

Lecture notes on social enterprise

Does Capitalism Need Social Business?

Rajeev Dehejia

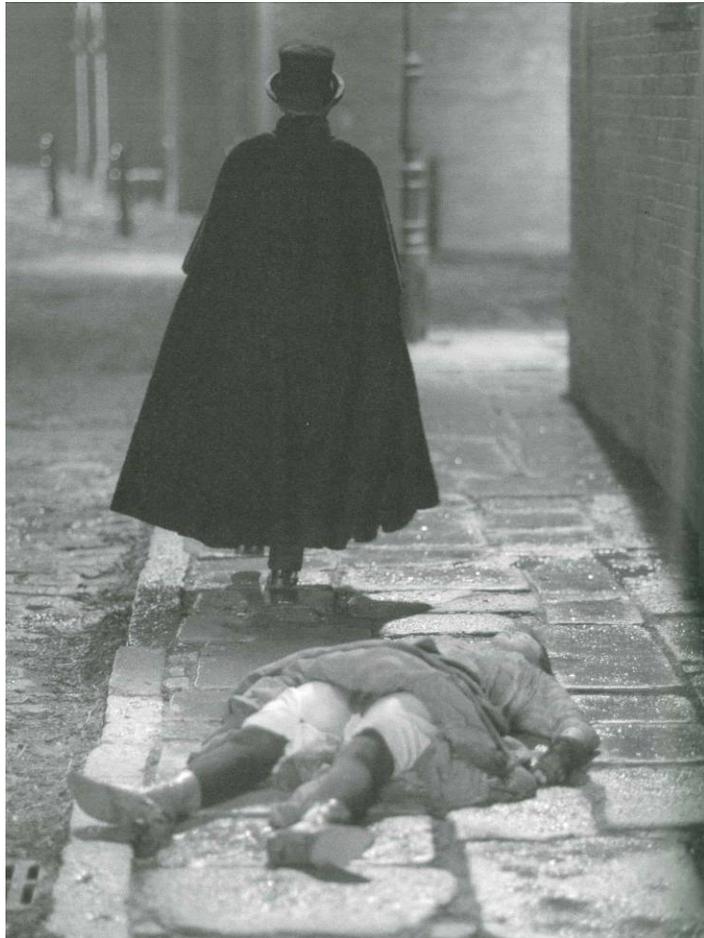
Mumbai



Saw an urgent gap. Took over a public role. Cross-subsidized.
For-profit status with a non-profit investor on the board.
Now spreading in India, extending Dial 108. Acumen Fund
investment.

East End of London, 1880s

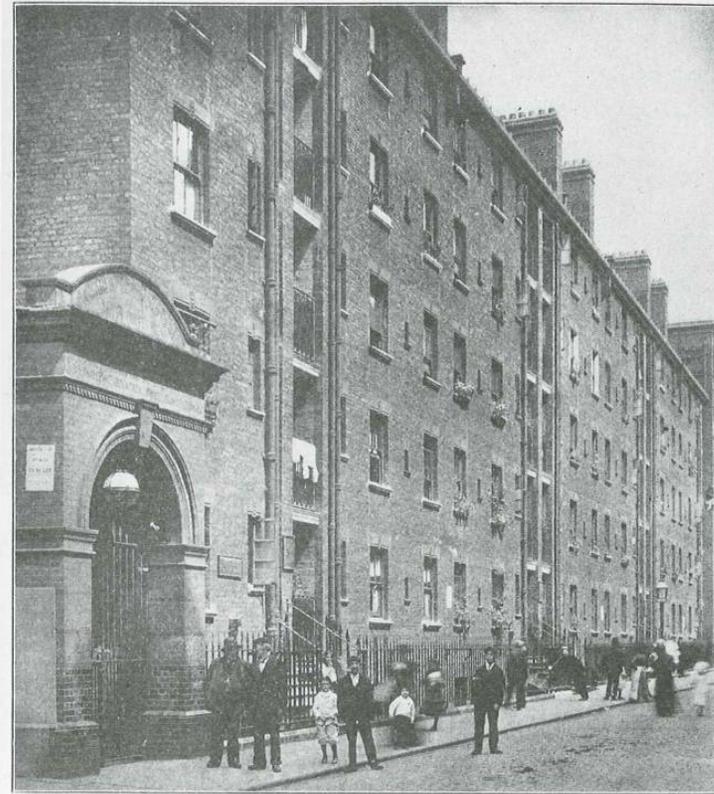
Jack the Ripper



The Charlotte de Rothschild Dwellings



COMMON LODGINGS AND 'FURNISHED ROOMS': HOUSING IN 1880s WHITECHAPEL



Working-men's homes near Middlesex Street, c.1902
The Four Per Cent Industrial Dwellings Company was formed in 1885 to provide model tenement dwellings for Jewish families. The Charlotte de Rothschild Dwellings in Flower and Dean Street shown here opened in April 1887.

The Four Per Cent Industrial Dwellings Company

Business Model:

£50,000 in 5000 shares of £10 each. Net return of 4%.
Privately subscribed mostly.

Social mission:

“...it is considered that many investors will be found willing and even anxious to contribute their capital towards a scheme, which while yielding a moderate and safe return, will largely tend, not only to improve the dwellings of the poor, but also reduce the high rates now paid for the minimum of accommodation.”

Mills Houses in New York

Mills House No. 1 Bleecker St.



It was the prototype of the philanthropic hotel movement, although Mills emphasized that his hotels were run efficiently so as to make a modest profit for investors.

“A CIVILIZATION WITHOUT HOMES”

139

dry, entertainment, and even sex—homeless men reduced a highly sentimentalized and almost sacred aspect of middle-class life to the cash nexus. Just as the descriptive terms of cheap lodging came down to price—the ten- and twenty-five-cent lodging house—so did lodging proprietors themselves renounce the cultural attributes of home in favor of bare market relations. “We are in the hotel business to make a living,” explained one hotel developer to Nels Anderson.

We give the men the best service they can pay for. We give nothing away and we ask for nothing. . . . We hold that the men have a right to criticize us and come to us if they are not satisfied with the service we give. That is business. The man who pays seventy-five cents for a bed has a right to seventy-five cents’ worth of service. If a man can only pay twenty-five cents for a bed he is entitled to all that he pays for and is entitled to kick if he doesn’t get it.⁵³

US Housing market

- Guarantees and subsidies support the low-end of the market
- LISC (Local Initiatives Support Corporation)
- Community Development Financial Institutions

Cataracts

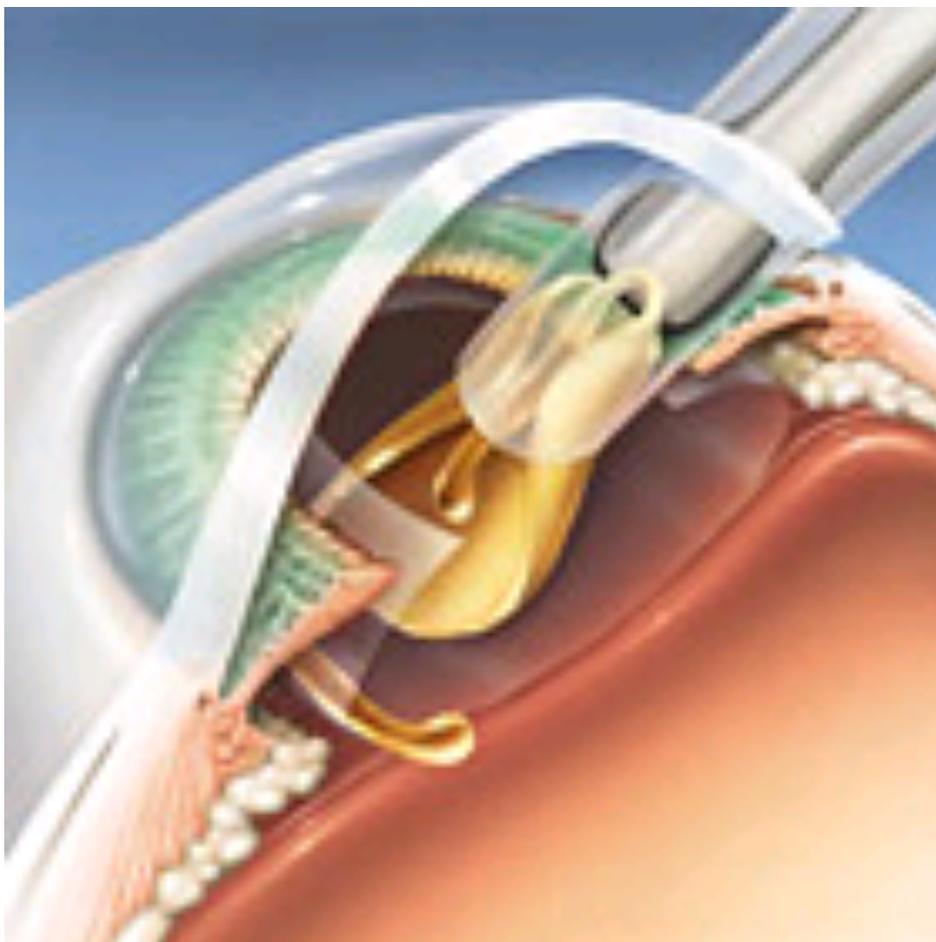


Combating Blindness

- WHO: 37 million people are blind.
 - 161 million people with sight impairments worldwide.
- 75 million blind people predicted by 2020.
- 90% live in developing countries.
- 70% of vision problems are due to cataracts, trachoma, or glaucoma
- 75% can be cured or prevented.

Source: Deutsche Bank, Eye Fund 1 Presentation materials.

