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**Scaling for Significance:**

**Schumpeter Meets the Social Sector**

**(Short)**

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March, 2017

*The Alluring Promise of Social Entrepreneurship*

1. Social entrepreneurship offered itself as a practice (and a movement) that could deal more effectively with social problems than either government agencies, or established nonprofit organizations, or commercial enterprises.
2. Animated by passionate individuals with new ideas about how to deal with problems that had left many to poverty and oppression despite past efforts, fueled by a new breed of venture philanthropists who wanted to “give back” the knowledge and part of the wealth they had accumulated in their own entrepreneurial efforts, and justified by a shared confidence that greater reliance on entrepreneurship and competitive markets could work their magic in social and public sectors as well as commercial sectors, a widespread movement was launched. Individual social entrepreneurs were celebrated. Competitions for good ideas were held. Conferences were organized, articles and books were written, and intellectual discussion about the power of this new force in the world began.
3. Depending on where one decides to identify the start of this movement, we have now been at this distinctive kind of work in the world for about two decades.
4. That period has seen some significant successes, and the development of new ideas that seek to generalize from these successes to a wider set of possibilities than the particular enterprises that formed the basis for the theory. These concepts include such ideas as the following:
   1. “bottom of the pyramid” opportunities for both commercial growth and the alleviation of social problems:
   2. “corporate social responsibility movements” that have brought social and political pressure on private corporations to go beyond their legal requirements to improve individual and social welfare by refraining from acting in ways that harm social welfare, and engaging more actively in ways that improve social welfare
   3. “hybrid organizations” designed and managed explicitly to produce a mix of financial and social returns as a form of blended value;
   4. “social enterprises” that have developed more efficient and effective methods for achieving particular social results in domains such as health care, education, and child care and depend on “earned revenue” from beneficiaries as well as third party payes such as voluntary contributors and government financial support

While these concepts differ from one another in important ways, they all seek to identify explicit ways in which primarily (but not exclusively) market enterprises (private enterprises focused on earned revenues from consumers of products and services) and market forces (consumer demand for goods and services spread across firms in competitive markets) might be engaged in the solution of social problems; thereby ending the long stagnation of productive capacity in what could be described as the social or public sector.

*Facing Up to the Uncertain Results*

1. Despite the many particular successes of “social entrepreneurs” acting in alignment with one or more of the ideas described above, it is not at all clear that these efforts have “moved the needle” much in producing an impact on important social conditions. If we used the framework of the International Declaration of Human Rights as a device for identifying the particular social conditions that could be viewed as the special target of producing enterprises in the social or public sector, and we reviewed the principal indicators of impact, it would be hard to say that the social entrepreneurial impact has had much impact. Even the greatest success of social entrepreneurship – the micro-finance industry – has had only limited results when measured against the scope of the problem whether observed at the output level (access of the poor to reasonably priced credit) or at outcome levels (number of individuals moved out of poverty by virtue of improved access.)
2. Whether one looks at performance across these sectors from the macro perspective, or consults the social entrepreneurs who have been laboring in the vineyards for years to produce precisely these social and public results, the problem looks the same: the innovative ideas about how to solve social problems using private enterprises (both commercial and voluntary) organized in markets where firms compete to achieve the desired results does not seem to be working. The enterprising initiatives seem to get stalled at the point after the ideas have been developed, after they have been fielded and tested, and just at the point where the entrepreneurs are looking to tap into a large stream of revenues (evidence of public support) that will carry their initiative to scale and impact.

*Re-Thinking The Theory and the Practice of Social Entrepreneurship*

1. This raises the following questions: why is this happening, what is wrong with the theory that we have been relying on both to commit our individual lives to social entrepreneurial, innovative efforts, and what can be done to re-conceptualize our work and create the conditions that will make it more productive?
2. My simple answer to these questions is that we have allowed ourselves to be misled by a compelling theory about what drives dynamic efficiency and productivity in commercial markets, and assumed that the process would be roughly similar in the social sector. The big mistakes lie first, in failing to understand the nature of the demand that animates and guides productive activity in the social sector, and second, in failing to understand the processes that could sustain sustained productivity gains in the particular sub-sectors that constitute the social sector. To understand what we need to do next, we will have to shed the simple general theory and ideology that has so far guided and supported the social entrepreneurial movement, and learn how to analyze the empirical facts that describing the structure, conduct, and performance of particular social industries, and particularly the forces that are encouraging or impeding sustained productivity gains in those industries. Let met develop these ideas in a bit greater length.

