutrition, health care, and education to be fundamental human rights and require the state to fulfill these social needs; this is especially true of services for children. Social justice requires attenuation of the effects of the "lottery of birth"—that is, children born to poor parents tend to grow up to be poor adults and pass their disadvantages on to their children. Social justice and equal opportunity require that all children have access to a certain level of education. Even the late Milton Friedman was an advocate of the school voucher system and argued that the state should not withdraw totally from the field of education. Education is a function that should not be left to free markets.

THREE SECTORS

For-profit, public, and not-for-profit organizations are very different on several dimensions, as summarized in table 1. Public and not-for-profit organizations usually incur an economic loss, not because they are inefficient but because they intervene in cases of market failure or cater to people who cannot afford market prices. Therefore, these organizations need to find funding to cover their losses. Governments have the legitimate power of coercion and can impose taxes on citizens to fund public activities, whereas not-for-profit organizations must rely on donors motivated by altruism.

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

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

Scaling Up

Modern financial markets can provide virtually unlimited quantities of capital, provided a venture is expected to earn economic profits, which makes it fairly easy for for-profit organizations to scale up. Public organizations enjoy the privilege of access to the government treasury for resources needed to scale up, subject of course to approval from the political powers. A major challenge for not-for-profit organizations is how to scale up their activities to an extent sufficient to satisfy social needs.[18] With a few exceptions, such as the Gates Foundation, not-for-profits have not been able to attract sufficient capital to significantly scale up their activities to provide services directly. However, they can act as catalysts, advocates, and watchdogs that prod for-profits and public organizations to fulfill their responsibilities adequately to satisfy social needs.

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

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

Social Value

All three types of organizations can and should create social value. The market mechanism and government regulation ensure that private for-profit firms create value. A well-functioning political system ensures that public organizations create social value. Not-for-profit organizations can usefully supplement the political system to ensure that private and public organizations create social value. However, there is no well-defined mechanism to ensure that not-for-profits themselves create social value. Fortunately, most philanthropists are good people with values congruent with those of society at large, but society nevertheless must rely on the benevolence and wisdom of donors and/or the managers of not-for-profit organizations to create social value.

Education should not be left to free markets, nor should it be left to a civil society that caters to the differing values of philanthropists. For example, consider schools that teach extremist religion and even preach violence, such as the *madrassas* in certain countries, or the less extreme example of a Christian school that teaches creationism instead of evolution. These, too, are civil society, therefore it is not reasonable to rely on not-for-profits to satisfy social needs on a large scale. Because of its lack of accountability to a democratic polity, civil society cannot be a substitute for the government.

Allocating the Output

The three types of organizations use very different mechanisms to allocate the goods they produce. For-profit companies allocate goods based on market prices. If there is a shortage of goods, public organizations do not use price to clear the market and instead allocate the goods on some other basis. In a perfect democracy, all citizens are politically equal and public organizations allocate goods on the basis of citizen rights. Unfortunately, many governments are far from democracies, let alone perfect democracies, and public organizations often allocate goods on the basis of political power and patronage. For example, personal and property security are public goods, and markets cannot fulfill this social need. Therefore, police protection is a public activity. In keeping with the concept that all citizens are equal, the government claims to provide equal police protection to everybody. However, it is not accidental that rich neighborhoods tend to be better patrolled than poor neighborhoods.

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

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

Governance

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

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

Distinct Boundaries

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

Profit and Not-for-Profit Boundaries

Social enterprises with a hybrid structure attempt to tap conventional investors who are interested in making profits while pursuing social missions. A recent headline in the *International Herald Tribune* read, "As profit and charity mix, both may lose; hybrid companies suffer from tension between mission and bottom line."[25] Several hybrid ventures have split up or been dissolved in the last few years, such as the Global Giving Foundation (a social venture capital fund), World of Good (whose mission was to connect small artisans with major retailers), and Pura Vida Coffee. Jeff Hussey, the investor who took control of Pura Vida Coffee and converted it into a for-profit company, says that "the business model was flawed. Whenever you have an organization of human beings with a blurry mission, you get blurry results."

An individual providing financial resources to a venture and expecting to earn a return lower than the cost of capital is behaving as a philanthropist, not an investor. This individual is, in effect, making a donation equal to the difference between the cost of capital and the expected return. This is not to suggest that philanthropists are irrational, but that there is a critical difference between a philanthropist and an investor. Investors expect to earn more than the cost of capital, and philanthropists expect to earn less than the cost of capital. This is an either-or distinction; there is no blurring of boundaries and no hybrids. Expected returns are, of course, impossible to determine accurately ex ante. The actual returns earned ex post might and often do differ considerably from the expected returns. The cost of capital is difficult to calculate accurately in practice; a great deal of research in the field of finance is devoted to this issue. The fact that both the expected return and the cost of capital are difficult to assess accurately does not invalidate the conceptual distinction between philanthropy and investment.

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

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

Many publicly traded for-profit firms make philanthropic donations and some even operate philanthropic organizations. Milton Friedman argued that firms owned by shareholders should not engage in philanthropy, since managers would be donating money that belongs to shareholders and the primary objective of publicly traded companies is to maximize profits for those shareholders.[26] Individual citizens, however, do have a civic and arguably a moral responsibility to be philanthropic. Microsoft is not philanthropic and does not give away money belonging to its shareholders, but Bill Gates has been giving away his personal fortune. Companies should do well; citizens should do good. Even if one disagrees with Friedman, these philanthropic activities are always quite small relative to the size of the parent organization, and often are isolated within a separate organization, such as the Google Foundation. In any case, considering such firms to be hybrid organizations is hyperbole.

