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CONTENTS

The Economics of Social Business

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The idea of socially-oriented business is not new, although Nobel Peace Laureate Muhammad Yunus has certainly given an enormous impetus to it by his articulate branding of it as "social business". The reason his campaign has caught so much public attention is at least partly its timing. Global capitalism, driven by the singular pursuit of profit, has in recent times exposed some of the worst excesses of the system – repeated global financial meltdown, the increasing concentration of wealth and the unmitigated environmental damage associated with the looming threat of climate change. French economist Thomas Piketty's (2014) convincing analysis in his recent best-selling book *Capital in the Twenty-First Century* as to why the current capitalist system will lead to an unabated process of wealth concentration has only helped to add fuel to the fire of public discontent. It is not surprising that the global business community is eager to embrace the idea of social business, at least in its public posture, almost as a penance for the sins that have been committed.

In the world of academia, while the business schools in many top universities worldwide are already offering dedicated courses on social business, the response from mainstream economics is at best lukewarm. Why? First, the idea of social business is still too fuzzy for an academic discipline that claims the status of a science. Muhammad Yunus describes it as a business which has a social mission rather than profit-seeking as its main purpose and the owners of which do not earn any dividend from profit (Yunus 2007). That definition may fit a wide range of non-profit business models so that it may be easier to say which business does not qualify than which one actually does so as a social business. For example, consider a business, say, owned by a trust, which is run entirely on the basis of profit maximisation but the profits are spent for philanthropic purposes; yet it will not qualify as a "social business" even though it does not generate private dividends. There needs to be some 'social' element other than profit-maximisation in the way the business itself is run.

Second, while admitting that many market distortions do exist, economists are accustomed to the elegant theorising of the efficiency of the market economy that is rooted in the premise of self-seeking behaviour and the "profit motive"; and this academic tradition has continued ever since Adam Smith famously remarked that we owed our breakfast not to the benevolence of the baker and the butcher but their attending to self-interest. Yet, this need not be so. According to a long-forgotten strand of economic theorising, the success of a competitive free-enterprise economy can be shown to depend on people pursuing *self-chosen* interest, which can be altruistic or anything else (Winter, Jr 1969). These theoretical results are, however, derived under highly restrictive conditions; but one may argue that the assumptions underlying the welfare economics of competitive market economy are themselves far removed from reality and serve only as a point of departure. There are also economic arguments that point to incentives of economic agents other than self-interest underlying the efficiency of the market system. For example, it was once argued by some economists that the so-called "Japanese ethos" of loyalty of the Japanese workers to his firm and to his co-workers rather than individual self-seeking was the key to the success of the Japanese economy (Morishima 1982). The "Japanese ethos", in contrast to the Western business culture, is in fact an example of a broader phenomenon analysed by Hirsch (1977) regarding how behavioural modification by breaking away from individual self-interest can help better achieve the fulfilment of those very interests. Incorporating motivations other than self-interest in the working of the market economy should not be therefore altogether new to economic theorising.

In the real world of the market economy, it is now the generally accepted view that private business must exercise some measure of social responsibility beyond looking after shareholder interests. The question is how to do it best. Modern-day smart CEOs worldwide know that strategic spending on corporate social responsibility (CSR) activities can be in the long-run business interest of their firms. However, the phenomenon is reversed in the case of a social business, which takes advantage of viable business models while pursuing its overriding social goals. Indeed, an advantage of social business over conventional corporate philanthropy, as argued by Muhammad Yunus, is that once an investment is made in a social business, its benefits will continue as long as that business remains in operation, while companies have to allocate funds annually for their CSR activities. This is similar to the advantage that a revolving fund for a microcredit programme may have over annual transfers to the poor under social safety net programmes. It is no coincidence that Yunus happens to be the pioneer of both microcredit and social business.

