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THE CASE OF SOCIAL ENTERPRISES**

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THE GROWTH OF ORGANIZATIONAL VARIETY IN MARKET ECONOMIES: THE CASE OF SOCIAL ENTERPRISES

Carlo Borzaga, Sara Depedri, Ermanno Tortia*

ABSTRACT

Institutional and organizational variety is increasingly characterising advanced economic systems. While traditional economic theories have focussed almost exclusively on profit-maximizing (i.e. for-profit) enterprises and on publicly-owned organizations, the increasing relevance of non-profit organizations, and especially of social enterprises, requires scientists to reflect on a new comprehensive economic approach for explaining this organizational variety. The paper examines the main limitations of the orthodox and institutional theories and comes to assert the need for creating and testing a new theoretical framework, which considers the way in which diverse enterprises pursue their goals, the diverse motivations driving actors and organizations, and the different learning patterns and routines within organizations. The new framework of analysis proposed in the paper draws upon recent developments in the theories of the firm, institutional evolution, and motivational complexity to explain the presence of diverse types of organizations on a continuum ranging from purely for-profit and commercial forms to socially-oriented entrepreneurial ones.

KEYWORDS: Social enterprises, organizational pluralism, neo-institutional economics, behavioral economics, organizational continuum

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We ... have focused too long on one particular model, the profit maximizing firm, and in particular a variant of that model, the unfettered market. We have seen that that model does not work, and it is clear that we need alternative models. We need also to do more to identify the contribution that these alternative forms of organization are making to our society, and when I say that, the contribution is not just a contribution to GDP, but a contribution to satisfaction.

Joseph Stiglitz (2009), Nobel Prize for Economics, Columbia University.

Dilemmas nested inside dilemmas appear to be able to defeat a set of principals attempting to solve collective-action problems through the design of new institutions to alter the structure of the incentives they face. ... But some individuals have created institutions, committed themselves to follow rules, and monitored their own conformance to their agreements, as well as their conformance to the rules in common pool of resources situations.

Elinor Ostrom (1994), Nobel Prize for Economics, Indiana University.

1. Introduction

While it always has, institutional and organizational variety is increasingly characterising advanced economic systems. While traditional economic theories have focused almost exclusively on profit-maximizing (i.e. for-profit) enterprises and publicly-owned organizations, it is impossible to deny the importance of a large sector which includes an heterogeneous mix of organizational—or otherwise associative—forms, which do indeed play a crucial role in providing many goods and services, in supporting development, and in reducing poverty and marginality. What has been sometimes referred to as the 'social economy' and sometimes the 'third sector', is a variegated set of these types of intermediate organizations. The most traditional and widespread of these forms are non-profit organizations and cooperative firms. However, new arrangements have emerged over time, both within and outside of these traditional categories. These new organizational solutions are often grouped under the heading of 'social enterprise', a new entrepreneurial form combining a social aim with business-like management (Borzaga and Defourny, 2001; Anheier and Ben-Ner, 2003). The interest in social enterprises is firstly explained by the importance increasingly acquired, in both developing and developed countries, by non-profit organizations and other types of socially-oriented firms delivering, for example, social services, ethical finance and micro-credit, or supporting fair-trade and the work-integration of disadvantaged people. Furthermore, social enterprises have often emerged (and are emerging in many countries) through a bottom-up process. Civil society has directly responded to the new needs of citizens by creating new organizations that are better able to cope with market, contract and state failures in the delivery of social and welfare services than more traditional organizational forms (i.e. public bodies and for-profit firms).

The increasing importance of social enterprises and the interest in both the scientific and political domains have recently stimulated various legislative reforms designed to recognize these entrepreneurial organizations pursuing a public-benefit aim¹: first of which were the UK law on the Community Interest Company of 2005 and the Italian law on the *Impresa Sociale* of 2005. These two laws define social enterprises as socially- (or community-) oriented entrepreneurial organizations producing public, quasi-public, collective and meritorious goods and services, and pursuing social more than private objectives. The organizational types contemplated by this general definition have spread into different sectors and fields of activity, adopting different kinds of ownership and organizational forms. Furthermore, the organizational mission of social enterprises explains why they limit their profit aim and reduce private appropriation through the accumulation of locked assets directed to the development of the production activity. Since their main objective is not private appropriation by the controlling stakeholder(s), different objectives defended by different stakeholders may often be accommodated in the firm's governance. This characteristic also explains the diffusion of social enterprises that adopt multi-stakeholder governance structures.

