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# Creating Social Value

By Philip Auerwald | Illustration by Don Kilpatrick III

The idea that social entrepreneurs create something called social value—good works that go above and beyond what traditional entrepreneurs and businesses deliver—is a dearly held tenet of the social change movement. But what exactly is social value, and how do social entrepreneurs go about creating it?



ocial entrepreneurs are often held up as today's heroes. They are feted at the Clinton Global Initiative conference, grace the cover of *Fast Company*, draw adoring crowds at Harvard Business School confabs, and even appear on *The Oprah Winfrey Show*. Yet for all of the adulation, our understanding of the value that social entrepreneurs bring to society remains fuzzy, and in some instances, even controversial.

Many of those who believe that social entrepreneurs play a vital role say that the evidence supporting their views is straightforward and compelling. Social entrepreneurs matter for the same reason that other entrepreneurs matter: because they generate new, disruptive models for organizing human activity. The difference is simply, and importantly, that conventional entrepreneurs focus on creating financial value, whereas social entrepreneurs focus on creating *social value*. Without initiatives undertaken by social entrepreneurs, the status quo would stand uncontested and critical societal challenges would remain unresolved.

Those who question the importance of social entrepreneurs, however, say they are simply being realistic. While entrepreneurs capture imaginations and tug at heartstrings, large firms are quietly doing the work of creating stable jobs for workers and low-cost products for consumers. "The greatest agents for sustainable change are unlikely to be [social entrepreneurs], interesting though they are," opined the Jan. 31, 2008, issue of *The Economist* in its review of John Elkington and Pamela Hartigan's book, *The Power of Unreasonable People*. "They are much more likely to be

the entirely reasonable people, often working for large companies, who see ways to create better products or reach new markets, and have the resources to do so.” When it comes to the creation of opportunity and value, this thinking goes, the ongoing contributions of Wal-Mart Stores Inc. and McDonald’s Corp. dwarf those of a dozen Grameen Banks. To argue otherwise is to place sentimentality above the hard logic of scale.

These two viewpoints are not as divergent as they appear. The unifying premise that entrepreneurs and large corporations both create social value is not really in dispute. What is in dispute is the type and quantity of social value that can be attributed to each. The contrasting views of social entrepreneurship find their parallel in contrasting views of social value. One view of social value is exemplified by Harvard University economist Robert Barro. Writing in response to a speech by Bill Gates delivered at Harvard University’s commencement exercises earlier that month, Barro (in a June 19, 2007, op-ed in *The Wall Street Journal*) expressed puzzlement at the fact that Gates focused his remarks on the work of the Bill & Melinda Gates Foundation rather than on Microsoft Corp.’s contributions to society. “By any reasonable calculation Microsoft has been a boon for society,” Barro argued, “and the market value of its software greatly exceeds the likely value of Mr. Gates’ philanthropic efforts.”

Barro helpfully differentiates the market value of the goods sold by Microsoft from the social value derived from those sales: “Suppose that a copy of a new version of Windows sells for \$50 (and is typically charged as part of the price of a personal computer). Microsoft’s revenue from Windows would then equal \$50 multiplied by the number of copies consumers snap up. Microsoft’s earnings are the revenue less production and development expenses. But that’s not the social value. That comes from the increase in productivity created when businesses and households use the software. The social benefit equals the value of the extra product, less the total paid for the software.” By this definition, every entrepreneur is a social entrepreneur and every market transaction creates social value, the bigger the better.

Writing in the fall 2008 issue of the *Stanford Social Innovation Review*, James A. Phills Jr., Kriss Deiglmeier, and Dale T. Miller, in “Rediscovering Social Innovation,” take a strikingly different view of social value. These authors broaden the domain of inquiry from social entrepreneurship to “social innovation,” which they define as follows: “A novel solution to a social problem that is more effective, efficient, sustainable, or just than existing solutions and for which the value created accrues primarily to society as a whole rather than private individuals.” This view of value creation puts a great deal of weight on the difference between social and private problems to be solved on one hand, and the social and private value created as a consequence of novel solutions on the other.