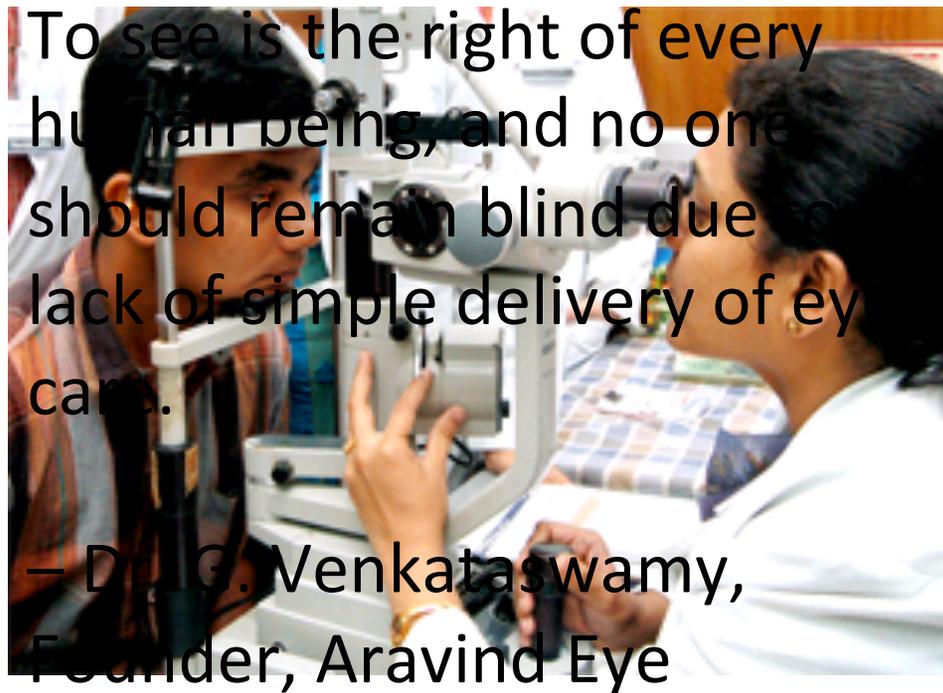
Cataracts



Intraocular lens
implantation

\$US 1600-2500

Aravind Eye Hospital, India



To see is the right of every human being, and no one should remain blind due to lack of simple delivery of eye care.

– Dr. G. Venkataswamy,
Founder, Aravind Eye
Hospitals

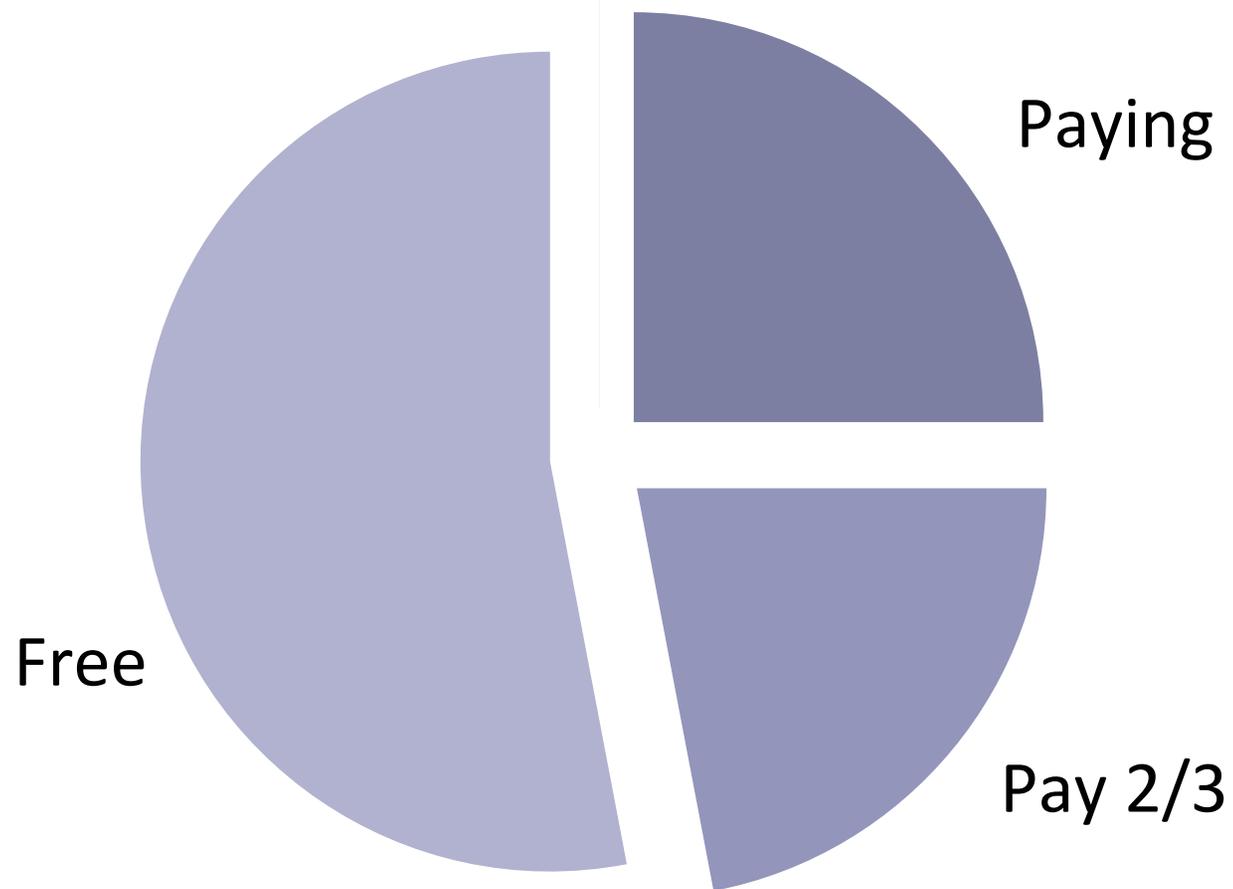


Dr. G.
Venkataswamy
("Dr. V")

18 million services since 1976



Cross-subsidization of customers



David Green, Aurolab



Non-profit manufacturing business connected to Aravind.

Aurolab cut price of intraocular lenses from \$100 (in US) to \$4 (in India).

One of largest intraocular lens manufacturers globally. 7% market share



Microfinance

- Rather than simply accepting the failure of credit markets, Muhammad Yunus set out to create a new kind of financial institution for the poor:
 - Charged interest rates high enough to reduce subsidy.
 - Priority on rapid growth
 - Reliable organization that provides a range of services

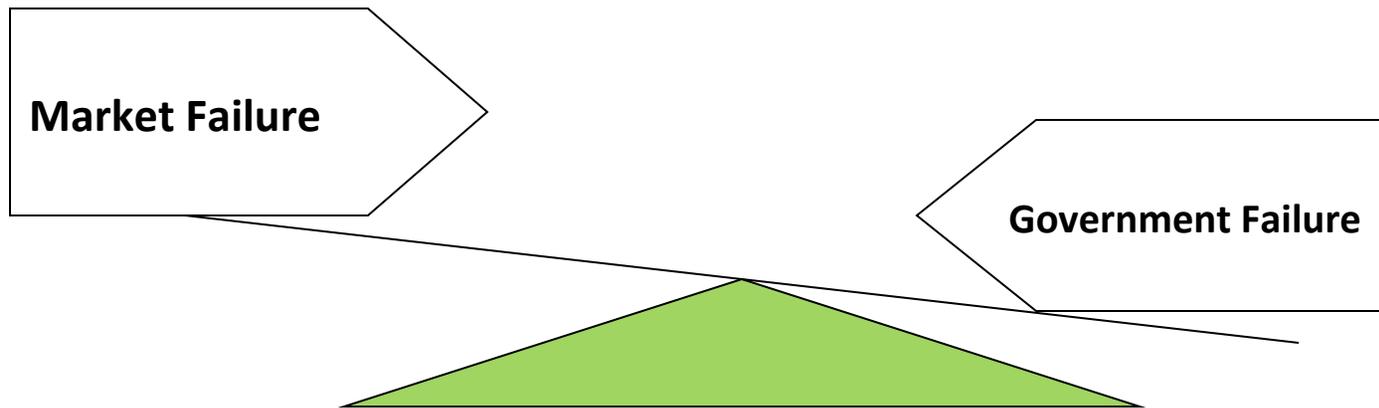
Microfinance debates

- Are too prices too high?
- Are subsidies necessary?
- Will commercialization lead to “mission drift?”
- Answer so far: there’s a workable middle ground which is neither fully subsidized nor fully commercial

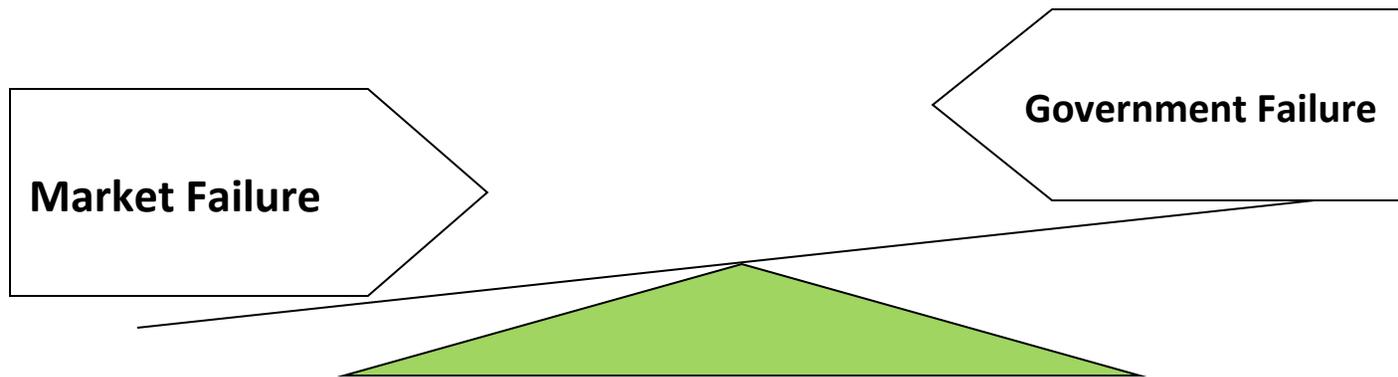
Examples all involve

- Creating locally-responsive **institutions**
- A socially-oriented goal (not just profits).
- Mobilizing private sector (or private sector ideas)
- **Scale**, organic growth
- Creation of a workable business model, even if the institution is not fully profitable
- Refusal to accept government provision as the necessary response to market failure.