There seems to be, however, even a more promising way of reconciling the idea of social business with mainstream economic thinking. A social business is expected to achieve its social objectives by producing some socially-oriented products or services that are not supplied by profit-oriented businesses. Examples may include marketing products that have public health benefits or promoting some environment-friendly or employment generating technology. These products and services are supposed to have what economists call "public good" characteristics with beneficial externalities; that is, their benefits extend beyond what would be otherwise reflected in the market demand and business profits. As a result, these goods and services will be under-supplied, or not be supplied at all, by profit-maximising businesses. Because of the absence of the compulsion of profit maximisation, an implicit subsidy is involved when such products or services are produced and supplied by social businesses; only the subsidies in this case come not from the public exchequer but from foregone business profits. Such subsidies can be justified in economic theory as a legitimate means of correcting market distortions and deficiencies arising from the so-called economic externalities.

The above line of reasoning can in fact be a more fruitful way of conceptualising social business instead of either trying to fit it in the grand scheme of the theory of competitive market equilibrium or attempting to reconstruct the entire logic of the efficiency (albeit with large-scale shortcomings) of the profit-oriented market economy. Furthermore, by adopting such an analytical approach, it is possible to show that, far from creating distortions in the market economy, social businesses can in fact be so designed as to address at least two major sources of shortcomings of the market economy: first, the inefficiencies resulting from the 'externalities' discussed above; and second, the fact that the market economy allocates resources 'efficiently' only in relation to the market demand resulting from a given distribution of income. Thus, producing and marketing consumer items at affordable prices targeted to the poor can be seen as a way of trying to redress the income distributional problem that is inherent even in an otherwise efficiently functioning market economy. The same is true for social businesses that may be set up for adopting production technologies or for marketing products that can create income-earning opportunities for the poor. By the same logic, the socially-oriented microfinance institutions which provide financial services to the poor and can cover their operating costs from interest earnings can qualify as social businesses.

Yet another way of interpreting the idea of social business in terms of conventional tools of economic analysis is to relate it to the problem of project selection for public sector investment based on social cost-benefit analysis. Such an analysis is designed to rank projects on the basis of net social benefit by accounting social costs and benefits as distinct from the private ones and by taking into account both the problem of economic externalities and income distributional considerations. However, while the social cost-benefit analysis is applied to determine the priorities of public sector investment, the concept of social business belongs entirely to the domain of the market economy driven by private investment.

This brings us to a more serious concern about social businesses; and this has to do with the informational problem that may arise from their not being able to take full advantage of market signals in making decisions about prices and products. The informational deficiency may arise in perceiving what is good for society while not necessarily maximising profit as allowed by the market. Prices and profits, resulting from self-interested behaviour, serve a useful signalling function, since the interests of each person are best known by the person herself or himself. As Amartya Sen aptly puts it, "Doing good is not an easy matter with informational deficiency" (Sen 1984). One has to only recollect O Henry's story 'The Gift of the Magi' to see how the pursuit of altruism can lead to frustration. Social businesses need to therefore tread between the Scylla of market failures from externalities and the Charybdis of informational deficiency. A safeguard against messing up the market mechanism is, however, provided by the stipulation of running social businesses at least on a no-loss basis, which provides a bottom line for using the market as a disciplining force. Overall, it may be more useful to judge the comparative merits of non-profit-maximising behaviour of social businesses in particular practical contexts rather than in terms of any given notion of efficiency or optimality of market mechanism.

The problem of informational deficiency is also linked to business risks. Private capitalists or their financiers take risks while investing in new business ventures. They are willing to undertake the risk of business failure because of the lure of earning profits; in fact, the riskier the investment, the higher are usually the expected returns from profits. Donors and philanthropists, however, may feel less comfortable with the idea that the social businesses they are investing in may, in some cases, fail to deliver the goods, and they may therefore like to see strict pre-project scrutiny in place. For example, can enough market segmentation be ensured so that the benefits from the products and services intended for the poor do not go to non-poor consumers? Or, given the "public good" characteristics of these products and services, will there be a need for social campaigns to create demand? Moreover, while profits and shareholder dividends are taken as performance yardsticks of profit-motivated businesses, it will be difficult to find one such single measure of success for a social business, so that the performance of each one has to be evaluated in terms of meeting its particular avowed social objectives. A possible approach may be to examine the *social relevance* of the project that may appear obvious in a broader context rather than focusing on any narrowly interpreted impact assessment. How far the social business campaign can create an impact will perhaps depend to a large measure on the resolution of these issues. Motivating the institutions and individuals with enough capital to embrace the idea, of course, remains a more fundamental challenge.

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