While traditional non-profit organizations with mainly advocacy and distributive aims are compatible with orthodox economic theories, the emergence and spread of non-profit organizations with entrepreneurial behaviour—like social enterprises—seems to contrast with the predictions of these theories and therefore requires new and more convincing explanations. The new theory requires especially to reconsider the specific socio-economic and historical characteristics of organizations. Firstly, in most countries, the public welfare state has been subject to stricter financial constraints due to the growing inability of public finance to support it, and to limitations in the bureaucratic procedures for welfare services delivery. Furthermore, the recent international financial crisis has reinforced the idea that the role of both the state and the market need radical rethinking because, on the one hand, self-regulated markets have been unable to properly predict and counter the massive deficit that has swept through financial markets, and, on the other, the state has been forced to commit a huge amount of resources to bailing-out nearly bankrupt economies, leaving the social entrepreneur as one of the few actors able to take over social and welfare services and develop new ones. The study of different ownership and governance forms in the theory of the firm is again relevant because different firm types can perform differently in crisis situations. Indeed, while many for-profit firms and other investor-owned organizations have been badly hit by the crisis, third-sector organizations are facing the crisis without significant losses, given their lower dependence on financial markets. At the same time they are being asked to help minimize the negative consequences of growing unemployment and poverty. Their recent growth contradicts the thesis that non-profit oriented firms represent a residual organizational form which will be superseded by the ongoing development and perfection of competitive markets (Hansmann, 1996).

Given the current state of economic development, there is a stronger need than in the past to invest in the understanding of social enterprises and other associative forms of enterprises (Stiglitz, 2009). This process should start with the development of new theoretical insights. The objective of this study is to contribute to explaining the emergence and growth of social enterprises as part of the institutional and organizational variety that underpins the development of contemporary economic

¹ Enterprises with clear social aims and which produce services in a stable manner initially took the legal form of cooperatives. Thus they were mainly regulated by cooperatives law (in Italy, Law 381/91 on social cooperatives). The legal definition of social enterprises was only later developed.

systems. A new interpretive framework is drawn for better interpretation of the new phenomenon. This framework extends beyond traditional approaches, which include primarily the neoclassical and new-institutionalist paradigms. It adds insights taken mainly from evolutionary and behavioural economics. It shows the importance of the institutional framework and motivational drivers of actors involved in non-profit-oriented firms in influencing their ability to produce public and quasi-public and private goods in innovative ways. This allows firm objectives to be widened by bypassing the exclusive focus on profit maximisation and the dominance of monetary incentives in economic behaviour. The various organizational and ownership forms can be arranged along a continuum moving from the prevalence of financial and egoistic goals to the pursuit of social aims. The continuum ranges from purely for-profit and commercial forms to socially-oriented entrepreneurial ones, passing through mutual-benefit and other types of associative enterprises.

2. The state of the art

Traditional economic approaches to the variety of firms have focused mainly on cooperatives; only recently have they paid some attention to non-profit organizations. They have explained the emergence of the various types of organizations mainly in terms of efficiency, regarding them as minimizers of the contract costs with their various stakeholders. Furthermore, the literature on non-profit-oriented firms has considered the non-profit constraint to be the crucial institutional device enabling their social role. The non-profit constraint allows the organization to overcome market and contract failures, most notably in the presence of asymmetric information and the production of services of a relational nature. Indeed, this constraint helps ensure that resources are employed in the interests of stakeholders other than the owners of the organization. Moreover, the distribution constraint encourages greater attention to the quality of services, limiting the opportunism of organizations and reducing asymmetric information about quality. The overall advantage of the non-profit distribution constraint is that it fosters fiduciary relationships, especially between organizations and stakeholders exposed to problems of information asymmetry (Hansmann, 1996).