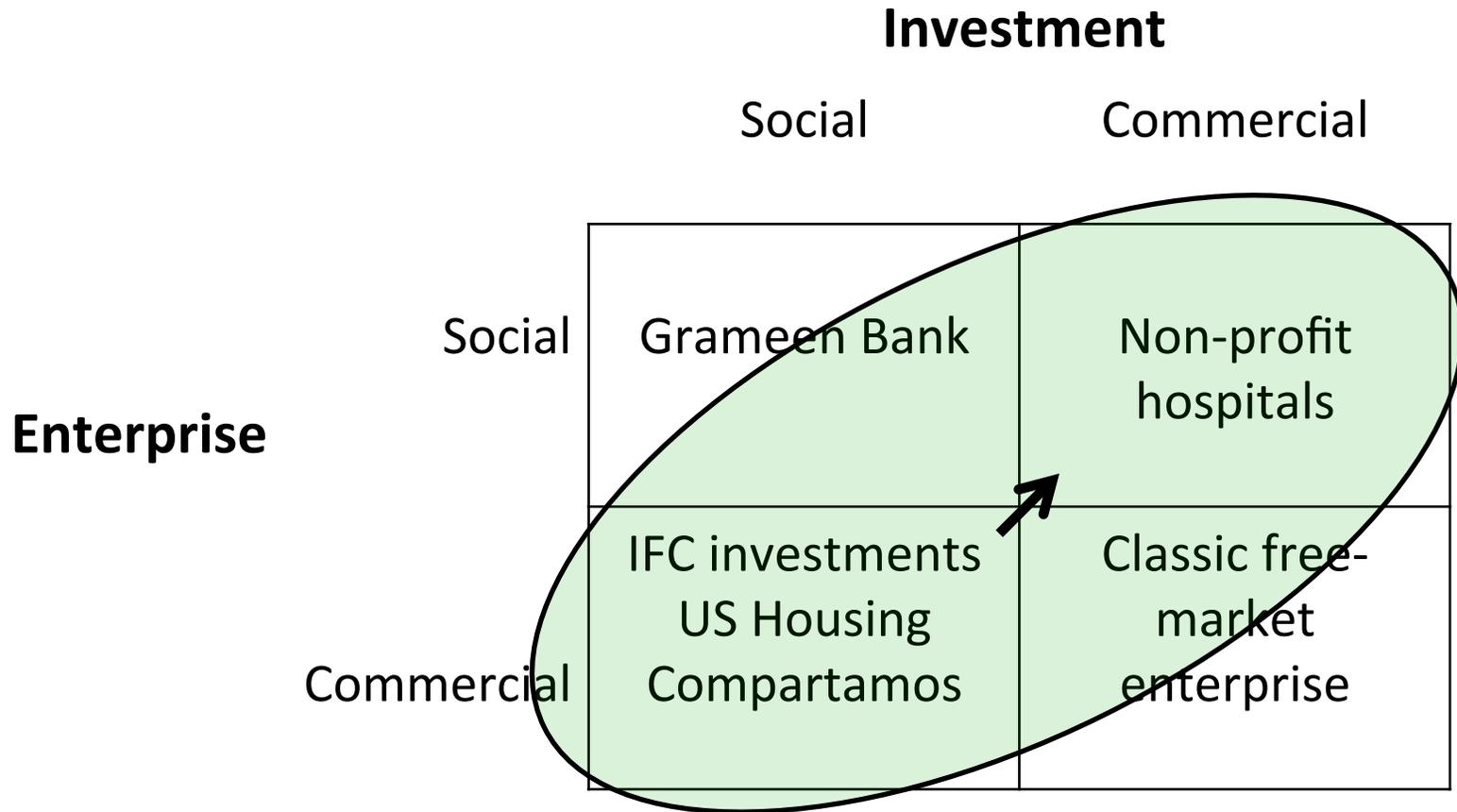
Traditional view: Markets vs. governments



Traditional view: Markets vs. governments



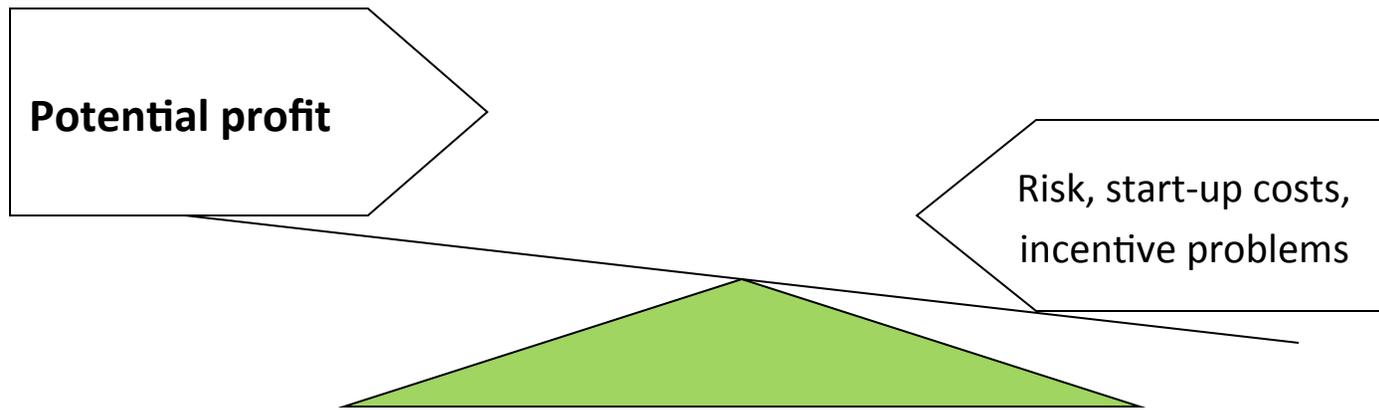
How is enterprise financed?



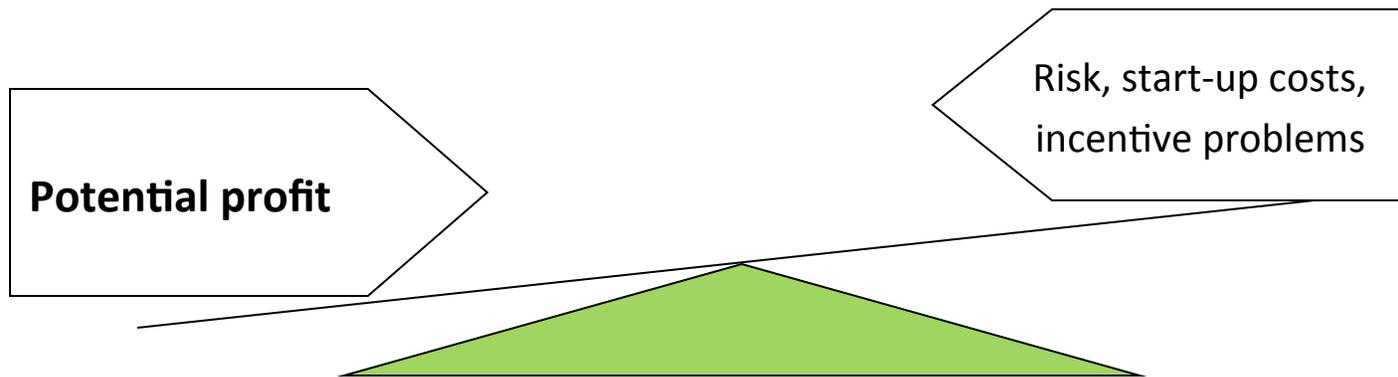
How do capital, ownership and governance structures change according to the social mission of the firm?

Fit within expanded existing theory of corporate finance?