To the skeptic, this narrow view of social value would seem a difficult dichotomy to sustain. Is the individual not the fundamental unit in a society? To be sure, the benefits of improved health and education, to name just two areas of social concern, ultimately are privately captured by the individual whose health or education is

enhanced. If so, what is the difference between “private” and “social” problems and value creation? Certainly, social innovation cannot be limited to those few goods that are communally owned.

Such a restricted view of social innovation is, of course, not what the authors intend. They offer additional resolution in their definition of social value: “The creation of benefits or reductions of costs for society—through efforts to address societal needs and problems—in ways that go beyond the private gains and general benefits of market activity.” The operative concept here, and the real differentiation from Barro’s view, is the reference to benefits that “go beyond ... market activity.” This phrase directs us to the Achilles’ heel of Barro’s otherwise seemingly solid analysis. Barro knows that markets for many goods are imperfect or nonexistent. As a consequence of incomplete markets, the value of trade between two individuals in many cases will not reflect impacts on third parties. Such impacts are termed “externalities” by economists, capturing the idea that significant costs or benefits of a transaction are “external” to the parties directly involved in making the deal.

Although there is much more to the difference between social and private value than the notion of externalities, that one idea is enough to indicate the limitations of Barro’s analysis. If we accepted Barro’s characterization at face value, we would have no choice but to hail Exxon Mobil Corp. as one of the world’s leading creators of social value. But anyone suspicious of such a line of argument would have sound theory behind him. The value of the transactions in which Exxon Mobil is engaged may actually overestimate the social value the company creates, because it excludes consumption of environmental, health, and other goods for which markets do not exist or are imperfect.

The view of social value that Barro advocates in his op-ed article is thus oversimplified to the point of being disingenuous. The contrasting view of social value advanced by Phills, Deiglmeier, and Miller, however, has elements of significant insight, but may be interpreted too narrowly. A more realistic definition of social value—one that can be used to better understand the role that social entrepreneurs and large businesses play in society—lies somewhere between these two poles.

## UNDERSTANDING VALUE CREATION

To understand the term social value, it is important first to understand what *private value* is and what role entrepreneurs play in creating it. The best way to do this is to start with a simple economic transaction. Suppose I buy an ice cream cone at Ben & Jerry’s for \$2.50. I was willing to pay up to \$3 for the cone; Ben & Jerry’s spent only \$2 to make the ice cream cone and bring it to market. I walk away with 50 cents of psychic benefit, forming the basis for consumer value (what economists term “consumer surplus”), and Ben & Jerry’s banks 50 cents of profit, forming the basis for producer value (what economists term “producer surplus”). The *residual value* that consumers and producers each claim—the value left over after the transaction—is the lure that brings each party to the market.

The benefits to the parties directly engaged in market transactions are measurable in terms of just this type of residual value. Indeed, the nearly universal practice of measuring human welfare in relation to

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# From Social Entrepreneur to Corporate Titan

India's Tata Group has for decades been among that country's largest and most influential industrial conglomerates. With \$62 billion in annual revenues, and businesses ranging from steel and chemicals to hotels and tea, it is big by any measure. Among its recent and best-known initiatives is the plan to sell the world's least expensive car (approximately \$2,500), dubbed the 1-lakh car.

It may come as a surprise, then, to learn that the founder of the Tata Group, Jamsetji Tata, was one of the world's first and most successful social entrepreneurs. Nearly a century before anyone uttered the term *corporate social responsibility*, Tata built a business empire that defined its mission as creating both profits and social value. Tata, who died in 1904, is quoted on the Tata Group's Web site as saying, "In a free enterprise, the community is not just another stakeholder in business, but is in fact the very purpose of its existence."