*The Gospel According to Schumpeter: Entrepreneurs as the Key to Dynamic Efficiency*

1. In many important respects, all those interested in the potential of social entrepreneurship are the disciples of Joseph Schumpeter. It was Schumpeter who drove economic theory beyond its concerns for allocative efficiency (ensuring that producing firms made products and services which individuals really valued and would pay for), and for technical efficiency (creating competitive markets that would force producing firms to find low cost methods of producing particular goods and service not only to maximize profits but simply to survive), and added an important focus on “dynamic efficiency” (the challenge of ensuring sustained productivity gains in the economy as a whole as new technologies and new demands emerged.) Over the long run, it was dynamic efficiency, or economic development, that would lead to increased social welfare. And they key to that, Schumpeter argued, was a large supply of profit motivated entrepreneurs with new ideas who were prepared to run the risks of developing new methods, new products, and new services, and pushing them into existing competitive markets. This constant supply pressure from entrepreneurs, combined with consume demand that animated and guided production choices would create a “gale of creative destruction” that would force low performing firms out of business, freeing up both capital and consumer dollars to fuel the growth of new and better methods, and new and better products and services.
2. This compelling image of the conditions that encourage dynamic efficiency in the commercial sector has cast its spell over our thinking about how to improve productivity in the social sector as a whole. If only there were enough entrepreneurs with good ideas! If only they could have the funding to develop and test their ideas! If only they could gain entry into existing markets for whatever it was that they were providing to produce desired social results! Then, the static, poor performance of production efforts in the social sector might be converted into much more dynamic “industries” hard at work and succeeding in solving social problems.
3. That compelling vision focused our primary attention on the “supply” side of the social sector – the array of organizations that mobilized and deployed assets to produce material changes in the quality of individual and collective life; and more particularly, on the innovative entrepreneurs who were prepared to challenge the status quo. [[1]](#footnote-1) Much less attention was given to the “demand” side of the social sector – the flow of revenue that would enable the new ideas not only to launch, and not only to sustain themselves, but also to reach a scale that could produce a significant social impact compared with what societies had been able to achieve before.