New view: Tipping the business equation



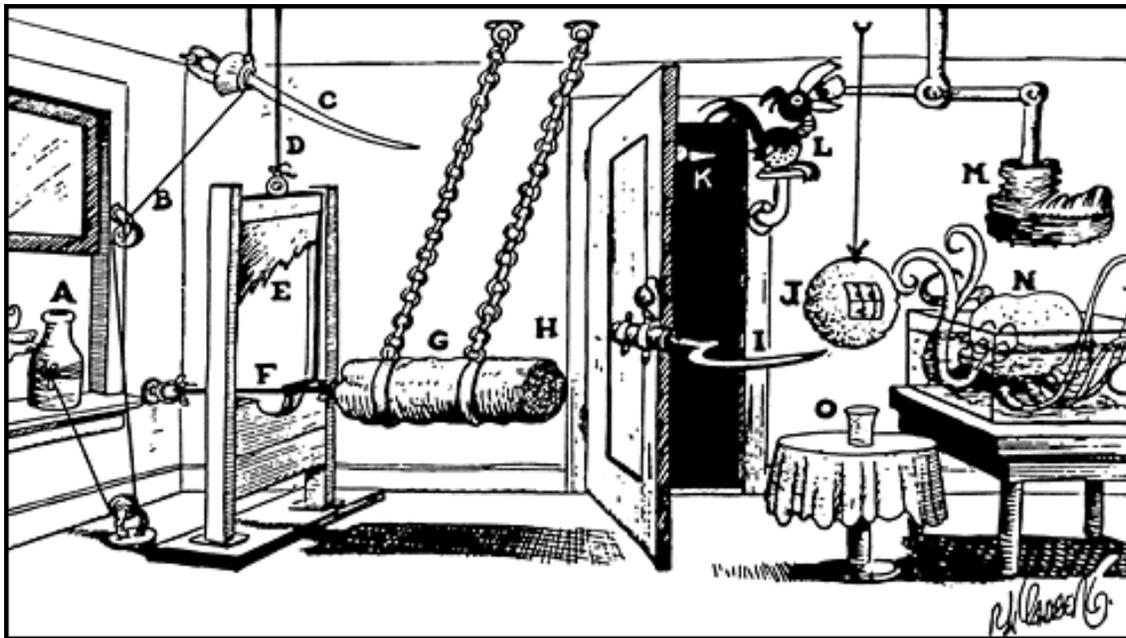
New view: Tipping the business equation



Implications for allocations

Traditional model

1. Discover what will help (medicine, education, finance, training...)
2. Then figure out how to deliver it.



Developing an effective
pill is a start.





But how will it be delivered?

Social business model

1. Figure out how to deliver goods and services.
2. Keep innovating in what gets delivered.



<http://www.kiva.org/lend/108438>

Questions

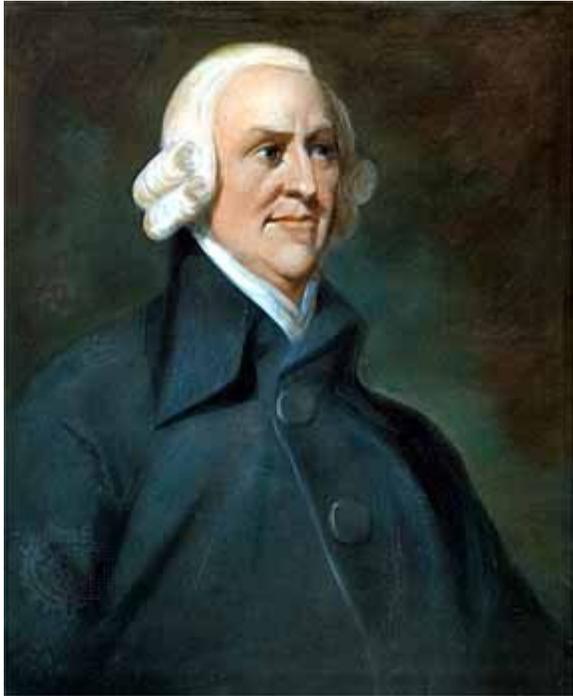
- Why mix charity with business?
- Why invest rather than make grants?
- What, if anything, is new?
- Theory?
- Facts?

Capitalist business does not need subsidy

World Bank, circa 1985

- Anne Krueger, VP Development Economics and Deepak Lal, Research Administrator
- **Argument: Subsidy hurts business**
 - Undermines efficiency, creates rent-seeking
 - World Bank should support property rights and enabling environment
 - Separation of efficiency and distribution
 - Back to Kornai's "soft budget constraint" of communism
 - Profit goal creates discipline.

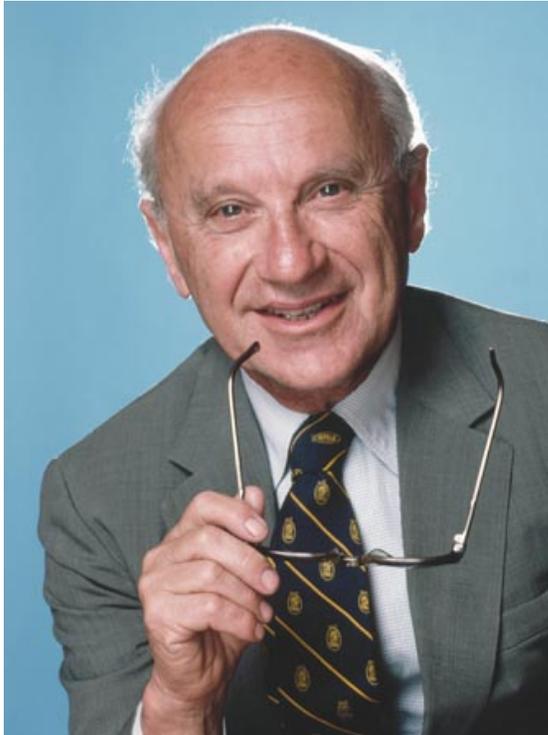
Adam Smith



Wealth of Nations

“It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.”

Milton Friedman



Capitalism and Freedom:

In a free society, "there is one and only one social responsibility of business... to increase its profits so long as it stays within the rules of the game..."

What changed in theory?

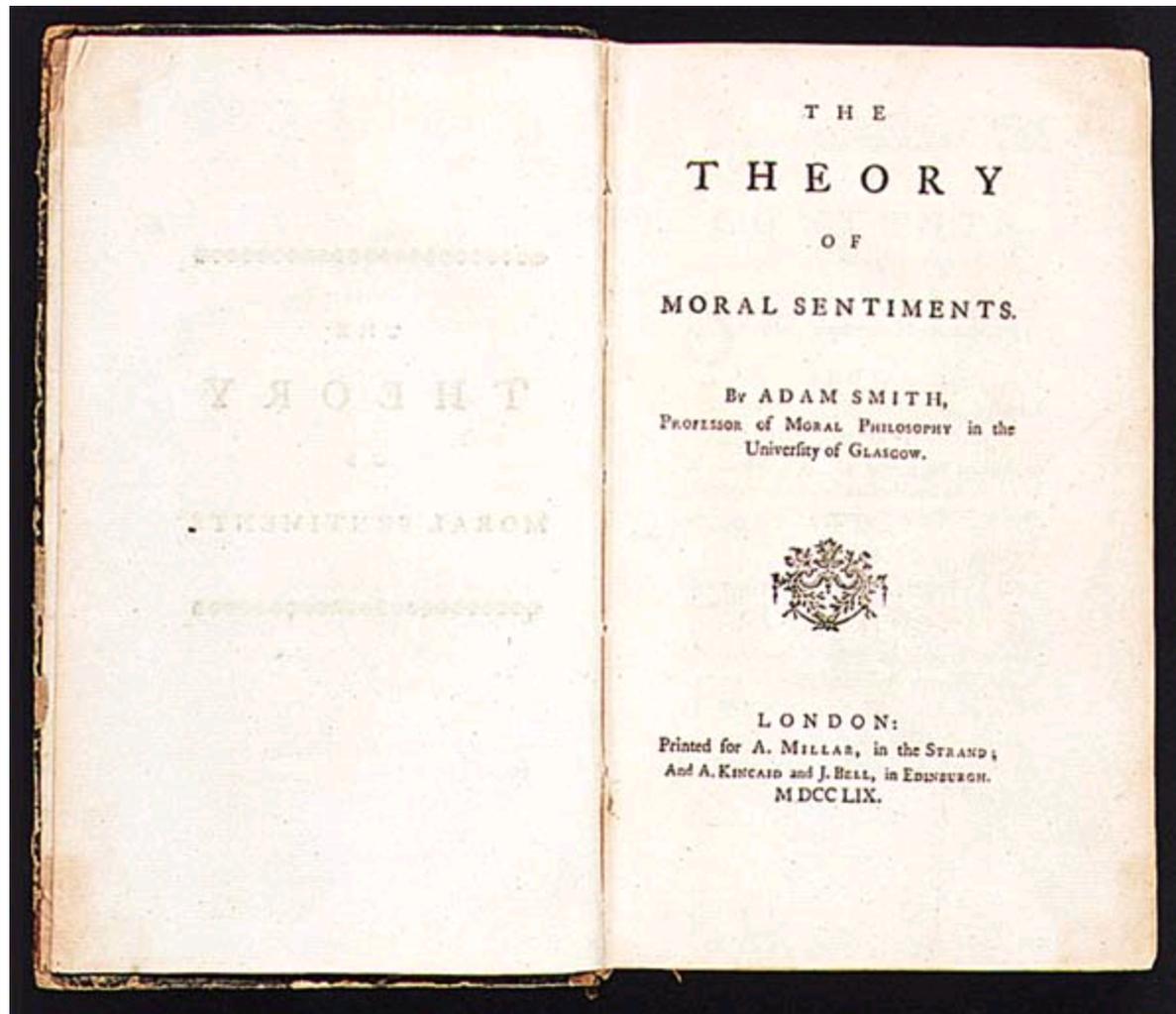
The Economics of Information



Principal-agent problems: we can't even assume that economies will be constrained Pareto efficient.

(Greenwald-Stiglitz, *QJE* 1986)

Recognition of “social” preferences



Unburying the altruists

Self-interest may drive economies, but altruists can be pivotal.

- Willing to absorb costs of:

- Information costs

- Supporting socially-motivated staff

- Risk, experimentation

- R & D, fixed costs

- Incentives for scarce entrepreneurial talent

Social investment strategy

Deploy philanthropic and public funding to “crowd in” private, for-profit investment

- “Completing” markets vs. “Filling in gaps”
- Achieve mass scale
- Re-channel scarce entrepreneurial talent

What does \$1 of donor funds create?