It is almost impossible to visit India and not be aware of Tata Group's presence. It includes not only the industrial entities, but also a stunning array of public service institutions, including the Tata Cancer Hospitals, Tata Institute of Social Sciences, Tata Trusts, and the Indian Institute of Science in Bangalore (founded by Jamsetji Tata). The Indian Institute of Science is one of India's top technical universities and is the main reason that Bangalore has emerged as a major hub of information technology services.

More than an illustration, the Tata story is an allegory. Entrepreneurial value creation and corporate value creation are not two different stories. They are, instead, distinct chapters of the same story: the social entrepreneur became the corporate titan. —P.A.

gross domestic product (GDP)—the magnitude of flows of goods and services in the economy—is fundamentally grounded in the logic of consumer and producer surpluses: the more exchange, the more value created. In this frame of reference, Barro is right: No institution can match the power of the large corporation in creating value.

A more broadly construed notion of the residual value created in the course of a market transaction, however, turns out to be the key to understanding the role of entrepreneurship. For all the different notions of entrepreneurship, the most fundamental and enduring is the definition of the entrepreneur as the claimant of the residual value generated by a new venture. Where producer and consumer value are derived from single transactions (for example, the purchase of a Ben & Jerry's cone), the residual value claimed by an entrepreneur is derived from the process of building a venture (for example, the founders' equity in Ben & Jerry's itself).

The most obvious value that is created by new ventures is a financial one, but that is not the sole result of these activities. In fact, residual values can take nonfinancial forms. There are two principal types of nonfinancial residual value that can be claimed by an entrepreneur: reputational and ethical. Reputational value is perhaps the most important of the two. Muhammad Yunus, for example, may be able to claim truthfully that he has never received a dividend from Grameen Bank. But, there is no doubt that he personally has claimed a dominant share of the *reputational residual* that the venture has created. In this regard, Yunus is no different from John D. Rockefeller, Bill Gates, or Steve Jobs. Personal reputation—like a brand for a corporation—is a valuable privately held asset.<sup>1</sup>

Another significant category of residual value derives from the

ethical reward. The existence of an *ethical residual* is precisely what makes it possible for products that have a clear and persuasive ethically based brand to be priced at a premium. Recognizing this, explicitly ethically based companies—for example, the Body Shop and various fair trade ventures—expend considerable resources to communicate to consumers their nonfinancial corporate goals. Ethical residuals can also be tangible assets: Charitable institutions such as the American Red Cross and Greenpeace USA have built sustainable business models based entirely upon the creation, and reinvestment, of the ethical residuals that motivate charitable giving, and that over time are capitalized in strong and enduring brands.

## CREATING SOCIAL VALUE

The extent to which each of these three basic categories of private value—financial, reputational, and ethical—is pertinent for a given entrepreneur or venture will vary greatly. But, regardless of the composition of the residual value, it is clear that without at least one of these values there is no such

thing as entrepreneurship.

Yet entrepreneurs also perform other functions that generate value. Any venture—including a restaurant or hardware store—through its presence in a competitive market is generating some increase in the private value captured by others. By offering new jobs, they keep existing companies from underpaying their employees; by offering new goods and services they keep existing producers from overcharging otherwise potentially vulnerable consumers. The existence of entrepreneurial activity in markets and the eventual reinvestment of residuals do nothing less than create the possibility for economic growth and social progress.

The residual value claimed by entrepreneurs also provides a resource that can be used to address societal challenges in instances where markets might be poorly developed or non-existent. Residual value creates opportunities for reinvestment and cross-subsidization of activities that may potentially benefit people not involved in the original transactions.

For Ben & Jerry's, for example, the ability to charge a price above the minimum cost of service provides the resources it needs to support an array of other activities—some potentially "profitable" in an accounting sense, some not—consistent with the founders' respective visions of beneficial societal impact. In the case of Ben & Jerry's, the subsidized activity is the work of its foundation, as well as its employee relations practices and community outreach. India's Tata Group is another example of a business started by a social entrepreneur that has grown into a \$65 billion a year multinational corporation. (See "From Social Entrepreneur to Corporate Titan" above.)