*Looking Squarely at the Demand Side for Social Improvement*

1. Unfortunately, what we have learned is that problem may not have been on the supply side of the social sector, but instead on the demand side. To see the problem, however, one has to first back up a bit and think about how the demand side for social sector production is socially constructed.
2. One can reasonably start with the demand that comes from individual consumers with money to spend on improving their own conditions. The desires of individuals to improve the quality of their individual lives has long been seen as the key driver of production of goods and services in the commercial sector. But those interested in social entrepreneurship understood that consumers did not buy only trinkets for themselves; they bought and paid for many things that are essential for a good, dignified life. Consequently, if one looked closely at the “final demand” for the many goods and services that we think of as part of the social sector -- the sector in which production systems are mobilized to produce results such as safe shelter, drinkable water, infant and maternal health, protection from child abuse and neglect, early childhood and primary education, infectious disease control, medical care for acute and chronic conditions, equal employment opportunity, safe and healthy jobs, protection against crime, the vindication of civil and political rights, etc. – a significant portion of the final demand for some particular goods and services would come from individual consumer purchases. If individuals were able and willing to pay for these individual level goods, then we could safely leave the level and distribution of the production of these goods to commercial markets.
3. There are several problems with this view, however. The first is that the goods and services to be produced in the social sector are observed, consumed, and evaluated at two different levels. At the individual level, the social sector is not only concerned with the satisfaction of individual wants, but also with meeting individual needs, and vindicating individual rights as well as satisfying individual desires. The key difference between defining a good as an individual want on one hand, or a need or a right on the other has to do with the degree to which both those who are needy and oppressed, and those who are witnesses to their need and oppression, might feel that third parties had some moral responsibility or duty to ensure that the individual need would be met and the individual rights vindicated. Of course, individuals could differ significantly about what individuals were entitled to, and what other individuals would be obliged by a sense of duty to provide for them. For example, I might feel that I was entitled to a fancy car due to my long work and public service, but others would say my desire for the car wasn’t a need or a right, and that if I wanted a fancy car I should earn the money and buy it. That was up to me. It was of no concern to the rest of society. On the other hand, having just been arrested for a crime I did not commit, I might feel that I had both an urgent need and a right to a lawyer even though I could not pay for one. The society might agree that my desire for a lawyer was something that they viewed as a need and a right, and were willing to provide a lawyer to me as a matter of individual charity or collective responsibility of some kind.
4. The second, closely related problem is that as an individual member of society with views of what I wanted, needed, and felt I had a right to, and a view of what other individuals could call on me (and others in the society) to provide to them in recognition of their needs and rights (which I shared), I could evaluate the social conditions under which others were living either in terms of particular individuals to whom I felt some relatively intimate connection (e.g. family, friends, neighbors, fellow congregants, those with whom I shared an ethnic culture), or in terms of much more aggregate and impersonal connections (e.g. citizens or residents in my local or national government, or even simply as other human beings regardless of where they lived.) Instead of noticing that my good friend and neighbor Joe was suffering from a chronic illness and the death of his wife who had worn herself out caring for him, and wanted, needed, and deserved from help from me as part of our long friendship, I might learn that there were many in my town, or my state, or the world who were similarly disadvantaged, and be motivated to help deal with the larger less intimate as well as the smaller more intimate problem. My individual concerns would be attached not just to other concrete individuals to whom I felt a personal bond, but also to an aggregate condition that could be more or less accurately represented by some statistic that captured not only some individual conditions, but also how many in some particular more abstractly defined social unit suffered from the need or injustice.
5. This leads to the third problem: If I focused only on Joe, I could act to meet his needs (and perhaps recognize his right to be cared for) by acting on my own, or assembling our poker club to held Joe out with visits, or money for medicines or whatever he “needed” and we felt he “had a right to.” If, however, I began thinking about many other Joe’s who might exist in a wider society, I might have to reach out for larger social institutions capable of acting on a larger scale. That could include larger voluntary associations such as churches or other charitable associations. Or, it could include government agencies that had been created as a result of citizens deciding to tax and regulate themselves to meet individual needs and vindicated individual rights (aggregated up to the social level where all members of a particular class would be entitled to benefits of some kind provided by other members of society through the actions of democratic governance)
6. Table 1 summarizes the argument I have been making about the character of the demand side in the social sector: the particular kinds of individual and collectively created desires not only to satisfy our own individual material desires, but also to satisfy what we as both individuals and collectives are willing to view as individual needs and individual rights that make a claim on each of us as individuals, or all of us as some kind of society. One could dismiss all the above as a kind of morality tale with little empirical reality or substance to back it up. But if that were true, it would be hard to explain a key empirical fact; namely, that if one were to look at the subsectors that we associate with the idea (and the reality!) of the social sector as a whole – poverty alleviation, famine prevention and hunger reduction, the provision of clean water, infant and maternal health, reduced violence against women, primary education, etc. – one would quickly find that some portion of the effective final demand – the overall total spending on efforts to alleviate these conditions – would come not from consumers or direct beneficiaries of these efforts, but from third party payers.

Table 1: Individual, Social and Public Arbiters of Value and What They Value

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Arbiter of Value** | **What They Value and Act to Produce** | | | |
| Individual Arbiters of Value | Own Material Well Being | Well-being of Others | Moral and Legal Duties to Others | Ideas of a Good and Just Society |
| Social/Civic Arbiters of Value | Material Well-Being of Group | Well Being of Group Members | Moral and Legal Duties to Others | Ideas of a Good and Just Society |
| Public Arbiters of Value | Economic Development | Satisfy Needs of Others | Vindicate Rights  Impose Duties | Achieve a Good and Just Society |

