SOCIAL BUSINESS: A VIABLE BUSINESS MODEL?

Abstract:

CSR has almost become a requirement for businesses, yet the inherent conflict between the social and economic objectives has not been resolved. In recent years, Social Business and Bottom of the Pyramid have emerged as alternative models for businesses to deal with expectations that business must engage with societal issues that are a part of CSR. In this paper, we compare the alternative models to examine their viability and the critical assumptions on which each one rests. While no model provides a full resolution of the underlying concerns, each one exists within the larger space of corporate governance.

Key words: Social business; corporate social responsibility; business models.

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In recent times, several new businesses, especially start-ups, have emerged where the owners announce that they are motivated by a desire to do good to society. The media has begun using the generic term ‘social business’ while referring to such ventures. Others have argued that corporations large and small can have a heart and should operate in a compassionate manner in how they deal with their stakeholders (see, for example, Mackey and Sisodia, 2013)

Such expectations have raised questions about what is a social business, and the frameworks under which it can have expanded activities. These questions go towards not only the operation of a business and how the company is structured, but also bring into question the legal and regulatory frameworks under which businesses are created and exist within society. In particular, the expanded role of a business brings into focus what may be termed as the business model.

The primary purpose of a business, as widely understood, is to earn a profit by serving a customer need. The sustainability of the business is ensured when the customer need continues to be satisfied at a price that covers cost and earns the owner/investor a desired return, namely, profit. When the customer need is not met and/or the profit is not realized, the business begins to unravel. The possibility of a loss will motivate owners to turnaround the business, failing which, they face bankruptcy or liquidation. The self-interest remains a strong motivator in avoiding loss and may be said to be the feature that keeps the model inherently sustainable, since self-interest provides the requisite motivating and corrective mechanisms.

Over the years, various other demands on a business have emerged that deviate from this simple profit making business (PMB) model. These include the expectation that firms engage in activities that aim to meet a social responsibility (CSR), that they target their attention at the needs of the poor (bottom of the pyramid, BOP), or that the very purpose of a particular business should be to meet social and economic objectives (social business, SB).

In this paper, we review the fundamental assumptions and justification of the various business models with a view to understanding whether they are inherently sustainable: what causes them to be created, and remain viable, or fail if they do not meet their objectives. A quick overview of the different models is given in Table 1. After a review of each model, we conclude that each model has some element of weakness, yet each satisfies a different need within the broader space of governance structures.

A Profit Making Business Model

The term business model is used to describe how revenue is generated, value created, and related logistics or supply chain issues are resolved (Schweizer, 2005). In the type that we term a Profit Making Business model (PMB), the consumer of a product or service pays a price that is the primary source of revenue for the supplier of the product or service. The owner has to ensure that there is a sufficient surplus after costs are covered to ensure a profit. In some businesses, a weak link between the user and the payer for the product or service resulted in variations on the basic model. For example, in the education and toys industries, the parent is the payer, while the child is the user. In another variation, multiple customers with different needs exist who share the price. Thus, in the news media business, the newspaper or radio/television subscriber does not pay the full price for receiving the news, and shares it with the advertiser who uses the media to for a different purpose, namely, advertisement.

When there is a split between the sources of revenue, as in the instances above, then the product/service provider is conflicted in her actions since she begins serving two masters. This conflict is often reported in the news media business, about whether the news coverage is influenced by the interests of the advertisers. A similar conflict is often faced by administrators of educational institutions in their focus on the students as the customer versus the student as a product and society as a customer. When one moves away from the simple PMB, inherent flaws in the variations may sometimes lead to a collapse of the business, although for a while at least it may have several followers. The variations in businesses in the 'dot com' era and the millions of investment lost testify to this. Most of these hinged on faulty assumptions about consumer behavior (Magretta, 2002) and who will pay for the service or product provided.

When the nature of the business model is widened to include issues beyond revenue/costs/profit to that of purpose, governance, and regulation, then several other forms of organization need to be considered. This is especially so when we introduce questions about the fundamental purpose of a business and the role of business in society into the PMB.

Corporate Social Responsibility

The simple PMB model is grounded on the concept of self interest. Namely, that the owners of the firm producing the good or service are driven by the motive to earn a surplus and provides economic value in the process. Adam Smith, with his famous injunction of an 'invisible hand' that guides the behavior of an economic being argued that the pursuit of selfish objectives, by itself, satisfies the needs of others. Most economists and business scholars have taken this to mean an almost exclusive focus on profit maximization. Smith's book the *Theory of Moral Sentiments* preceded his more popular *Wealth of Nations.* Hence, it is worthwhile to bear in mind Sen's injunction that 'Smith did not assign a generally superior role to the pursuit of self-interest in any of his writings.'(1988, p.25). Smith recognized that there are several motives for transactions beyond that of self-interest.

