Is there an Economics of Social Business?

WAHIDUDDIN MAHMUD*

The idea of social business, as advocated by Nobel Peace laureate Muhammad Yunus, has drawn considerable attention from the global business community and many business schools around the world, but so far there has been little response from the mainstream economic profession. This paper explores the reasons for this apathy and the ways in which the concept of social business could be reconciled with economic theorising. It also argues that a rigid definition of social business may leave a grey area in between such businesses and the purely profit-motivated ones, particularly since the “social” element may exist in various shades in the running of a business. Although the paper primarily looks at the analytical aspects of the concept of social business, it does examine some of the risks and pitfalls involved in the actual implementation of such a business idea.

Keywords: Social Business, Economics of Social Business, Corporate Social Responsibility

I. INTRODUCTION

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 to do with its timing. Global capitalism, driven by the singular pursuit of profit, has in recent times exposed some of the worst brutalities 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.

While many top business schools worldwide have already included the topic of social business in their curricula, the response from the mainstream economists sat best lukewarm. There could be two reasons for this apathy. First,

* Former Professor of Economics at University of Dhaka, Bangladesh.

the idea of social business may appear to be too fuzzy for the analytical tools of economics—an academic discipline that claims the status of a science. Muhammad Yunus describes it as a viable business model which has 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 range of socially-oriented business models, all of which may not strictly qualify as social business according to the criteria set by (Yunus and Weber 2010: 1-9). There are clearly some borderline cases as we shall discuss later. 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.” This academic tradition has continued ever since Adam Smith famously remarked that we owed our breakfast not to the benevolence of the baker or the butcher but their attending to self-interest.

The main purpose of this paper is to explore if and how the idea of social business could be reconciled with mainstream economic thinking. In doing so, however, we pay relatively less attention to the extent to which social businesses can actually succeed in achieving their professed social goals in practice. Even less attention is paid to the promise of social business in bringing about any significant change in the way global capitalism works. After all, we are only looking at some analytical aspects of the concept, while, in Yunus’s own words, the full promise of the concept of social business lies in the realm of “dreams” that cannot be perceived or realised “by using the analytical minds trained to deal with hard information that is currently available” (Yunus and Weber 2010: 206).

II. CAN SOCIAL BUSINESS BE UNIQUELY DEFINED?

The defining characteristics of a social business, according to its proponents, are that (a) its profit stays with it and is not paid back as dividend; (b) instead of maximising profits, its mission is to do some social good (such as in the field of education, public health, access to technology and environment protection); and (c) it must be able to attain financial sustainability (Yunus and Weber 2010:3). These characteristics should distinguish a social business from a company doing corporate philanthropy, that is, setting aside some of its profits for spending on what are known as corporate social responsibility (CSR) activities. No matter how much profit is set aside for philanthropy, there needs to be something in the way the business itself is run (that is, having some social motive) other than

merely generating profits. The problem, however, is to clearly define that “social” element as a yardstick against which a social business can be clearly identified.

However, even corporate philanthropy in the form of CSR may be part of a business model. Modern-day smart company executives worldwide know that strategic spending on CSR activities can be, in the long-run, business interest of their firms. Thus, CSR is sometimes seen as a way of delivering some social good, such as promoting healthy foods, with the objective of cashing on the goodwill thus created for the company in the long run.¹ The phenomenon is, however, reversed in the case of a social business, which takes advantage of a viable business model while pursuing its overriding social goals. But since both the models incorporate some social elements in the running of the business and differ only in their ultimate goal, the distinction may sometimes get blurred. In fact, a social mission and a commercial motive may coexist at least in the initial stage of many innovative ventures, such as those taking advantage of a new technology. An example in Bangladesh is the mobile-phone-based money transfer system, called *bKash*, which was conceived for facilitating the money transfers of relatively poor people, such as the financial transactions of small traders or of urban workers to their families living in rural areas.² This e-money model has turned out to be extremely successful and has been adopted by other banks in Bangladesh as a profitable business. In fact, there are many examples of business model worldwide for which it may be difficult to make a clear distinction between non-profits developing viable business models and for-profits having a social mission (Mills-Scofield 2013).