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

Profit and not-for-profit organizations do work of course together. There is a growing feeling on both sides that not-for-profits working with businesses can achieve more than they can by attacking from the outside.[27] Not-for-profits acting as advocates and catalysts can find common ground with for-profit businesses genuinely interested in solving social problems. But, it is critical that the not-for-profits maintain their legitimacy by preserving their independence and capacity to criticize. A critical role of not-for-profits is to serve as watchdogs to ensure that businesses and governments fulfill their responsibilities. While there is common ground, there is also a fundamental conflict between the interests, motives, and roles for-profits and not-for-profits play. Effective partnerships are more like project alliances than hybrid organizations.

Public and For-Profit Boundaries

There has been a recent proliferation, especially in developing countries, of hybrid organizations that blur the line between public and for-profit organizations.[28] Many Chinese and Russian companies have complex and somewhat opaque ties to the government. The hybrid company Dubai World, which was at the center of the recent financial crisis in Dubai, was variously described as state controlled, state supported, quasi-state, and parastatal without fully clarifying the exact roles and responsibilities of the state and the shareholders.

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

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

The argument for blurring the lines between for-profit and public organizations is vastly overstated and problematic. Supporters of hybrid organizations have "long argued that they enjoy the best of both worlds: the security of the public sector and the derring-do of the private sector." But this can easily turn into the worst of both worlds, as "the biggest problem with hybrid companies is that they are inherently confused organizations."[29] Governments have the unique power of legal coercion: the ability to tax their citizens and regulate markets. Only governments can use taxes to cover the economic losses of public organizations. No private organization enjoys this privilege, nor should it have opaque access to this privilege. This leads to hybrid organizations almost always being highly politicized, to the detriment of the citizens.

It is important to distinguish between these hybrid organizations and old-fashioned state-owned enterprises that do not involve private shareholders. Governments do occasionally manage for-profit organizations, especially in communist, formerly communist, and socialist countries, such as China and India. However, with the decline of the communist ideology, the prevailing policy in most countries today is that governments should provide goods only in case of market failure or political consensus for equitable distribution. When governments go beyond these boundaries, they are probably crowding out the private sector to the detriment of social welfare.

Sources of Revenue

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

The revenue structure of not-for-profits varies considerably across countries. In developing countries, client fees account for 62 percent of revenues, compared to 45 percent in developed countries. By contrast, the government provides only 22 percent of not-for-profit organizations' revenues in the developing countries, compared to 48 percent in the developed countries. This paradoxical result underlines the dual character of the not-for-profit sector in developing countries, with a substantial portion of the sector providing services to an affluent clientele willing and able to pay for superior education, health, and related services. For example, the misnamed public schools in the UK and other Commonwealth countries, including India, are really prestigious private not-for-profit schools that charge high fees and cater to the affluent elite. A smaller component of the not-for-profit sector in developing countries, with limited support from the government, provides services to the disadvantaged.

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

Example: Higher Education

The three types of organizations can, and do, coexist to fill the same social need. For example, higher education is provided by for-profit, public, and not-for-profit universities and colleges. The market for higher education functions quite well, although it does have significant positive externalities, such as a more informed citizenry and higher national productivity. These externalities are a form of market failure; on this logic, education should not be left to markets alone and some government intervention is warranted. A bigger problem with a market-based approach to education is that many children of less affluent parents would not be able to attend private for-profit universities. This perpetuates intergenerational inequality and is perceived as socially unjust in many societies. Therefore, in most countries the government heavily subsidizes higher education, and public universities historically have played a dominant role. Not-for-profits often play a role too and fill a market niche. Given economic growth and burgeoning demand for tertiary education and training in recent years, for-profits have been growing rapidly in some countries.

A distinctive feature of higher education in the U.S. has been its diversity. Public organizations accounted for 74 percent of the 18.3 million students enrolled in degree-granting institutions in 2007.[30] The so-called land-grant universities were started in 1862 to focus on the study of agriculture and engineering. Now all the U.S. states subsidize public universities to varying degrees. Some public universities, such as University of Michigan and the University of California, Berkeley, which are considered among the best universities in the world, have clearly been entrepreneurial and value-creating organizations. The prominence of public universities is a relatively recent phenomenon. The oldest colleges and universities, such as Harvard, Princeton, and Yale, are all not-for-profit institutions founded in the seventeenth and eighteenth centuries and they originally had religious affiliations. Today's not-for-profits are usually secular, enjoy high status and a reputation for academic excellence, and charge high tuition. Not-for-profit universities and colleges play a particularly large role in the U.S., probably for historical reasons and due to the culture of philanthropic donations. Given the increasing demand for higher education in recent years, private for-profits have been growing rapidly; enrollment in for-profit degree-granting institutions has increased from 0.3 million in 1997 to 1.2 million in 2007.[31] The largest of these, the University of Phoenix, is expanding rapidly; in 2009 it increased its enrollment by 22 percent over the previous year, bringing its number of degree-seeking students to 443,000.[32] For-profit colleges are still viewed with skepticism by some consumers and policy-makers, especially with regard to their academic standards. For-profit college leaders claim they attract students because they are more nimble and entrepreneurial, and respond to the marketplace more quickly than not-for-profit and public colleges.

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

The above discussion of higher education demonstrates that all three types of organizations—for-profit, public, and not-for-profit—can be entrepreneurial and create social value. Superior organizations have both characteristics to a significant degree. The three types of organizations play different roles in society, and it is a good idea to maintain clear boundaries between these sectors. The motives and governance mechanisms of these organizations are not only different but incompatible. Social entrepreneurship is simply old-fashioned not-for-profit organizations trying to use modern management processes. Improving efficiency is a good idea, but this does not change the nature of the organization.

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