Social investment:



Multiplication
or leakage of
funds

X

Who and
how many
people
reached

X

Average
impact per
capita



Strategy to extend the idea

Deutsche Bank Social Investment Fund Structure

Commercial
Investors

Senior debt
gets *higher*
returns

Senior Debt

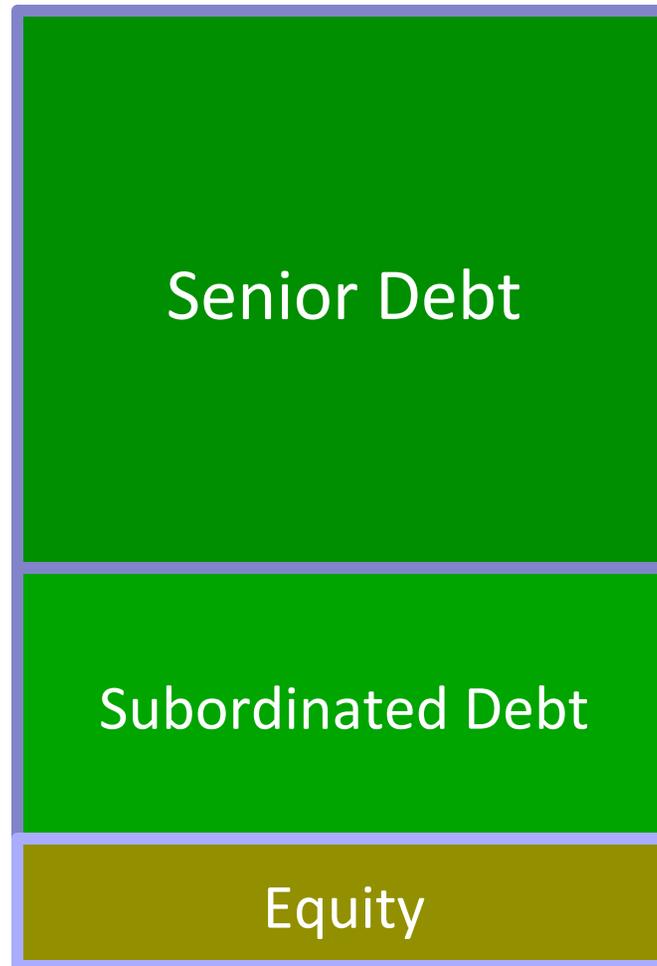
Social
Investors

DB gets
management fee

Subordinated Debt

Donors

Equity



Summary

- Premise of social business is different:
 - Between not-for-profit or for-profit.
 - Not redistribution.
 - Not a change in property rights.
 - Instead, a change in the basic business model.
 - Often goal is **access** to basic, reliable services.

How this relates to previous models

- Traditional models for socially-oriented activities:
 - Not-for-profits
 - All profits are retained to further the goal not distributed to owners / shareholders.
 - Cooperatives
 - For-profit enterprises that are owned by someone other than shareholders:
 - Clients, e.g., mutual insurance.
 - Workers, e.g., farmers' cooperatives (or lawyers)

Traditional firms

- Traditional firm is viewed as one solution to the moral hazard problem of teamwork.
 - Working in a group can be more productive.
 - But saps incentives, since I am only fractionally rewarded for incremental effort.
 - Hire a monitor who becomes residual claimant of profits.
- But if the incentive or information problem is sufficiently severe may opt for coops or not-for-profits.

But is the social business model always optimal?

“The Illusion of Sustainability.”

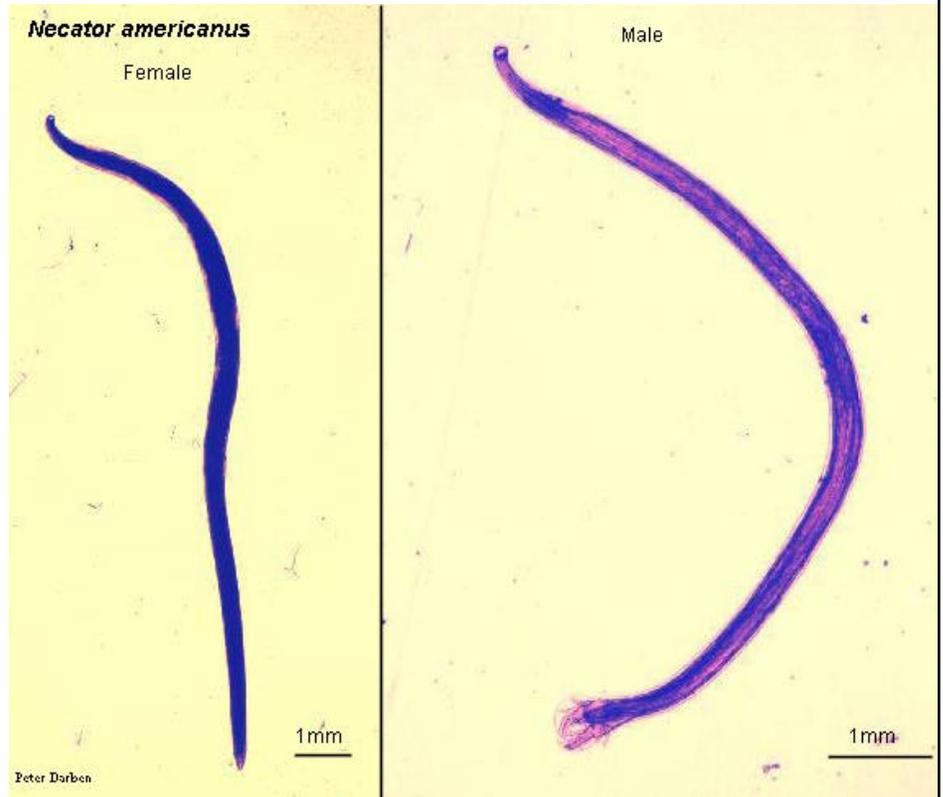
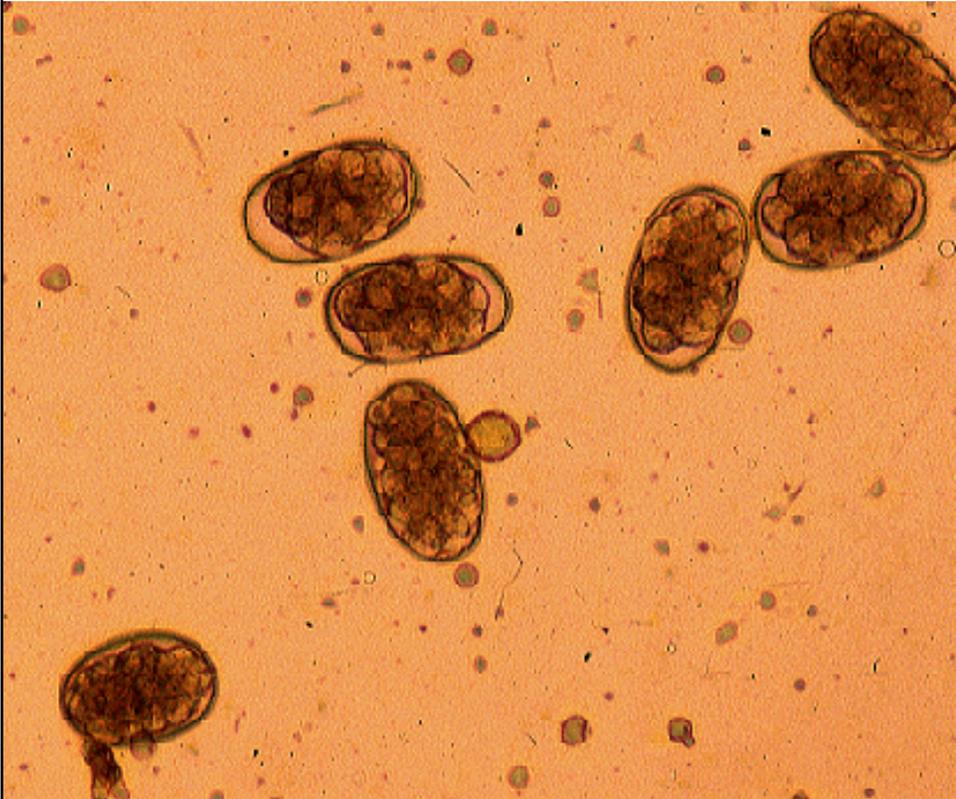
Michael Kremer and Edward Miguel. 2007.
Quarterly Journal of Economics, August:
1007-1065