An advantage of social business over conventional corporate philanthropy, as argued by its proponents, 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 thus no coincidence that Muhammad Yunus happens to be the pioneer of both

¹There is increasing interest in the global business community in what is called “impact investments,” that is, investments made by companies and other organisations with the intention to generate social and environmental impact alongside a financial return.

²*bKash* is a subsidiary company of a commercial Bank, the BRAC Bank, which, in turn, was set up by the world-famous NGO, BRAC (stands for Bangladesh Rural Advancement Committee).

microcredit and social business. But, even this characterisation of social business leaves some grey area in the case of companies that are set up with a major (if not the sole) objective of generating profits for doing philanthropy. These companies may be run on a purely commercial basis, but the profits are, wholly or largely, spent on socially-oriented activities, thus providing a sustainable source of funds for spending on such activities. Examples in Bangladesh include some commercial enterprises owned by the *Kumudini Welfare Trust*, the entire profits of which are diverted to spending on the charitable activities of the Trust. Another example is Renata Pharmaceuticals—a purely market-oriented and a reputed company in its field in Bangladesh; a half of its annual profit goes to the *Sajida Foundation*, which is a microfinance institution but also carries out many socially-oriented activities.³

While the conventional CSR spending of a company, often carried out by setting up a foundation, may lie outside the concept of social business, a company can set up a subsidiary that may very well qualify as a social business. In fact, experiments in setting up this kind of social business involving large multinationals seem to have so far caught the most attention. The “Grameen” family of companies in Bangladesh, which are joint ventures with reputed multinationals, belong to this genre of social business. The joint venture company called Grameen-Danone, for example, is one such experiment aimed at producing low-priced yogurt containing micro-nutrients missing in the ordinary diets of children from poor families while also helping to market milk produced by poor rural households. Among other such companies, Grameen-BASF is to make and market chemically-treated mosquito nets at affordable prices for the poorest; Grameen-Veolia is to provide safe drinking water at affordable price in villages where arsenic contamination of groundwater is a serious problem; Grameen-Adidas is to produce shoes for the lowest income people, particularly to protect rural children from parasitic diseases transmitted through walking barefoot; and Grameen-Intel is to help solve various problems of the rural poor, for example, by providing healthcare in villages.⁴ What remains to be seen is whether these companies can attain financial viability while also catering to the needs of the intended beneficiaries.

³Both Renata Pharmaceuticals and the enterprises of *Kumudini Trust Foundation* are recipients of a CSR award jointly sponsored in Bangladesh by the Standard Chartered Bank and the *Financial Express*; but the award committee had doubts about whether the conventional idea of CSR, rather than some notion of socially-oriented business, applied to these companies. Incidentally, the present author happens to Chair the award committee.

⁴For details, see Yunus (2007) and Yunus and Weber (2010).

Another kind of social business is represented by “a profit-making company owned by poor people, either directly or through a trust that is dedicated to a predetermined social cause” (Yunus and Weber 2010:2). This leaves out co-operatives that are run purely for profit for benefit of the member-shareholders and serve no particular social objective. But, as argued by (Yunus and Weber 2010: 7-8), co-operatives may be regarded as social business if they fulfil the double criteria of (a) being owned by poor people, and (b) are run in a way so as to create some social benefits, such as housing co-ops that make affordable home for the working-class people, or banking co-ops that provide financial services to otherwise underserved clients. An example is the Self-Employed Women’s Organization (SEWA) of India, which is a trade union that organises women for self-help by providing financial and other services to its rank-and-file members. Similarly, Grameen Bank, whose majority shareholders are its member-borrowers, may also fit this category of social business (Yunus and Weber 2010: 2). However, in both these cases, the ownership of the poor in terms of earning dividends may be only notional, since their clients benefit mainly through the financial services that they provide (e.g., small credit and deposit schemes). In fact, the claim for Grameen Bank to be a social business perhaps lies more in its having become a financially self-sustainable microfinance institution (MFI) rather than in its member-borrowers owning the Bank and earning dividends from its profits.