Following the efficiency approach, theories have emphasized some significant limitations of cooperative firms and non-profit organizations. Specifically, they identify the main disadvantages of these organizations as reduced efficiency and a lower ability to invest (Ward, 1958; Furubotn and Pejovich, 1970), and as inflated governance and decision-making costs due to the heterogeneity of the interests pursued by the membership (Hansmann, 1996). The non-distribution constraint itself is the source of some disadvantages because it restricts the opportunity to collect financial resources for investments. This also implies that cooperative and social enterprises are supposed to be transitional organizations destined to disappear with the completion of markets. The theories have thus disregarded the ability of cooperative and social enterprises to control decision-making costs through appropriate governance structures and to increase production and social surplus by defining a mutual benefit and public benefit objective and by setting value on motivational factors not exclusively linked to self-regarding and monetary aims.

Furthermore, little attention has been paid to the way in which social goals and stakeholder involvement interact with the presence of the non-profit constraint so that non-profit-oriented firms produce a higher social surplus which they are able to distribute more fairly than other organizational forms. In this regard, the public-benefit aim, the pro-social motivations of the patrons of the organization, and forms

of governance based on the involvement of all the main stakeholders come to the fore. Some recent studies evidence indeed that a specific outcome of the non-profit constraint is its ability to favour the expression and the flourishing of intrinsic motivations (Valentinov, 2007, 2008).

To identify the way in which non-profit-oriented firms pursue the satisfaction of social needs we may consider their advantages in pursuing social goals. Some authors have recognized the contribution these organizations make by increasing the supply of goods or services provided, focusing on generating donations (Weisbrod 1988) or involving consumers (Ben-Ner and Van Hoomissen 1991). Some studies have emphasized the net increase in employment generated by non-profits and the opportunities created for people who are difficult to employ. However, both theoretical and empirical analyses have rarely investigated the ability of not-for-profits to guarantee x-efficiency and to gather resources other than donations, especially through market exchanges. In addition, some empirical studies on specific areas of activity have shown that not-for-profits perform better than public agencies and for-profit firms.² Furthermore, researchers have generally not recognized the advantages that not-for-profits derive from their ability to manage human resources. Instead, they have concentrated on the capacity of not-for-profits to identify the demand for general-interest services and to provide innovative services to meet social needs.

The aim of the following sections is to demonstrate that the institutional, organizational, and motivational features of non-profit-oriented firms crucially influence their ability to increase the social surplus in terms of increased production of public-benefit services, and to distribute resources to the less well-off, thereby reducing poverty and marginality. Purposeful intervention in the solution of social problems and the positive effects on employment and output are conjugated with unintended positive spillovers in terms of reinforced trust at the local level and the development of networks of co-interested subjects and organizations committed to collaborative more than competitive interaction (Borzaga and Becchetti, 2010).

3. New approaches to the study of social enterprises

The limitations of existing theories of social enterprises require the creation and testing of a new theoretical framework that correctly accounts for the entrepreneurial and organizational variety of contemporary economies, starting from in-depth analysis of the underlying institutional variety. Social enterprises should be contextualised in a theory of how these organizations, and productive non-profit firms in general, pursue their goals in connection with the underlying organizational processes and proprietary form. To this end, they may define an appropriate incentive structure that comprises not only monetary incentives but also appropriate intrinsic, social and relational elements (Bacchiaga and Borzaga, 2001).

Consequently, full understanding of social enterprises requires assuming the existence of different types of motivations driving actors and organizations, of different learning patterns within organizations, and of diverse mixes of resources in organizations.³ More precisely, our framework of analysis draws upon recent developments in the

² See Cutler and Berndt (2001) on the medical care industry and Krueger and Malečková (2003) on education.

³ The relevance of intrinsic motivations in the social sciences was underlined several decades ago by some of the classic works in social psychology, for example Maslow (1954), Deci (1975), and Deci and Ryan (1985). More recently, the debate on intrinsic motivations has spread in economic science from the work by Frey (1997), who evidences a possible crowding-out effect of intrinsic motivations by extrinsic incentives when the latter are misaligned with self-determined objectives.

theories of the firm, institutional evolution, and motivational complexity to explain the crucial changes in ownership rights and governance rules that have been necessary both to implement the new entrepreneurial form of the social enterprise and to meet the needs and motivations of the actors involved. Analysis of the governance structure can yield a better understanding of the different patterns of involvement of different stakeholders. However, at the same time, governance structures also reflect different aims and the prevalence of social over financial and economic objectives. Hence, objectives, governance rules and economic aspects should be incorporated into the same analytical scheme if proper account is to be given to institutional variety.