1. The amount of the productive activity in these sectors that is borne by individuals paying for themselves through consumer purchases, relative to the amount that is spent by third parties such as voluntary contributors and donors and governments at various levels will vary a great deal from country by country, and from sub-sector to subsector. In the United States, for example, the vast majority of the spending (the final demand) for productive activities, goods, and services that seek to educate primary school students is government. Only a small portion is paid by individual consumers. Similarly, and somewhat surprisingly, when one looks at the case of health care in the United States, one can quickly demonstrate a critically important government role in supporting the final demand for health spending. That begins with the fact that Medicare and Medicaid – programs financed directly with tax dollars – account for 56 % of spending on medical care. One can add to that the observation that much of the privately financed medical care generated by employers providing health insurance to their employees was made possible by government’s establishment of collective bargaining rights which allowed workers to bargain successfully with their employers to include health insurance as part of their compensation. And, one could even treat the mandate imposed by government on individuals as part of ObamaCare that required them to purchase insurance from private insurance companies as government demand for health insurance.
2. As an important empirical fact, then, the effective demand – both in terms of human motivations, and in the capacity of those motivations to generate financial revenue flows to support the productive activity of producing enterprises in the social sector – comes not just from consumers spending money on their wants, but also from individuals making voluntary contributions of money, labor and voice, and polities deciding that they are willing to tax and regulate themselves to meet both the individual desires of those who have needs and rights but cannot accomplish that with their own resources. In fact, we might treat the presence of moral and financial demand for productive activity as the defining characteristic of the social sector. If all individuals in society were able to satisfy their needs and vindicate their rights as both they and others in the society saw them by paying for these individual goods and services, we would not have to talk about, or help to create and shape a social sector: we could leave everything to the workings of the market. It is only because the market will not necessarily produce social conditions that provide for individual needs and vindicate individual rights, that we have to create something other than a market driven by individuals with money to spend to satisfy their own wants, meet their own needs, and vindicate their own rights. We create a demand for the improvement of individual and collective social improvements that expresses itself normatively and financially through the actions of voluntary contributors, and citizens making choices in polities about the particular social purposes that are consistent with their ideas of a good and just as well as prosperous society.
3. In retrospect, it should not be surprising that “consumer demand” alone would not be able to guarantee that important new ideas in the social sector could scale to significance. After all, much of the social sector was focused on helping those who were particularly impoverished and oppressed, and whom markets had not reached to transform their conditions because they had no money, and no effective power to turn the producing sectors of society in their direction to meet their needs and vindicate their rights. But a key conclusion of this analysis is that if we want social sector firms and industries to work like commercial sector firms and industries, we have to pay close attention to the demand side of the voluntary sector as well as the supply side.

*Tapping into the Demand from Voluntary Donors and Government for Innovation and Scale*

1. If third party payers – voluntary contributors and government – are important parts of the effective final demand for generating improvements in social conditions because individuals with money to spend on their own welfare, their own needs, and their own rights do not create either enough, or an equitable distribution of effective final demand, then we have to think through the question of how social entrepreneurs can overcome this key limitation, and make the best possible use of voluntary contributors and government in developing and launching their ideas, and scaling them to significance.
2. One way to think about this is to make visible the critical difference between the kind of financial support one needs for start-ups, and the kind of financial support that is needed for scaling to significance. Table 2 presents a very simple diagram that distinguishes between investment capital to get things started, and revenues that are necessary to sustain and scale an enterprise to significance. It also distinguishes among these activities in the private, voluntary, and government sectors.

Table 2:

Sources of Financing for Start-Ups and Scaling in the Social Sector

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Commercial Markets** | **Philanthropic/Voluntary Sector** | **Government** |
| *Start Up Capital* | Commercial investing at market rates of return | Foundation grants (with or without performance goals) | Social research and development funds |
| *Funds to Support Scaling and Sustaining at Social Impact Level* | Consumer Revenues | Leveraged by other foundations  Find commercial market  Policy advocacy for government financing | Government financing through grants, contracts, entitlements, vouchers |