deworm the world

<http://www.dewormtheworld.org/>

Deworming the world



Hookworm eggs

http://missinglink.ucsf.edu/lm/virus_and_parasites/hookworm.html Hookworm

Parasitic worms

■ Prevalence

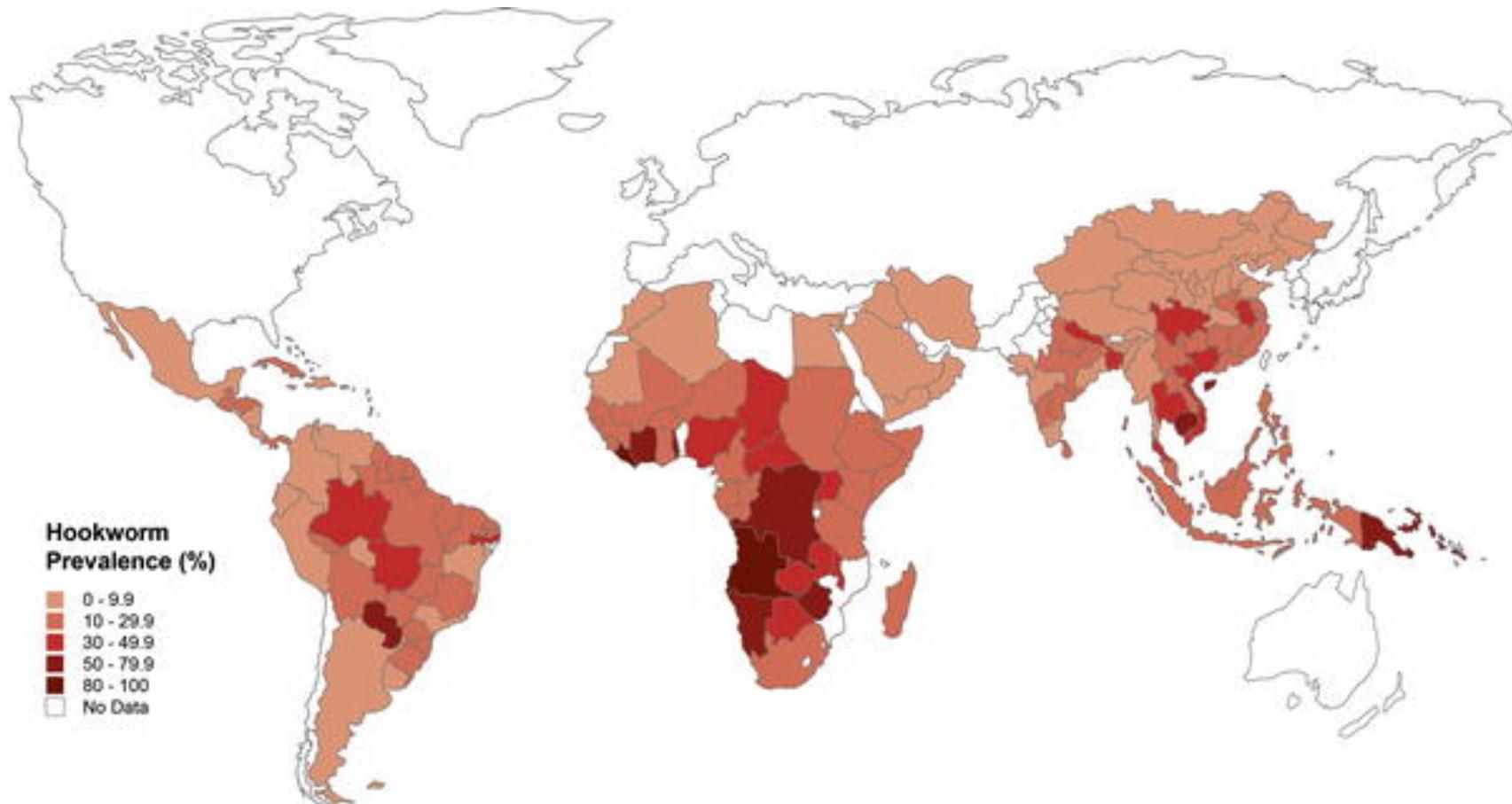
- Over 1.3 billion people worldwide are infected with hookworm,
- 1.3 billion with roundworm,
- 900 million with whipworm,
- 200 million with schistosomiasis.

■ Most have light infections, which are often asymptomatic, but more severe worm infections can lead to

- iron-deficiency anemia,
- protein energy malnutrition,
- stunting,
- wasting,
- listlessness,
- and abdominal pain.
- Heavy schistosomiasis infections can have even more severe consequences.



Hookworm prevalence today



<http://www.stanford.edu/class/humbio103/ParaSites2006/Hookworm/epidemiology.html>

Private benefits of deworming

- Private benefits of deworming are not always easy to see.
 - Main private benefit is improvement in nutritional status in the months following treatment.
- Deworming is a cost-effective way to improve schooling:
 - \$3.50 per extra year of school participation generated

External benefits of deworming

- Kids become reinfected with worms, so treatment must be repeated indefinitely.
- 3/4 of the social benefit of treatment comes through reducing disease transmission to others (Miguel and Kremer [2004]: large external benefits).
- Argument: **externalities** justify the on-going public provision of deworming medicine.

Approaches to deworming

- Periodic medical treatment with low-cost drugs.
- Health education.
- Cost-sharing payments (users pay >0 but $<$ full retail cost).
- Influencing social behaviors.

Deworming experiment

- 30,000+ primary school students in Kenya
- 90% suffer from intestinal worm infection
- 3 groups of 25 schools each
- Intervention:
 - Education on worm prevention
 - Deworming medicine
- Staggered implementation => randomly-selected treatment group was:
 - Group 1 schools in 1998
 - Groups 1 and 2 schools in 1999-2000

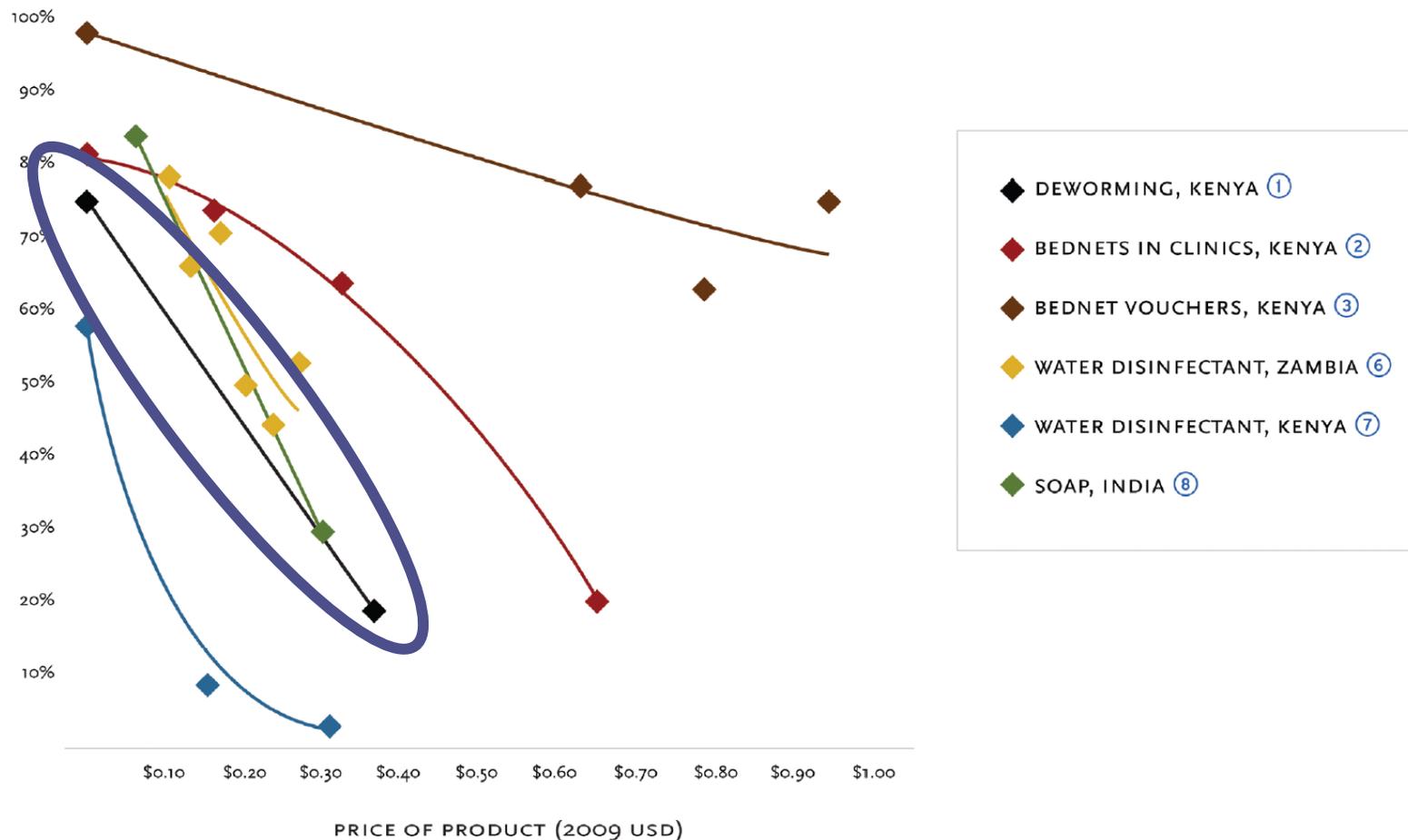
Basic results

- Introducing a small fee for deworming drugs (“cost-sharing”) => 80% reduction in treatment rates.
 - Low private valuation for deworming.
 - Take-up was not sensitive to the exact (positive) price.
- Intensive school health education had no impact on worm prevention behaviors.
- Verbal commitment “mobilization” had no impact on adoption.

Big decrease in demand when price > 0

FIGURE 1: DEMAND FOR PREVENTIVE HEALTHCARE PRODUCTS BASED ON PRICE

charge pregnant women in Kenya.



Source: "The Price is Wrong: Charging Small Fees Dramatically Reduces Access to Important Products for the Poor." J-PAL Bulletin, April 2011

Externalities: Implications for sustainability

- Take-up fell as more individuals were exposed to deworming through their social network
 - Private valuation of drug is low.
 - Temporary intervention will not drive take-up through social learning.
- No large pure-imitation effects → expanding temporary subsidies beyond a small number of people will not affect long-run take-up.
- Alternative interventions are not effective at deworming
- Argument for free distribution, not social business

Avoiding Malaria

One of the world's biggest killers.

Long-lasting antimalarial insecticide-treated bed nets (ITNs) are known to reduce infection.



Antimalarial bednet in Cambodia. Photograph: Paula Bronstein/Getty Images.
<http://www.guardian.co.uk/society/sarah-boseley-global-health/2012/apr/25/malaria-africa>.