As a first step in explaining the economic nature of social enterprises, it is necessary to assume that individuals—including entrepreneurs and managers—are characterized by motivational complexity. Self-interested preferences interact with relational, procedural, and intrinsic aspects of human behaviour (Ben-Ner and Putterman 1998).

Secondly, a satisfactory theory should overcome the conventional conception of the firm, mainly because of both the neoclassical and the neo-institutional assumptions of self-interested motivations and profit-maximization, on the one hand, and of the static approach to institutional and cultural changes on the other (Borzaga and Tortia 2007). Moreover, social enterprises and non-profit organizations are difficult to evaluate in terms of the traditional concept of efficiency used in the case of for-profit firms. This is because the activities pertaining to this area of the economy have non-traditional features, such as a high degree of contract incompleteness both on the labour and product markets, the delivery of services characterised by high relational intensity (Gui and Sugden, 2005), pronounced information asymmetries (Hansmann, 1996), and risks of free-riding linked to the public nature of some of the services provided. Non-profit-oriented firms often employ pools of resources that can be characterised as common insofar as their uses are rivalrous, but not excludable (Ostrom, 1994). On the other hand, the services that they produce are often collective in nature because they are excludable but non-rivalrous. For example, the common ownership of assets is widespread among social enterprises – both cooperatives and non-profit organizations – while many of the services produced are not rivalrous, as in the case of cultural performances and education. Given these peculiarities, it is difficult to connect the evaluation of the role of these enterprises with simple accounting measures such as profit or value added; it is likely to be linked to other, more qualitative variables, such as the quality and effectiveness of the services produced, the intended and unintended social effects, and the intensity of the motivations expressed by the actors involved (Tortia, 2010; Borzaga, Depedri, and Tortia, 2010). Therefore, a broader conception of production efficiency is required, which is likely to be unconnected or weakly connected with the profit dimension.

In light of these observations, an adequate theoretical account of social enterprises requires an innovative conception of the firm in which profit maximization is no longer an essential condition. An alternative approach is to consider firms as complex organizations that must coordinate actors characterised by different motivations in the pursuit of production through the implementation of suitable proprietary and governance structures. According to this approach, the economic and institutional nature of firms does not necessarily entail the private appropriation of net surpluses. A new account of the firm can help explain the existence of entrepreneurial organizations that conventional economics views as altruistic, but not productive. An alternative approach should emphasize the impact of social enterprises on the formation and dissemination of more inclusive governance forms, the valorisation and the spread of non-monetary motivations, and a more equitable distribution of

resources. This linkage between monetary and non-monetary aspects of production is made possible by the development of behavioural and evolutionary economics, which have recently contributed to greater understanding of the importance and role of non-investor-owned organizations. They have introduced more realistic hypotheses and flexible methodologies showing that human behaviour cannot be described solely in terms of self-interest (Fehr and Gächter 2000; Fehr and Schmidt 2001).

From an evolutionary and behavioural perspective, firms cannot be conceived as mere maximizers of the net returns accruing to their investment programmes and operating in competitive markets; rather, they must be interpreted as coordinating devices operating in imperfect economic environments where the production of value added, and not the maximization of profit, is the best predictor of firm survival and expansion. Firms organize production to satisfy needs that may be private and material but also collective, social, relational, and psychological (Dopfer 2005). When individual activities are unable to achieve the expected results effectively or efficiently, there evolve organizational routines which allow people to come together and arrange production on a collective basis. The objective of this process is the enjoyment of the results (the surplus) deriving from the activity. But the social function is the satisfaction of needs, and the enjoyment of the results must involve all stakeholders, and not simply the investors. Social goals can be pursued through the implementation of specific organizational routines, such as the socialization of a firm's capital and stakeholder involvement in decision making.