One can well imagine several areas of economic activity that an individual can pursue without doing good to others, or even actually doing harm to others. These instances of externalities or market failure bring about the justification for regulation. Yet, the underlying premise is to let an economic activity alone and treat deviations as aberrations that can be dealt with.

Freeman (1984) brought into sharp focus the arguments that businesses operate in a society and have a responsibility to that society that may go beyond the concerns of its immediate economic activity. Corporate social responsibility (CSR) requires a business to take responsibility for the effect of its actions on stakeholders, as against only stockholders. Stakeholders include consumers, employees, the community and the environment. However, a fundamental conflict that could not be resolved was how to manage the tradeoff – when concerns for the stakeholder might interfere with the fundamental responsibility towards the stockholder.

This contradiction in the idea of CSR led to its spanning a wide range of meanings, making the definition of CSR malleable (Aguilera, et al., 2007). Although the oft stated objective of 'doing well by doing good' brings to fore the contradictions in the corporation's objective, it can also help to narrowly define the sweet spot which circumscribes the kind of activities a business can be engaged in where it can meet its dual goals. The scope of CSR efforts can therefore range from ‘to do no harm’ at the minimum, to ‘doing good’ at the other end.

The idea that businesses should engage in CSR is a popular one and, as surveys show, the public battle has been won by CSR. Almost all organizations and corporate leaders espouse CSR. 95% of CEOs surveyed by McKinsey in 2007 said society now has higher expectations of business taking on public responsibilities than it did five years ago. The priority given to corporate responsibility has been rising over the years by a survey done by the *Economist* (Economist, 2008).

The *Economist* categorized three levels of CSR. (1) At the basic level is philanthropy – companies that contribute a percentage of their profits to charity, or write a check at the end of the year. This is also termed arm’s length philanthropy due to almost nil involvement of the corporation in the activity. (2) The next level includes those who see CSR as an aspect of risk management - oil exploration companies being careful of oil spills, pharmaceutical companies dealing with health and safety issues of new drugs; the risk to corporate reputation for companies from child labor; these defensive objectives lead them to create codes of conduct and subscribe to agencies who monitor and report. (3) The third layer comprises of the companies who see it as an opportunity and even a source of competitive advantage (Ex., Porter and Kramer, 2006). This is the doing well by doing good group. Toyota taking the lead with its Prius hybrid vehicle is an example.

Companies report specific benefits from taking part in CSR. Surveys show people reporting that they feel proud to work in the company; it helps with recruitment – applicants/interviewees mention CSR activities; and it develops managers in understanding how the world works. Enhanced reputation of the company also leads to better market presence and increased sales.

When companies involve themselves in CSR activities that are related to their main business, or utilize the competencies of the organization, then there is a greater possibility of justifying the activity. In these collaborations, one can even make the case that it is a win-win situation, namely, that the organization also learns in the process of contributing to society. Such instances of ‘relevant’ CSR efforts include: (a) TNT, a logistics giant located in Amsterdam, has an emergency- response team that works in partnership with the World Food Program, to assist countries in cases of flood, tsunami etc. kind of emergencies, and (b) Standard Chartered Bank working with BRAC, an NGO in Bangladesh, on microfinance.

However, from a perspective of the models’ sustainability, objections remain due to the inherent conflict between economic and social objectives. The company’s managers are utilizing investors’ funds provided for a different purpose when they spend on activities with a social objective. The traditional view of a business as one that works to operate a profit and leaves the social activities to NGOs or the government continues to derive strength due to the difficulty in reconciling the conflicting objectives. That these activities are not for the companies’ to indulge in but the responsibility of the government and indulging in them is a distraction for the company continues to be a popular notion.

Reviewing previous literature, Margolis and Walsh (2003) find that at the very least, a majority of 127 studies show a positive relationship between a corporation's social and financial performance. Yet, they argue that theoretical and methodological weaknesses in these studies results in continuing research to explore the relationship. This brings us back to the inherent tension between social and financial performance. If the corporations' performance is acceptable to the market, it may take an active role in CSR, while if its performance drops in relation to the industry, then CSR becomes difficult to justify.