Whether the MFIs qualify as social business remains another grey area. Other than Grameen Bank, the microfinance programmes in Bangladesh are run by numerous non-government organisations (NGOs) which were initially established for “social mobilisation” of the rural communities along with service delivery, but later on shifted their emphasis to the provision of credit to the poor—hence now commonly known as NGO-MFIs. Thus, while their social mission is not in doubt, the test for qualifying as social business lies in their ability to become financially sustainable.⁵ Some of the large ones among them may now very well pass this test; although initially dependent on external funds, the microcredit programmes of these NGO-MFIs have now become financially self-sustainable, and have even started generating surplus for funding non-credit services for their clients. In contrast, there is an alternative profit-oriented model of microcredit programmes practiced in many countries, especially in South America, with the main goal of maximising shareholder dividend; these MFIs clearly lie outside the scope of social business.

⁵For a detailed discussion of the growth of the NGO-MFIs in Bangladesh, see Mahmud and Osmani (2016), Chapter 2.

Businesses of NGO-MFIs

Besides their microfinance operations, large NGO-MFIs in Bangladesh have gone into commercial ventures that again may lie in the grey area of social business, if one were to go by the strict criteria set for defining such a business. Although these enterprises do not generate any private dividend from profits, they are often run purely as profit-oriented businesses, sometimes even catering to upmarket consumer demand (e.g., fashion clothing). Yet, these enterprises have a potentially crucial role to play in helping to reinforce the social goals of microcredit programmes in poverty alleviation and employment creation. This they can do by supporting the scaling up of micro-enterprises of the borrower-clients of the MFIs, such as through the provision of market access and adoption of improved production technology (including product design, quality assurance, etc.). The MFIs have a comparative advantage in making such businesses viable, because they can economise on overhead costs due to their institutional presence in rural areas and networking with a large pool of spatially dispersed small producers.⁶

There are already some notable examples of many such innovative MFI businesses. One of these, *Aarong*, is operated by BRAC on commercial lines to market domestically and internationally products of small/micro-enterprises (such as handicrafts, garments, handloom and sericulture products and pasteurised milk and milk products). Another example is *Grameen Check*, a handloom product that is marketed both in the domestic and international markets. Grameen Telecom, a minority-share partner of a multinational mobile operator, offered a technology to create an income-generating activity for its borrowers, namely “village women” providing mobile telephone service for villagers. The BRAC Bank, another venture of BRAC, established in 2001, goes beyond traditional commercial banking to serve small entrepreneurs through dedicated countrywide so-called SME branches.⁷ Its small-business banking model emphasises relationship banking and collateral-free lending of up to US\$14,000, with wide coverage in rural areas (World Bank 2012:164). It is noteworthy that BRAC bank used to have a larger portfolio of bad loans compared to many other private commercial banks in Bangladesh at least to start with; it may be a reflection of the limitations of serving small entrepreneurs within traditional commercial banking; or, it may also suggest that a commercial

⁶On the downside, NGO-MFIs often lack business experience and depend on low-cost investment funds leading to high rates of failures of such businesses.

⁷SME stands for small and medium enterprises.

bank with a social mission need not be judged only by the quality of its balance sheet as long as it is not in the red. Clearly, the “social” element in the running of a business may come in different shades and may not always be amenable to unambiguous categorisation.

III. RECONCILING WITH ECONOMIC THEORISING

Can the concept of social business be accommodated within the main body of economic theorising? Or, at the least, can the analytical tools of economics be applied to explain and evaluate the working of a social business? Neither the proponents of social business nor academic economists have shown much interest to answer these questions. Apart from the definitional ambiguities, economists may be uncomfortable with the absence of the profit-maximising behaviour which lies at the core of the theory of firm and welfare economics based on market efficiency. As mentioned earlier, the emphasis on the profit motive in economics goes back to Adam Smith who was a great believer of the virtues of the so-called “invisible hand” that is supposed to work through the self-interested behaviour of businessmen. Amartya Sen, for example, has often lamented this singular focus on profit motive; fortunately, he says, the real world is richer in human qualities than described in economics textbooks (Sen 1984).

Alternatives to profit motive and the self-seeking behaviour of economic agents have occasionally appeared in the analytical constructs of economics, but never became part of the mainstream. 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). While these theoretical results are derived under highly restrictive conditions, 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 their firm and to their co-workers rather than individual self-seeking was the key to the success of the Japanese economy (Morishima 1982).⁸The “Japanese ethos,” in contrast to the Western business

⁸It is noteworthy that the proponents of social business argue that such businesses can provide an enjoyable work environment in which workers have a sense of pursuing a social mission; cf. Yunus and Weber (2010:3).