The activities of Ben & Jerry's, Tata Group, and similar enterprises around the world would not have been possible without the ability to provide the original paying customers with a desired service. The ability to create social value derives from the existence of a residual in the creation of private value.<sup>2</sup>

Of course, entrepreneurs can do much more to create social value than direct profit in the service of society. They can also create social value by engaging in activities that have an impact that extends beyond what they are immediately doing, what economists call generating positive externalities. The Amazon Conservation Team, for example, helps indigenous people maintain their cultural heritage by documenting their knowledge, and it helps protect their environmental heritage by mapping their territories.

The most significant positive externality created by entrepreneurs, perhaps, is the beneficial impact that they have on governance. In fact, it is precisely the failure of governments that creates opportunities for social entrepreneurs, just as the failure of existing corporations creates opportunities for other types of entrepreneurs. Furthermore, the large corporations that Barro, Aneel Karnani, and others of like mind tend to celebrate for their job-creating capacity are often active—if, at times, unwilling—participants in societal processes that reinforce the centralization of power and poor governance.<sup>3</sup>

The phenomenon is most clearly evident in countries (most poor) plagued by corruption and public sector mismanagement, but it is also a fundamental feature of democratic, economically advanced countries. Joseph Schumpeter articulated this fundamental paradox of capitalist economic advancement: Growth driven by entrepreneurial opportunity contains the seeds of its own undoing. Where the bumper sticker version of Schumpeter emphasizes the notion that entrepreneurs can challenge powerful incumbents and thus achieve “creative destruction,” the more nuanced corollary is considerably less bullish.<sup>4</sup> When combined with the status quo-preserving tendencies of political institutions, yesterday's entrepreneurs' success in building large companies can actually undermine prospects for today's entrepreneurs. As a result, sustained development is achievable only through active efforts to preserve the possibility of entrepreneurship in its myriad forms—economic, social, and political.

The actions of entrepreneurs of all types serve to decentralize power. In many contexts, entrepreneurs—social and other—serve to make both markets and governments function more efficiently. They increase transparency and accountability, reduce the power of incumbents by increasing consumer options, and introduce technological and organizational innovations. In these and other ways, they put pressure on incumbents (including governments) to improve the quality of goods and services provided. Understood in its complete context, entrepreneurial entry is a vital element of a dynamic process that compels economic efficiencies to work in the service of, rather than in opposition to, good governance.

### BRINGING BACK MORALS

Up to this point I have emphasized the extent to which the actions of entrepreneurs create both private value through provision of goods and services, and social value by improving the efficiency of markets and governments. Another important dimension of entrepreneurship

and value creation pertains to equity, not efficiency.

Consider the value created by the Aravind Eye Care System, a collection of hospitals and clinics founded in 1976 by Dr. Govindappa Venkataswamy, or “Dr. V” as he was known to all, a retired ophthalmologist living in the south Indian city of Madurai. Aravind's product is the restoration of sight. Its customers are the blind, many of them desperately poor. The challenge that faced Dr. V was to reduce the cost of a procedure and increase its availability. In the years that followed, Dr. V developed a business model inspired by Ray Croc, the founder of McDonald's, not by Florence Nightingale. In the last 30 years, Aravind has cured more than 2 million people of blindness. That Aravind offers its cataract removal procedures free to its poorest patients is only one side of the equation—and the less interesting one at that. What makes Aravind distinct is that the value to the patients of the service provided—the restoration of sight—is so great. What is of significance, in other words, is the difference between price and private valuation: the consumer surplus.