Moreover, theoretical and empirical studies on group selection show that altruism and pro-social attitudes can help increase the imitative success of individuals, organizations, communities, and society by boosting sympathy, cooperation, trust, and a sense of community (Hodgson 1993; Bowles 2004; Gowdy and Seidl 2004). Pro-social attitudes, in their turn, support the production of greater economic surplus and social welfare, because they help reduce transaction costs and foster the pursuit of common goals. Motivational complexity also encourages the creation of a suitable institutional environment in which non-self-regarding motivations interact with self-interested ones and are supported by conformance to shared rules of behaviour and common values (Grimalda and Sacconi 2005; Sacchetti and Sugden, 2009). Relational and other-regarding preferences, together with an interest in fair procedures, play a crucial role in advancing the well-being of the actors involved (Helliwell and Huang 2005; Tortia 2008). They can be considered a non-monetary part of the mix of incentives offered by the organization (Bacchiega and Borzaga, 2001-2003). On the one hand, incentives need to be functional and effective for the pursuit of the organization's objectives; while, on the other hand, they must also match individual motivations as closely as possible. The incentive structure is implemented through governance and other working rules and may comprise different incentives to different degrees. In this context, we expect to observe that different incentive mixes are better able to foster the objectives of different organizational and ownership forms. Monetary incentives are not necessarily the most effective ones in all situations. On the contrary, where the stress is placed on mutual-benefit and social objectives, monetary incentives can be expected to be relatively less effective, while the flourishing of intrinsic motivations, reciprocity among co-involved actors, and the sharing of common rules and values are more likely to lead to increased efficiency and effectiveness in production.

Finally, economic and monetary objectives should cohere with the relational and social aspects of firm operation. Substitution between the two aspects (monetary and non-monetary) is possible but only to a limited extent. For example, in the case of

employed workers, higher wages can purchase their acceptance of an unpleasant work environment to only a limited extent; and this is an inefficient solution insofar as costs are increased. Voluntary work is an exception to the rule of the substitutability of monetary and non-monetary incentives because, in this case, the relevance of monetary incentives tends to be excluded entirely. Indeed, a motivational continuum can be envisaged where, at the one extreme, monetary incentives predominate irrespective of the importance of non-monetary aspects, while at the other extreme, volunteer work stresses intrinsic aspects alone.

4. An interpretive model of social enterprises

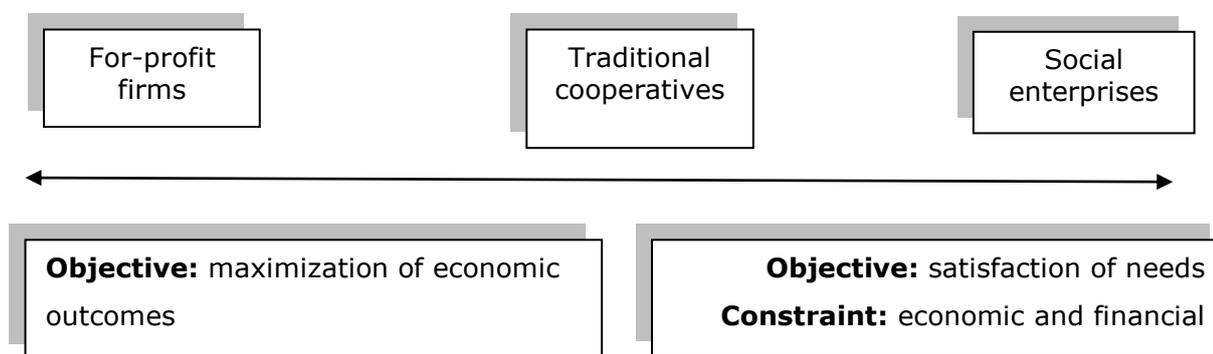
The main assumption behind our new model is that enterprises, far from being profit maximizers, are devices coordinating collective economic activities affected through the implementation of organizational routines, control rights, and governance structures which serve to satisfy individual or collective needs. Consequently, all enterprises must fulfil two conditions: they must satisfy a social need, and their activity must be economically sustainable. Needs can be private or collective, and their satisfaction requires the setting up of an appropriate production process to which the implementation of governance and organizational routines is functional. The function of needs satisfaction ranges from simple satisfaction of a market demand for goods and services⁴ – which is the production of a good or service that someone is willing to buy – to an exclusive stress on the satisfaction of social needs. Economic and financial sustainability is imposed by the necessity to reproduce the production process so that it can survive and expand in a context of scarcity and competition. The need to accomplish economic and financial sustainability is by no means equivalent to profit maximisation, for at least two basic reasons. The first is that firms must survive for long periods of time even if their behaviour is not directed to the maximisation of net surpluses. This behaviour is similar to that of profit-maximising firms in contexts of perfect competition, but it can be markedly different when imperfect competition prevails. The second reason is that profit maximisation, above all when it is performed in a short-term perspective, may deplete, instead of strengthen, the firm's survival potential, for example because it damages reputation and trust relations with customers, or because it favours short-term objectives instead of long-term ones. In our framework, economic and financial objectives range from an exclusive focus on financial and economic aspects – the core concern of profit-maximizing firms – to the consideration of economic and financial objectives as simple constraints that need to be fulfilled if the firm is to survive. This implies that, when an organization's main objective is not private appropriation, breaking-even more than profit maximisation is the relevant benchmark for the evaluation of entrepreneurial activities. Efficiency can be guaranteed anyway by market competition, public support, and the presence of proper motivational drives.