Social Business

The 'social business' model was first proposed by Muhammad Yunus, the founder of Grameen Bank and named so as to distinguish it from PMB. Yunus (2008) believed that organizations specifically targeted at meeting social goals can co-exist with PMBs. Rather than the CSR approach that requires all PMBs to also be engaged in CSR, the SB approach recognizes the inherent conflict between the economic and social objectives, and believes that some organizations can operate as a SB. Its structure is the same as the PMB, but its underlying motives (social) are different as also how it will be evaluated (creation of social benefits). Its main principle is that it should cover costs, and a nominal surplus generated that would be used to return the original investment of its investors and after that, used to re-invest in the business. The motivation for investing in a social business remains the same as that of a charity, namely, philanthropy. However, the advantage of a SB over a charity is that it is not constantly relying on donations to sustain itself, nor giving away its products or services for free, and it uses business principles of effectiveness and efficiency in how it manages its operations.

The investors, or owners, could be private individuals, a firm, a charity or even the government. To bring in the best of both worlds, the social business would ideally be a partnership between PMBs and a community, or an NGO. The SB would operate on PMB operating principles, such as hire people on merit, pay market salaries, etc., and compete for market share. It ‘must be at least as well managed as a PMB’ for a demonstration effect.

The social business model is not exclusive to the not-for-profit sector. It can be viewed as the business model that has focused on social development and profits (or less profits) are the outcome of the business activity. The drivers of these business models can be politics and the government. Examples include the new models of public health led by governments, markets like open source software or organic food requirements initiated by consumers, social movements, fair trade focused activity, microcredit enterprises, and childcare.

The operational survival of a SB is ensured by requiring the SB to charge a fee for the product or service and fully covering costs. However, the requirement that investors would not receive dividends but will only get their initial investment returned requires a social desire on the part of the investors, i.e., a desire to forego alternative forms of investment to invest in an activity in order to support its social objective.

The main principles of a SB include:

1. Non-loss and non-dividend basis. Nominal profit is used to return original investment and then reinvested to expand the scope, improve quality and services.

2. Proximity business model. Small plants or operations that are rural based, so as to engage the community not only as consumers, but in the supply chain (as distributors, etc.) so as to also generate local entrepreneurship.
3. Performance is evaluated on the organization meeting its social objectives, so measurement and tracking of performance important.

While these principles may aim to make the SB model sustainable, that is only in comparison to a charity which requires a constant injection of funds for operations. Also, many NGOs are so focused on their social purpose that their operations are often not designed on principles of efficiency endangering their operational viability.

Yunus suggested that the scope of activities for such a business would be in the areas of healthcare, education, IT, and renewable energy. Yunus visualized two models of SB. In Model A, companies would invest in a project to help the poor. (An example of this is the Grameen joint venture with Danone.) The PMB contributes investment, and also its business and management expertise. The PMB can sell its investment to the poor once the original funds have been recovered, or continue as owners and control the enterprise. In Model B, the majority ownership is in the hands of the poor (Ex., Grameen Bank) and thus the dividends will go to the poor. (See Michelini and Fiorentino, 2012, for other variations in the social business model.)

Although the concept of the SB is clearly laid out as an attempt to bring the principles of business into CSR by designing a separate organization for the purpose, it still relies on the principle of philanthropy for the initial investment, and thus is open to the same criticism as to why should a PMB divert its resources to non-economic activities.

The BOP Model

Another model that has gained currency in more recent times is that businesses must target the poor not out of considerations of charity but that of strategy. Prahlad and Hammond (2002) and Prahlad (2005) provided a strong argument for corporations to focus on the bottom of the economic and social pyramid in society (BOP). The BOP they refer to are the majority of the world's population who are earning less than $2000 a year. They argue that this segment of the population is ignored by MNCs due to misperceptions such as the low income as a barrier to consumption, and other barriers like corruption, illiteracy and inadequate infrastructure that inhibits access to those markets.

Interestingly, the prime justification Prahlad (2005) provides for motivating MNCs to address the BOP is the 'self-interest' of the organization, as in a PMB. The three areas that underlie this focus are: see the poor as customers and serving the needs of the poor is a rapidly growing market, it is also a source of efficiencies including lower costs, and it can be a source of innovation in trying to meet their needs. The GE example (Immelt et al., 2009) of innovation in China and India seems to illustrate this last point well.

Towards the end of their paper, Prahlad and Hammond (2002) raise the question of why should corporations serve the poor, and answer it by saying that alleviating poverty is a big challenge, and those are the kind of issues that big corporations should address. Thus, the BOP argument is positioned as an extension of Smith's invisible hand – namely, in serving the corporate self-interest by catering to the BOP, MNCs will also be helping alleviate poverty. However, the prime motive is that of a PMB and social objectives are a by-product.