Free distribution? Or social business?

Jessica Cohen and Pascaline Dupas: “Free distribution or cost-sharing?
Evidence from a randomized malaria prevention experiment.” *Quarterly
Journal of Economics*.



Free distribution? Or social business?

- Social business involves charging customers for products and services
 - “user fees”
 - “cost sharing”

- Arguments
 - Resources get to the people who value them most
 - The resources are less likely to be wasted
 - Can maximize scale/effectiveness when subsidies are limited

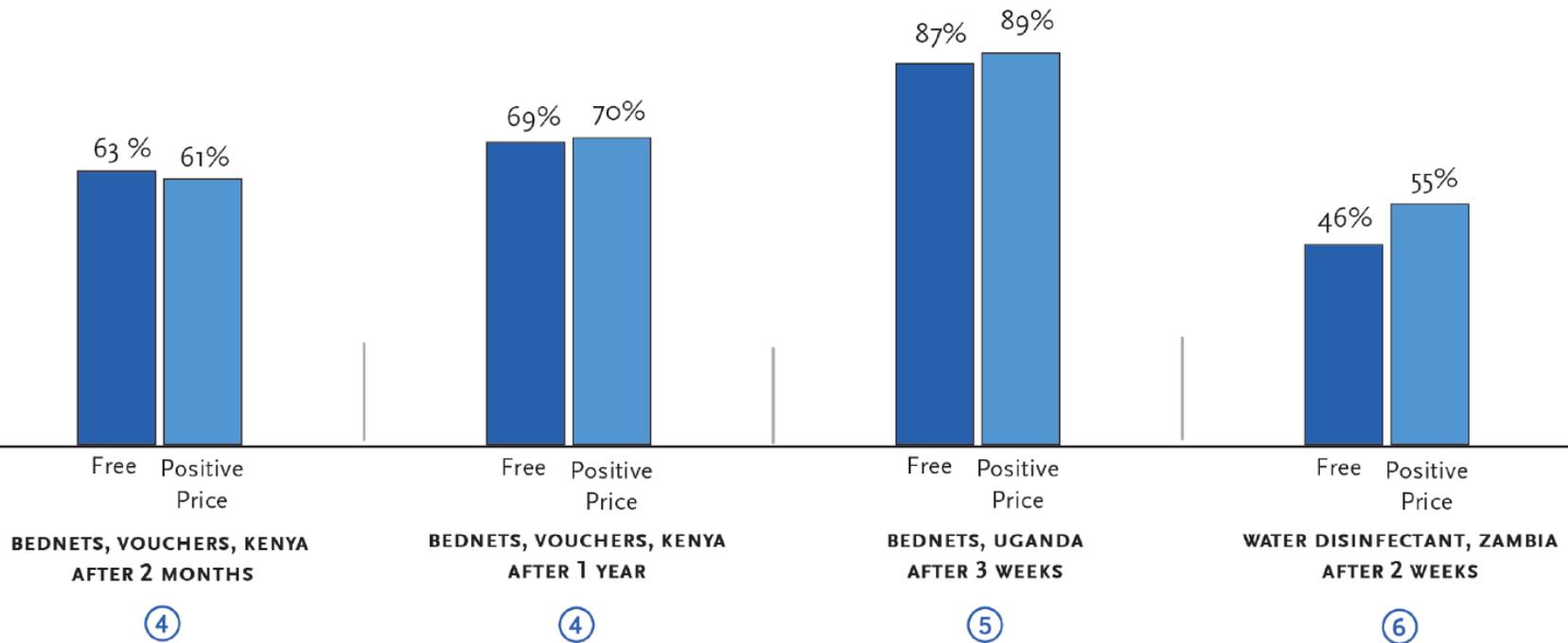
No evidence of wastage or selection

- Field experiment in Kenya
 - Randomized the price at which prenatal clinics sell long-lasting antimalarial insecticide-treated bed nets (ITNs) to pregnant women.
- Women who received free ITNs are **not** less likely to use them than those who paid subsidized positive prices.
- **No evidence** that cost-sharing induces **selection** of women who need the net more:
 - Women who pay higher prices appear no sicker than the average prenatal client in the area (proxied by measured anemia, an important indicator of malaria).

A slight success on usage

FIGURE 2: EFFECT OF PAYING ON USAGE

Usage rates between recipients of free products and those who paid



Source: "The Price is Wrong: Charging Small Fees Dramatically Reduces Access to Important Products for the Poor." J-PAL Bulletin, April 2011

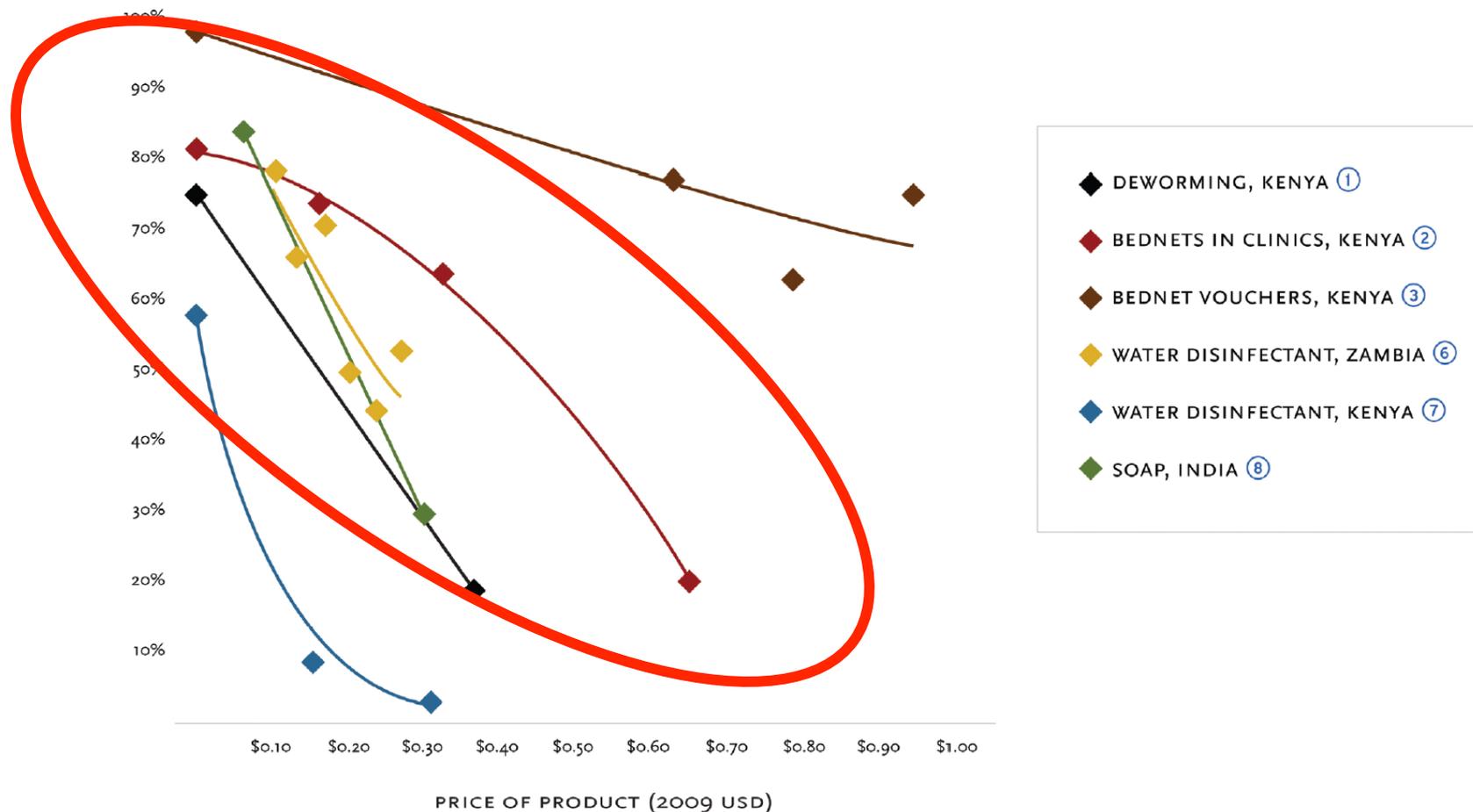
But big decrease in demand

- Bednets are sold to pregnant women for \$0.75.
- Take up of bednets drops by 60 percentage points when the price of ITNs increases from 0 to \$0.60 (from totally free to 90% subsidy).

Big decrease in demand when price > 0

FIGURE 1: DEMAND FOR PREVENTIVE HEALTHCARE PRODUCTS BASED ON PRICE

charge pregnant women in Kenya.



Source: "The Price is Wrong: Charging Small Fees Dramatically Reduces Access to Important Products for the Poor." J-PAL Bulletin, April 2011

Argument: free distribution

“Overall, our results suggest that free distribution of ITNs could save many more lives than cost-sharing programs have achieved so far, and, given the **large positive externality** associated with widespread usage of ITNs, would likely do so at a lesser cost per life saved.” [bold added]

Are we making conclusions too soon?