1. Using this simple table to frame my critique, I would suggest that we have been acting as though the principal problem that the social sector faced has been in finding enough social entrepreneurs with new ideas, and finding enough social venture capital to get them launched. Fortunately, that problem could be quickly solved by increasing the level and changing the nature of philanthropic giving – particularly the practices of large philanthropists and foundations.[[2]](#footnote-2) Much of the emphasis was on the cell in this matrix that captures the activity associated with developing and launching new ideas – primarily with support from philanthropists.
2. To some unknown but perhaps substantive degree, this focus tended to ignore the chance that pressures on corporations to behave more social responsible ways might generate socially productive ideas from the heart of commercial enterprises supported by consumer markets. It also ignored the chance that government was an active innovator as well, and had been searching more or less effectively for improved methods to deal with the social conditions they had been asked to solve. And, we may also have failed to notice government’s role in protecting and financially supporting innovative efforts in the commercial sector and voluntary sector that were relevant to efforts to solve important social problems. So, we may not have had a good fix on where innovative ideas could come from.
3. But the really big error might have been to ignore or downplay the question of where the effective demand for scaling new ideas to significance could come from. The assumptions seemed to be that we could count on “market forces” not only to motivate the creation of new ideas for solving social problems, but also to discriminate reliably among them as to which ones “worked”, and to scale up the successful ideas and discard the old. Market mechanisms may have worked well in sustaining and scaling goods and services for which a sufficient consumer demand existed that could be tapped to create the desired scale and distribution of the services to achieve the desired social results. But they could not be relied upon when the consumer demand was insufficient and mal-distributed among individuals. One also had reasons to be concerned that philanthropy and voluntary giving would be sufficient to sustain and scale a social change effort to social significance. The size of the social problems that animate the social demand for improvement or resolution are much larger than the voluntary sector can handle on its own. That means, that much of the focus on scaling to significance might have to turn to the bottom right cell of this matrix: the place where government decides to spend big bucks to produce social change. It is that that might hold the key to scaling social change.