Nestle Pakistan milk collection centers in the rural areas where there are no facilities for storage and refrigeration of milk is an example of BOP model where simple innovation by multinational company has made this market more productive and efficient. This initiative by Nestle has created hundreds of jobs and has far reaching economic and social impact that extends beyond the milk producing farmers. BOP initiatives by multinational organizations have both successful (e.g. Nestle milk collection centers in Pakistan) as well as failed ventures (e.g. Tata Nano by Tata group India). The success and failure of BOP initiatives can vary depending on whether people at the BOP were seen as producers or consumers (Karnani, 2007)

It is not that the needs of the poor were not being addressed by businesses. Some entrepreneurs, who often stayed small and privately owned, have been combining social and economic objectives from time immemorial. However, Prahlad and Hammond address their arguments at MNCs who have deep pockets and the knowledge to produce efficiencies and scale economies that can be passed on to the BOP who will also benefit from better quality and lower prices for the products and services.

Discussion

Table 1 provides a comparison of the different models discussed above, along several dimensions on which we have discussed the models in the sections above. In addition, the table includes a column on NGOs that operate as charitable organizations to serve as a contrast for discussion.

The criticism against the simple PMB model has mainly been a challenge of the notion of self-interest as being an adequate basis for the existence of a business. Both agency theory (Jensen & Meckling, 1976) which argues that managers' interests may run counter to the interests of owners and so their interests must be aligned through stock options, etc., and transaction cost economics (Williamson, 1975) which stipulates that managers' behavior must be monitored and controlled to prevent opportunistic behavior, appear to lean on the greed/self-interest of humans. These theories have been questioned as to their relevance (Ghoshal, 2005). The challenges to the Smithian argument of self interest have also come from non-economic sources, and are mostly philosophical. The view that business has a role in society beyond that of an economic being even has its supporters among the business community. Franck Riboud, Danone CEO, is quoted in the company's annual report as saying, "My vision for Danone: a company that creates economic value while creating social value" (Group Danone, 2010; p.1). The founder and head of the Virgin Group, Richard Branson (2011) is among the more recent to argue that 'business as usual' will not work anymore.

While it may be argued that businesses carry no moral responsibilities, it cannot be concluded that these institutions have no social obligations. Rachels (2002), arguing the social contract theory perspective says that the morality is in the set of rules that govern how people are to treat one another, and that rational people will agree to accept these rules for their mutual benefit provided others follow those rules as well. The social contract concept can be extended to society at large including business institutions (Donaldson and Dunfee, 1994)

The challenge posed by CSR has not been adequate because it does not deal with the conflict between the economic and social objectives although attempts to reconcile the two continue (Beckmann, 2009; Devinney, 2009). CSR is considered as an addition to the core strategy and hence is not considered as top priority of the managers. CSR based business models also require businesses to adopt the compensation structure that should measure performance based on both economic as well as CSR related areas (Slack, 2005). As long as market mechanisms (analysts, stock prices, etc.) evaluate purely based on economic performance, it would be difficult to justify the social expenditures. The SB model correctly diagnoses two problems with charity and NGOs, namely, the constant need for donations or funding for sustenance, and the absence of efficient operations, yet it is open to the same criticism as the CSR model, namely, why should a business even enter this space, and move away from its business objectives.

This problem is dealt with by the BOP model since it is a PMB and it is targeted at the poor with the aim of serving their needs, but this does not provide a complete answer since it will not meet those needs of the poor that would not generate a profit; and the wellbeing of the poor is only a by-product and not the main objective. Similarly, according to Karnani (2007), a critic of BOP, there is no fortune or glory at BOP for multinational organizations and if they want to try their luck at BOP they should focus on the people at the bottom of the pyramid as producers. The profit motive may not be well served by considering this market as consumers.

Trusteeship provides a philosophical argument that can aid the CSR and the SB models (Gopinath, 2005). As originally propounded by Gandhi, it rests on the idea of an individual considering those of his assets in excess of his needs as being held in trust for society and using them for that purpose. This brings a focus to an individual’s behavior and the need to think of utilizing resources for societies’ benefit. By extension, those who run organizations should also consider the need to use the organization’s ‘excess’ resources for a purpose greater than those of earning a return for investors. This is sought to be achieved not by force or legislation but through a transformation of the individual’s outlook and society’s expectations. Buffet’s initiative (2010) that rich people must commit to give away over half of their wealth may well fall into this definition of trusteeship.

Clearly, the space for organizations that meet the different needs of society is vast and allows diverse forms of organization to operate, as shown in Table 1. We see a potential for SB co-existing with these other forms in its own space. It is important to be set-up that way. Although it is still dependent on philanthropy to get started, by standing separate from a PMB indulging in CSR, it is clear from the start in its social and economic goals and strives to work with PMB efficiency. Many of our youth, when they can still afford to be idealistic, want to work in NGOs. SB organizations are places that can absorb them where they work to management principles before they decide to either stay or move on. Similarly, those who made a career in PMBs may, at some time, want to switch over to SBs as their personal contribution to society.