The two conditions represented by financial sustainability and the satisfaction of needs are combined and fulfilled to varying extents by different types of enterprise. It is thus possible to define a continuum of organizational behaviours and objectives (Bonatti et al. 2001). At one extreme of this continuum, economic and financial objectives predominate, and the social aim is simply a constraint. At the other extreme, public-benefit social objectives predominate, and the financial aim is only a constraint. The scheme presented in Figure 1 summarizes the approach.

⁴ When priority is given to the sale of goods and services over need satisfaction, preferences can be manipulated and result in the over-consumption of useless goods, often in conjunction with excessive expenditure on marketing and advertisement.

The left-hand extreme of the continuum is the classic model of the for-profit firm presented in microeconomic textbooks, and it is the only one studied in depth by economists to date. Yet it represents only one possible rationale for the creation of entrepreneurial ventures, and it does not necessarily apply to all enterprises. When economic and financial objectives predominate, we observe processes that are best expressed by the functioning of regulated financial markets that publicly price the value of firms on the basis of expected future returns.⁵ Indeed, the same principle is often dominant in non-publicly-quoted enterprises, where the pursuit of economic objectives is a necessary condition for the sale of the firm at the highest possible price.

Figure 1. Organizational objectives and the satisfaction of needs



The opposite extreme of the continuum is exemplified by those social enterprises that can be defined as 'pure' in that their activity is entirely devoted to public-benefit objectives, while financial and economic equilibrium is merely instrumental to this end. If the social aim strictly dominates, organizations do not sufficiently consider the financial constraints to their long-term existence and consequently only the financial support of private donors or other organizations (e.g., public administrations) may guarantee their survival. In other cases, however, social enterprises pursue the benefit of the community at large or of a specific group of clients (mostly disadvantaged people or people in need in general) but also undertake market activities with other parties and clients. Consequently, the financial constraint becomes a way for them to guarantee their long-term efficiency and does not conflict with the non-profit nature of the firm. Profits are in fact accumulated to asset lock for future members and clients (with an intergenerational social benefit).

A wide variety of intermediate firm types exist between the two extremes of the continuum. The most common of these intermediate types are cooperatives, which are explicitly mutual-benefit organizations, since their primary objective is to satisfy the needs of a group of members that control the organization by virtue of individual rights, not ownership of capital shares. Within cooperatives, the private benefit of investors is not predominant; nor is enhanced social well-being the main aim of the organization. However, the objectives of cooperatives may be monetary, as when they pursue maximisation of their members' incomes; but their objectives may also be non-monetary in nature and concern their members' needs. For example, worker