*The Path Forward*

1. These observations point towards the need for a significant shift in our thinking, and the development of a much more demanding form of analysis than we have relied on so far.
2. On one hand, we might have to give up our confidence that the important social change ideas currently being developed by social entrepreneurs can be scaled to significance through the power of consumer demand alone. If they could, presumably the market would have already found and exploited these opportunities. All that would be needed is just a “nudge” from society as whole to be on the lookout for activities they might carry out, or products and services they might produce and deliver, or environmental and social conditions they might be able to produce that would be socially (if not financially valuable) that they could do at low cost. For those social conditions that individuals and collectives in society define as social problems that do not generate an effective consumer demand because the individuals experiencing the conditions lack both the money and the status to demand improvement on their own, third party payers and supporters will have to carry the load. The third party payers include both voluntary contributors, and government acting in response to political pressures from citizens who want to use the government to help create what they see as a good and just society by dealing with particular social conditions they view as problematic. This means that many, if not most, social entrepreneurs will have to figure out how to build some kinds of social and political movements to help generate both the demand and the supply of social productive activities; mere marketing to consumers cannot do the job.
3. On the other hand, we will have to become much more knowledgeable than we now are about the particular supply and demand conditions that exist in the social sector as a whole, but perhaps even more importantly, in the particular subsectors that constitute the social sector as a whole. A path to explore here would be to recover the methods of industrial organization from economics. That now somewhat neglected field took it original inspiration from Schumpeter in the sense that it was particularly interested in the question of the degree to which particular industries could be relied upon to produce significant productivity gains over time. That was the way that industrial performance was defined: was the society benefitting from the forces that Schumpeter had identified as essential to motivating dynamic efficiency. That theory was tied to a particular idea about how the structure of an industry could affect the rate of innovation; namely, the more firms, and more competition, and the easier it was for new firms to enter particular markets, the more dynamic the industry would be.
4. But the theory also took account of what was described as the *conduct* of the firms in the industry as well as the basic *structure.* By *conduct*, the theory referred to the particular corporate strategies that were being pursued by each of the firms in the industry. For the most part, the assumption was that firms would behave competitively, and seek to develop and hold onto particular market niches that would allow them to earn profits above the industry average. They might also work very hard to increase their scale to enjoy what economies of scale were to be had in their particular enterprises, and to increase their market share so they could begin to enjoy some of the benefits of being a quasi if not real monopoly. On occasion, the competitive interests of the firm would suggest reasons to collaborate with their competitors as well as compete. They could combine to jointly activities such as research and development, or efforts to increase the social standing and appeal of their industry as a whole, or in joint political efforts to influence both government purchases and government regulation of their industry.
5. And, because the theory of industrial organization was concerned with sustained productivity gains, and that result was generated in large part by the rate at which innovations were created, tested, deployed, and diffused throughout the industry, the theory gave particularly close attention to the question of exactly where the innovations came from. This often focused their attention on how the research that could contribute to innovation at the basic or applied level was being produced: how much was there, who was producing it, and how was it being paid for. They also focused on the processes that moved from basic research to applied research to product and service development, to market testing, and diffusion.
6. There is every reason to suspect that these processes look quite different in the social sector in which the demand consists of consumer demand, voluntary contributions, and government spending, and the supply consists of commercial enterprises, nonprofit service delivery organizations, and government agencies.
7. Voluntary and government demanders/payers behave differently than individual consumers. They focus on wants and conditions they think are important and count as needs and rights rather than just consumer welfare. They focus on larger issues of equity as well as individual satisfaction, or the results achieved by a particular enterprise. They are often interested not only in advancing equity as a result, but also in acting equitably and fairly in the delivery of goods and services, and in efforts to create wider environmental conditions. Often, they make decisions as a collective rather than as individuals.
8. The nonprofit organizations and government agencies one can find on the supply side of social sector industries also behave differently than commercial suppliers. Nonprofit organizations and government agencies are loyal to missions that define value in terms of social results that includes but is not limited to client satisfaction. Both voluntary sector firms and government agencies are particularly vulnerable to and responsive to social pressure from social interests groups and the media precisely because they claim the role of acting for the public interest. Both voluntary sector firms and government are supposed to be open to and take advantage of their collaborative potential in achieving desired results rather than compete to be the enterprise that solved the problem. Voluntary sector firms and government agencies find it difficult to accurately measure the value they are producing, and that makes it difficult for those who are buying the social results the firms are producing to exercise the kind of accountability for performance that can reliably separate the good from the bad. In the place of performance accountability, both nonprofit and governance agencies are called to account for performance in terms of the reliability with which they follow “best practices” that are not really known to be best practices, and this kind of accountability tends to stifle innovation and obscure what constitutes performance rather than support it.[[3]](#footnote-3)
9. The mechanisms that support the activities that are particularly important to producing productivity gains – basic research, applied research, process and product research, production engineering, testing for value, launching as a sustainable enterprise, scaling up, -- are all also quite different in the social sector with the voluntary sector and government playing a much greater role.
10. So, we have a lot of work to do in trying to understand how the social sector really works to produce sustained productivity gains. And that knowledge is not likely to come simply by rehearsing Schumpeter’s theories. To understand exactly how the various social sector industries work – the producing organizations that seek to move the needle on social conditions –it is critical to our ability to help social entrepreneurs figure out where to go with their creative energy, how to test the quality of their ideas, and how to get the good ideas into action frequently and quickly enough that we can observe the steady productivity gains in these industries that we are all hoping to see.
11. We have long talked about the importance of understanding the ecology in which social enterprises work. And it may be that this metaphor and the methods associated with studying ecology will help us see the growth potential of individual social enterprises. But an alternative would be to adapt Schumpeter’s theory to the particular conditions of the social sector, and to learn more precisely and empirically about what can be done to improve the productivity of the particular industries that constitute the social sector through the use of the tools of industrial organization adapted to the three sector social production, financing, and valuation processes that either succeed or fail in producing aggregate social conditions that conform to individual and collectively developed ideas of a good and just society.

1. In this vision, the enemies of progress in social sector industries and enterprises were: 1) established nonprofit service organizations which were scattered, small, tied to tradition, and insufficiently accountable for producing real social impact with the funds they held; and 2) the government which had been captured by its own agencies and become the protector of producer monopolies in both the nonprofit sector and government instead of a collective consumer focused intently on achieving allocative efficiency, technical efficiency, and dynamic efficiency among the producing firms in the social and public sectors. The challenge was to create a gale of creative destruction in this system that constituted a large portion of the funding, and the productive capacity of the social system and open the space for the new entrants with the new ideas. [↑](#footnote-ref-1)
2. Have also made progress in developing capacities to aggregate and direct voluntary constributions from small donors, but much of the attention has remained on the big foundations since they look the most like the powerful hedge funds. [↑](#footnote-ref-2)
3. Note that these problems do not come from the weakness of a particular institutional form, and would not be solved if all the nonprofit organizations and government agencies were commercialized. The come from the fact that these organizations are seeking to produce changes in social conditions whose value is both contested and hard to measure in the world they occupy. The same will be true for any organization entering these particular lists. [↑](#footnote-ref-3)