But there is a catch. Strictly speaking, consumer surplus is defined by an individual's willingness to pay for a particular good. Yet willingness to pay is a function of income. Someone making one dollar a day cannot pay more than the entirety of her income, plus whatever she is able to borrow. From a human standpoint, we know that the ability to see is more valuable than an ice cream cone, even if they may be priced comparably. Is the field of economics so ethically bankrupt that it is unable to account for such an evident difference?

For most of the 19th century and the early part of the 20th, economists saw themselves as “moral philosophers,” as qualified to comment on the equity of societal processes as on their efficiency. That tradition came to an end rather abruptly with the publication in 1939 by John R. Hicks of the classic book *Value and Capital*—a work that took the creation of value as a starting point for fundamental theoretical synthesis. At a time when ideological excesses, such as communism and fascism, were becoming the norm, Hicks and his colleagues at the London School of Economics and the University of Cambridge were intent on reestablishing the field of economics on firm scientific foundations, immune to whim or rhetoric. Hicks asserted forcefully that the field of economics should be based not on the fantasy of objectively measurable happiness, but rather on subjective judgments of value as revealed through market transactions. Because utility was not measurable, interpersonal comparisons of well-being were out of bounds.

Such was the state of economics until the 1980s, when another of the great social scientists of the past century, Amartya Sen, set about to recover the metaphorical baby that Hicks had thrown out with the bathwater. One of his central contributions was establishing the theoretical basis for making interpersonal comparisons of well-being. The key was to focus not on commodities (and willingness to pay) as in the conventional model, but rather on *capabilities* (and willingness to live).

The notion of human capabilities (and its inverse, deprivation) is an important one, for it provides an additional dimension for measuring the creation of social value, and thus differentiating *social* entrepreneurship from other forms of entrepreneurship. Capabilities are measurable. Deprivation can be defined in absolute



terms. Not all of the benefits of entrepreneurship work through markets; in some cases, entrepreneurs may act directly to enhance human capabilities, increase freedom, or build levels of trust. The Aravind Eye Care System provides a striking example. The gift of sight is an end in itself. In this way, Aravind creates social value directly, in a manner not mediated through a market transaction, and captured only indirectly through market-based measures of societal progress such as GDP.

Sen's work fundamentally broadens the scope of information on which determinations of social value can be based, suggesting potential metrics for value creation that go beyond dollar-denominated consumer value and producer value. The restoration of sight is the restoration of a basic human capability in a way that the sale of an ice cream cone simply is not. Such enterprises, and the social entrepreneurs who create them, derive their impacts not from market exchange, but rather from the inherent value of the human lives that their actions help to preserve or enhance.

### SOCIAL ENTREPRENEURS ARE CRITICAL

But what can be said of the unforgiving logic of scale? Given the magnitude of 21st-century challenges—bringing an end to large-scale poverty, dealing with global climate change, and coping with emergent global threats to public health—what role can entrepreneurs of any type play in realistic strategies? The skeptic may still maintain that a handful of small enterprises and nongovernmental organizations, however well intentioned, will never make more than a dent in such immense problems. Whatever solutions exist will have at their center national governments, international organizations, and multinational corporations.

Such a view has the veneer of realism, without the substance. If anything is more naive than an unquestioning belief in the transformative power of social entrepreneurs, it is an unquestioning belief in the transformative power of national governments, international organizations, and multinational corporations. As already indicated, in many parts of the world where change is most urgently needed, governments are as likely to be part of the problem as part of the solution. In such environments, all institutions structured to work through national governments face serious handicaps. The 21st-century relevance of the United Nations and the World Bank—the two institutions most clearly tasked in the post-World War II order with addressing global challenges—is no more assured than that of social entrepreneurs.

Indeed, a somewhat paradoxical characteristic of our age is that even as technological and organizational changes occur on ever-compressing timescales, they increasingly lie beyond the direct control or influence of any single organization or coalition of organizations. Many institutions that not long ago had the power to be globally dominant through scale, scope, and closed system development are now seeking to reinvent themselves by participating in global networks built on shared, often open, standards.