⁵ However, recent financial crises demonstrate that the process of pricing stocks in financial markets is subject to severe imperfections leading to anomalous fluctuations and speculative movements in stock prices, which can become weakly connected with the real value of economic activities.

cooperatives may be created to guarantee the employment stability of their members, consumer cooperatives to guarantee better quality products, and credit cooperatives to guarantee access to credit for small producers. The high degree of membership involvement and a commitment to mutualism has a range of collective implications, such as the sharing of democratic rules and reciprocal aid. When economic objectives are predominant, cooperatives come closer to for-profit firms and usually pursue the maximization of per-member income (as Ward assumed in 1958). Conversely, when they do not distribute positive residuals to their members and use them to expand their activities, socialize resources through the asset lock, and pursue goals wider than purely mutualistic ones, they come closer to social enterprises. This is especially the case of social cooperatives.

The heterogeneous aims of organizations also generate diverse characteristics in their governance and management structures. Specifically, the prevalence of social over self-interested aims explains why cooperatives and social enterprises exhibit distinctive control and governance mechanisms characterised by democracy and fairness of treatment. Furthermore, social goals also include the well-being of employees and require all stakeholders to share the organizational mission. This interrelation with stakeholders explains the endeavour to involve people by implementing different incentive mixes. While incentives and exchanges with the stakeholders (mainly employees) are more informed by monetary incentives in the case of for-profit firms, in that of cooperative and social enterprises they are characterised by a higher degree of involvement and an emphasis on fostering intrinsic motivations. Inclusion and the sharing of common procedures may be juxtaposed with hierarchy, control, and the use of powerful monetary incentives as coordination mechanisms. Moving rightwards along the continuum, the relevance of monetary incentives progressively weakens as they become mere instruments in the pursuit of social goals, while the intrinsic and pro-social motivations increase in importance.

It can therefore be concluded that, for all the types considered, and especially social enterprises, organizational objectives and control rights condition the features of the production process: for example, they may influence how information circulates, knowledge is created and used, and competences and human capital are accumulated and retained (Hodgson, 1998). In social enterprises, reduced hierarchy and control favour the circulation of information that sustains the creation and spread of non-codified and tacit knowledge. This system of knowledge production is supported by the development of more informal and horizontal models of governance where trust and personal interaction play a more fundamental role than they do in other organizational forms (Frey and Osterloh 1999). For example, inclusive and participatory governance can help the organization attract and retain its management and workforce without making intensive recourse to career advancement and wage increases, but rather by valorising non-monetary motivations and pro-social attitudes. In for-profit firms, rather, the dominance of financial objectives and the hierarchy of organizational objectives relative to the objectives of non-controlling stakeholders tend to support the development of formalised procedures and codified knowledge.

5. Implications of the model

The approach proposed highlights that the close interconnection between institutional and motivational factors is the basis of organizational behaviour. On the one hand, different organizational and ownership forms favour the emergence, strengthening, and enforcement of different kinds of behaviour inside the organization. In this sense,

preferences are endogenous (Bowles 1998, 2004), because institutions are able to influence the behaviour of economic agents through a process of downward reconstructive causation (Hodgson 2006). The process of preference evolution occurs as the actors inside the organizational structure modify their initial propensities and behaviours over time. For example, the non-profit distribution constraint, inclusive governance, and the social objectives of social enterprises are likely to favour the creation of trust relations and horizontal control, whereas they limit the effectiveness of traditional governance schemes mainly based on economic incentives, hierarchy, and control. Intrinsic motivations, trust, and horizontal coordination can be sufficient to guarantee an adequate degree of efficiency even when monetary incentives and control are weak. Indeed, organizational models able to implement non-monetary incentive schemes based on trust and personal knowledge can result in increased x-efficiency due to a reduction of agency costs and the creation of new, non-codified knowledge.