Regulatory Response

Governance issues related to a business focusing on non-business activities may require appropriate legal and regulatory structures. Two countries have gone beyond regulations and incentives to guide corporate behavior and have mandated their involvement in CSR. Indonesia’s Law No. 40 (in 2007) was in response to public concerns about the effects of the mining company operations on the environment (Waagstein, 2011) and while the law mandated that companies act, clear guidelines were not spelled out. Government Regulation No. 47 in 2012 instituted a requirement that limited liability companies prepare a sustainability plan and budget and provided for sanctions in case of violations in their CSR obligations.

In 2013, India became the second country to legislate a requirement for companies to engage in CSR, through an amendment to its Companies Act. Firms with a net worth of over Rs. 500 crores (about $ 75 million) or annual revenues of Rs. 1000 crores (about $ 150 million) or net profit of Rs. 5 crores (about $750,000) were to allocate at least 2% of their profits to CSR (Bahl, 2014). It has been estimated that this would result in about $2.5 billion being invested in social projects by the corporate sector. Presently, companies have a reporting responsibility to explain their compliance and rules have also been issued stipulating what kinds of activities would qualify under these regulations to be considered CSR.

Another significant regulatory response is in the USA where, as of end 2016, 31 states have passed laws allowing the creation of a new corporate structure called the 'beneficial' or B Corporation (see Hiller, 2013). The standard legal format is for a company to be created as a 'C Corporation,' in which the CEO has the legal mandate to maximize returns to shareholders. This opens the company to legal challenge by shareholders if the company expends resources in activities that cannot be seen as directly maximizing shareholder benefit. In contrast, the new B Corporation is required by law to make a positive impact on society and the environment, while still making a profit. While the B Corporation seems to provide the framework to allow the company to pay attention to social impact, various questions arise. These are concerned the division of authority and responsibility between the owners and managers of a corporation (Mackay and Sisodia, 2013) and the role of directors (Haymore, 2011).

These examples of voluntary and mandatory approaches to social impact suggests that we are still looking for a resolution of the fundamental question of how to provide a formal role for a corporation that aims to deal with societal issues.

Conclusion

While recent trends in the literature suggests a broad acceptance that businesses have to take into account their impact on society, the form in which this is to be done is still not clear. In this paper we explored different models that try to incorporate the demands of business with social objectives. The models have tried to deal with it on operational and governance levels. While the goals of a business to maximize profit are crystal clear, to what extent can it also devote attention to social impact without compromising the business goals is an issue with which the models struggle.

No model has an overall dominance in trying to manage private/profit and social objectives. That is not necessarily a disadvantage and accommodates the varying demands of society, and the varying objectives of individuals who see a gap in society and desire to fill that need. There is plenty of scope for further research in this area as we try to understand, using data, the success and failures of various models.

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Table 1: A comparison of alternate business models

Type	**PBM**	**CSR**	**NGOs**	**Social Business**	**BOP**
Profit orientations	For profit	For profit	Not-for-profit	Non-loss (nominal profit).	For profit
Underlying assumptions	Rational actor, self-interest.	Self interest can be combined with social objectives.	Humans are social beings and needs must be met.	Humans are multi-dimensional.	Market forces ensure efficiencies
Investor motivation	ROI	ROI + 'fair play'	Charity (no monetary return); Trusteeship	Do good (investment returned); No-dividend. Trusteeship	Profit and Social objectives.
Revenue source	Users pay	Users pay	Users do not pay or subsidized price	Users pay full price or cross-subsidization	Users pay.
Objective	Profit maximization thru satisfaction of customer need	Profit max + CSR (Do good or at least do no harm)	Cater to a societal need	Using PMB business principles to solving social and environmental problems	Using capitalism to solve problems of the poor.
Regulatory structure	Companies Act	Companies Act; Global Compact	Trusts	Companies Act	Companies Act
Justification	Managers should return money to investors; it's for them to decide its use.	Shareholders are only one of stakeholders	Activity not being undertaken by for-profit corporations or insufficiently by government	Need business acumen while meeting social objectives.	Serving customer needs of the poor also satisfies social objectives.
Champions	M. Friedman	R. E. Freeman	Many	M. Yunus	C. K. Prahlad and S. Hart
Critics:	S. Ghoshal, A. K. Sen, M. Yunus	M. Yunus:			A. Karnani