Such global trends provide the final piece to the puzzle of entrepreneurship and social value. In a highly networked world, small-scale actors have the capability to achieve large-scale impacts in ways achievable in the past only through raw institutional growth. As Elkington and Hartigan write in their aforementioned book,

“Increasingly, small groups of people use multiple kinds of leverage to drive change on a disproportionate scale.”

Of course, the impacts of such leverage to drive change can be positive or negative. *The Economist* wryly directs readers' attention to the name Osama bin Laden, which Elkington and Hartigan “tucked away” in a footnote associated with this assertion. The juxtaposition is apt, and significant. Just as terrorism is the ultimate in antisocial behavior, so might social entrepreneurship turn out to be the ultimate in terrorist preemption.

The essence of terrorism is to employ any means to achieve societal change; the essence of social entrepreneurship is to link ends and means inextricably. The most powerfully viral idea inherent in social entrepreneurship is the oft-quoted Gandhian message: “You must be the change you wish to see in the world.” The message is not only a personal exhortation, but also a challenge to the old model in which private efficiencies are first maximized without regard to the social costs or benefits, and then resultant societal problems are fixed through the actions of governments or private foundations.

Whoever the agents of change turn out to be, it is clear that addressing 21st-century challenges will require the creative initiatives of many. “Civilization becomes more complex and difficult in proportion as it advances,” the Spanish philosopher José Ortega y Gasset observed more than 70 years ago. “Of course, as problems become more complex, the means of solving them become more perfect. But each new generation must master these perfected means.”<sup>5</sup> As this century unfolds, existing institutions and incentives may or may not be able to cope with new complexities. As, and when, new approaches are required, thanks will be due to those exceptional entrepreneurs who have sought practical solutions to societal challenges. To paraphrase the great Alfred Marshall,<sup>6</sup> “a score of Tatas” might thus do more to address global challenges than any government or other incumbent organization, whether corporate or not. ■

#### Notes

- 1 The desire for reputation is a powerful human motivator. Classic studies documenting systems of incentives among scientists apply equally to entrepreneurs—particularly social entrepreneurs. See Robert K. Merton, *The Sociology of Science: Theoretical and Empirical Investigations*, Chicago: University of Chicago Press, 1973.
- 2 Carl Schramm quotes Henry Ford II from a letter of resignation he wrote to the board of the Ford Foundation in 1977: “The foundation exists and thrives on the fruits of our economic system. The dividends of corporate capitalism make it all possible. ... In effect, the foundation is a creature of capitalism.” See Carl Schramm, “Law Outside the Market: The Social Utility of the Private Foundation,” *Harvard Journal of Law & Public Policy* 30, 2007: 356–415.
- 3 Aneel Karnani, “Microfinance Misses Its Mark,” *Stanford Social Innovation Review*, summer 2007.
- 4 In a 1928 paper titled “The Instability of Capitalism,” published in the *Economic Journal*, Schumpeter concludes (pp. 385–86): “Capitalism, whilst economically stable, and even gaining in stability, creates, by rationalizing the human mind, a mentality and a style of life incompatible with its own fundamental conditions, motives, and social institutions, and will be changed, although not by economic necessity and probably even at some sacrifice of economic welfare, into an order of things which it will be merely matter of taste and terminology to call Socialism or not.”
- 5 José Ortega y Gasset, *The Revolt of the Masses*, New York: W.W. Norton & Company, 1930/1994: 90–91.
- 6 Marshall was the author of *Principles of Economics*, among the foundational works in the field of economics. The original quote, from Marshall's correspondence, refers directly to the Tata companies: “A score of Tatas might do more for India than any government, British or indigenous, can accomplish.” See Alfred Marshall and John King Whitaker, *The Correspondence of Alfred Marshall, Economist*, Cambridge, U.K.: Cambridge University Press, 1996: 283.