FIGURE 3: PRICE SENSITIVITY FALLS
WHEN PEOPLE HAVE MORE TIME TO BUY



Source: "The Price is Wrong: Charging Small Fees Dramatically Reduces Access to Important Products for the Poor." J-PAL Bulletin, April 2011

Competing evidence from Orissa

Alessandro Tarozzi, Aprajit Mahajan, Brian Blackburn, Dan Kopf, Lakshmi Krishnan, Joanne Yoong

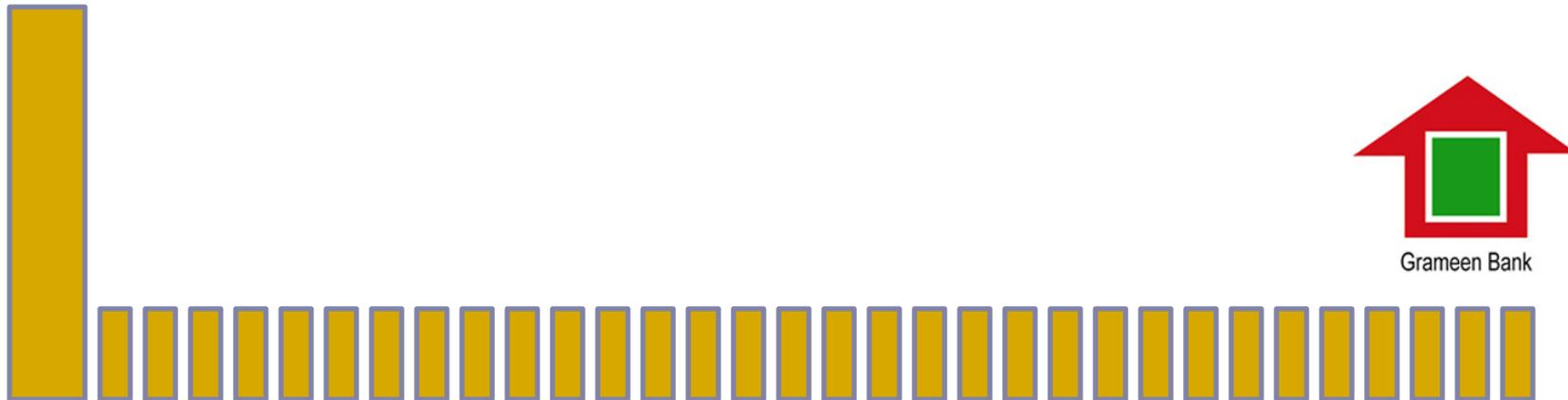
“Micro-loans, Insecticide-Treated Bednets and Malaria: Evidence from a Randomized Controlled Trial in Orissa (India)”

March 9, 2011



A lesson from *Portfolios of the Poor*

- Price is not all that matters.
- Cash flow implications matter too.
- When liquidity-constrained, more willing to purchase a major item if can do it in installments.



Orissa study

- Insecticide-treated bednets (ITNs) with micro-consumer loans vs. free distribution.
- Despite the un-subsidized price:
 - **52 percent of sample households bought at least one ITN**
 - Treatment group: 16 percent of individuals used a treated net the previous night
 - Control group: only 2 percent had used a net where nets were not offered for sale.
 - Free distribution group: 47 percent previous-night usage rate
- BUT: Neither micro-loans nor free distribution led to improvements in malaria and anemia prevalence, measured using blood tests.
- Conjecture: insufficient ITN coverage.

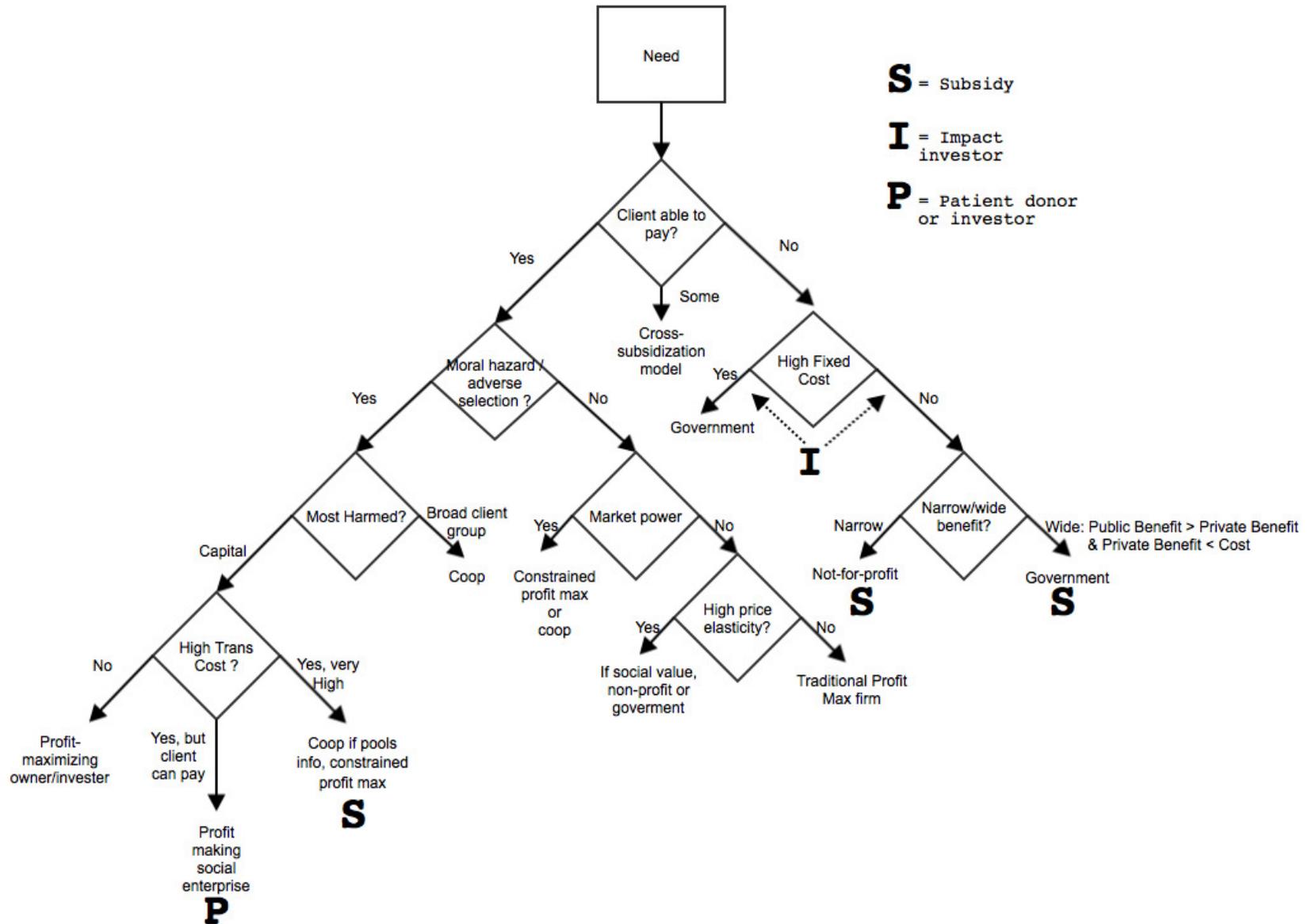
Not-for-profits

- Extreme case where no one owns the firm.
 - This is less a case of efficient monitoring than non-profit-status ensuring that clients are not harmed by others owning the firm.
 - E.g., hospitals or cemeteries.
 - Asymmetric information here is more like adverse selection (good managers, bad managers); non-profit reduces incentive for bad types to exploit clients (in above example, infirm or dead).

Coops

- Who becomes the owner? The patron (client, worker, investor) who can most efficiently monitor and organize.
 - Or the one most harmed if someone else owns.
- Classic example: one investor firm.
- However, sometimes better for workers to own.
 - If there is monopsony in the labor market.
 - For farm goods where land and labor are main inputs and bundled together in the farmer.
 - Farm work difficult to monitor – by being the owner their output is their share of ownership and incentive to work hard and avoid monopsony from middle-men (Amul).

Toward a framework



Summary

- Social enterprise is a promising strategy
- Places emphasis on solving “last mile problem”
- Yet it’s superiority depends on economic conditions and behavior responses.
- Need innovation in marketing, pricing, installments before concluding that free distribution is best.

TABLE 1: FEATURED EVALUATIONS

| PRODUCT | RESEARCHERS | LOCATION | PRICES TESTED | APPROXIMATE MARKET PRICE |
|--|-----------------------------|----------|-------------------------|--------------------------|
| ① Deworming medicine | Kremer, Miguel | Kenya | free, \$0.30 | \$0.50 - 1.50 |
| ② Long-lasting insecticidal bednets (at prenatal clinics) | Cohen, Dupas | Kenya | free, \$0.15 to \$0.60* | \$6.00 |
| ③ Long-lasting insecticidal bednets (vouchers given to households) | Dupas | Kenya | free up to \$4.60 | \$7.63 |
| ④ Long-lasting insecticidal bednets (follow-up to Study #3) | Dupas | Kenya | \$2.30 | \$7.63 |
| ⑤ Long-lasting insecticidal bednets (received cash or nets) | Hoffmann, Barrett, Just | Uganda | free up to \$7.63 | \$7.63 |
| ⑥ Water disinfectant | Ashraf, Berry, Shapiro | Zambia | free, \$0.09 to \$0.25* | \$0.25 |
| ⑦ Water disinfectant | Kremer, Miguel, Null, Zwane | Kenya | free, \$0.15 and \$0.30 | \$0.30 |
| ⑧ Handwashing soap | Spears | India | \$0.06 and \$0.30 | \$0.52 |
| ⑨ School uniforms, primary school children | Evans, Kremer, Ngatia | Kenya | free, \$5.82 | \$5.82 |
| ⑩ School uniforms, 14-year-old students | Duflo, Dupas, Kremer, Sinei | Kenya | free, \$6.00 | \$6.00 |

*These prices include prices initially offered to customers and prices offered after a second round of discounts.

Source: “The Price is Wrong: Charging Small Fees Dramatically Reduces Access to Important Products for the Poor.” J-PAL Bulletin, April 2011