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.

There may, in fact, be a promising way of reconciling the idea of social business with mainstream economic thinking—at least in the context of the literature on public policy. 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. In contrast, when these are produced and supplied by a social business having no profit-maximisation goal, an implicit subsidy is involved; only the subsidies in this case come not from the public exchequer but from the 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 perhaps be a more fruitful way of conceptualising social business instead 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,”⁹ 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

⁹The literature on welfare economics is replete with examples of both positive and negative externalities, such as arising from the “public good” nature of certain marketed items and from the adverse environmental effects that do not figure in a firm’s production costs.

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 otherwise underserved poor and are able to cover their operating costs from interest earnings, can qualify as social businesses, as mentioned earlier.

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. This approach to project selection seeks to maximise net “social” returns from public sector investment based on social costs and benefits which are distinct from private cost-benefit calculations because of taking into account both the problem of economic externalities (by introducing the concept of “accounting or shadow prices” as distinct from market prices) and income distributional considerations (by attaching different social weights to income accruing to different income classes).¹⁰ 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. Unlike public sector projects, a social business has to have available (no-loss) business model.¹¹ Moreover, applying the social cost-benefit approach to assess investment projects for a social business may face the practical problem of getting enough data and information required for such an analysis, particularly because of the innovative nature of such projects.

IV. IN LIEU OF A CONCLUSION: THE RISKS AND PITFALLS

The above discussions point to the promise as well as the likely pitfalls of the concept of social business. While the benefits to society are obvious in the case of a successful social business, there are some serious concerns about the

¹⁰For example, in the case of a social business catering to the needs of poor consumers, the social returns to the investment may take into account the social value attached to income benefit accruing to the poor consumers (arising from their buying the products at lower than commercially determined prices). If the consumption of the products entails some public good element, such as health benefits, the social benefits will be even higher.

¹¹Incidentally, by introducing the concept of economic or shadow pricing, economists have clearly broken away from the stereotype of what Oscar Wilde described as “someone who knows the price of everything and the value of nothing.”

difficulties in designing and implementing such a project. One of those concerns has to do with the informational problem that may arise from the fact that a social business may not be 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. Amartya Sen aptly puts it as, “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, therefore, need to 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 easier to judge the merits of social businesses in particular practical contexts, when the benefits are quite obvious, rather than in terms of any rigorous yardstick of market efficiency or optimality.

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?¹² 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

¹²Due to lack of consumer awareness, the nutrition-rich yogurt produced by Grameen-Danone, mentioned earlier, is alleged to have faced stiff competition from commercially marketed yogurt of inferior quality.

avowed social objectives. As mentioned earlier, 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.

REFERENCES

- Hirsch, F. 1977. *Social Limits to Growth*. London: Routledge and Kegan Paul.
- Mahmud, W. 2015. "The Economics of Social Business." *Journal of Bangladesh Studies*, 17 (1): 59-61.
- Mahmud, W. And S. R. Osmani. 2016. *The Theory and Practice of Microcredit*. Abingdon, UK: Routledge.
- Mills-Scofield, D. 2013. "Every Business Is (Or Should Be) a Social Business." *Harvard Business Review*, January 14.
- Morishima, M. 1982. *Why Has Japan 'Succeeded'?* *Western Technology and Japanese Ethos*. Cambridge: Cambridge University Press.
- Piketty, T. 2014. *Capital in the Twenty-First Century*. Cambridge, MA: Harvard University Press.
- Sen, Amartya. 1984. "The Profit Motive." Chapter 3, In *Resources, Values and Development*. New Delhi: Oxford University Press.
- Winter, Jr., S. G. 1969. "A Simple Remark on the Second Optimality Theorem of Welfare Economics." *Journal of Economic Theory*, 1(1): 99-103.
- World Bank. 2012. *More and Better Jobs in South Asia*. Washington, D.C.: World Bank.
- Yunus, M. 2007. "Social Business." Yunus Centre: <http://www.muhammadyunus.org/index.php/social-business/social-business> (accessed on March 15, 2017).
- Yunus, M. and K. Weber. 2010. *Building Social Business: The New Kind of Capitalism that Serves Humanity's Most Pressing Needs*. New York, USA: Public Affairs.