Conversely, economic actors do not join organizations as *tabulae rasae*, devoid of motivational content and complexity. Clearly, people self-select into different types of organizations according to the idiosyncratic features of their motivational drives. Hence the organization needs to devise proper ways to interact with the motivational complexity that characterises economic actors. The implementation of a proper incentive mix is crucial in this regard because all the relevant motivational factors need to be taken into account (Borzaga and Mittone, 1997). The organization's ability to combine monetary incentives with other organizational variables, such as the transparency of procedures (Tayler and Blader, 2000), may prove to be one of the main factors favouring survival and driving expansion. Empirically, it is clear that processes of self-selection are present in all entrepreneurial types. However, they become strikingly evident in the case of social enterprises and cooperative firms. People motivated mainly by economic and monetary rewards are likely to eschew employment in enterprises with social goals as they become dissatisfied with inadequate monetary incentives and career prospects. On the other hand, people motivated by intrinsic, relational, and other-regarding preferences will tend to choose organizations that have social objectives. Social enterprises become collectors of intrinsically motivated workers. Their organizational processes can favour the regeneration and spread of motivations of this kind also outside the organizational boundaries.

The proposed framework can thus be interpreted in two different ways: institutions shape individual behaviour, while individuals driven by different motivations self-select into different types of organizations. The former case can be interpreted as the process along which different types of organizations emerge according to the behavioural variety already existing in the system. The distribution and heterogeneity of the organizational forms provide a good approximation of the prevailing attitudes driving the economic agents. This is so because of the top-down process of downward reconstructive causation envisaged by the evolutionary approach (Hodgson 2006): existing institutions influence and constrain individual preferences and choices. In the latter case, actors driven by different motivations flow into different organizational forms. This process can also encompass modifications in the institutional architecture of firms due to the influence of the motivational drives, needs, and demands of actors as they strive to modify organizational processes in ways that fit better with their desired outcomes, in both private and social terms.

While the framework can account for general trends in the various organizational types, specific organizations can move nearer to, or even cross over into, other

organizational types. Various factors can cause horizontal movements. For example, by adopting criteria of corporate social responsibility such as self-regulation, ethical codes, or social accounting, for-profit firms can move rightwards by improving their social standing. The literature on corporate social responsibility (Freeman, 1991; Sacconi, 2007) has evidenced important development potential in this direction, though private appropriation is still unavoidably the main aim of for-profit firms. Similarly, for-profit entrepreneurs that place greater importance on the nature of the goods and services produced rather than on purely financial objectives can push their organizations rightwards. By contrast, social enterprises are usually located at the right-hand extreme of the continuum owing to their statutory choice of public-benefit aims; but the intensive development of commercial activities and use of monetary incentives may push them leftwards. As Figure 1 illustrates, cooperatives are positioned between the two extremes, but changes in the external environment (i.e., market competition) and in their ownership, control, and governance rules may move them closer to either the for-profit or the social enterprise poles. They can move in both directions when either private-benefit or social objectives are reinforced.

The position of different organizational forms can shift along the continuum over time because of reforms of the legal system, other contextual changes, or more general cultural trends. For example, during the 1980s and 1990s cooperatives in most European countries underwent a process of financial evolution that led to the introduction of new instruments, such as cooperative shares and bonds, which brought their behaviour nearer to investor-owned firms on the left-hand side of the continuum.⁶ Starting from these reforms and cultural trends, cooperatives have in some periods become organizations maximizing the returns on the investments made by members, with weak reference to the social nature of their institutional set-up. However, in the 1990s other reforms and regulatory decisions tended to push cooperative firms in the opposite direction, towards increased attention to social problems. Cases in point are the introduction of laws instituting social cooperatives (first in Italy in 1991⁷ and later in many other countries⁸) and in 1995 the adoption of the seventh principle of the International Cooperative Alliance (ICA), which requires cooperatives to contribute to the development of the communities in which they operate.

The continuum in this framework may have gaps where no organizational form currently exists. In such cases, new ventures may emerge to fill a particular gap. This phenomenon has been observed many times in the past; for example, the creation of cooperative and social enterprises has compensated for shortfalls in the public and for-profit supply of goods or services caused by the concentration of power in the market or the government's inability to intervene in the production of specific public goods. When the most suitable organizational form is absent in a specific national context, the existing forms can compensate for this void. However, the compensation can never be complete because of the shortcomings caused by an unsuitable and maladapted institutional frame. For-profit firms inevitably under-provide public goods, while standard non-profits would not represent the most efficient organizational form for producing standardised industrial goods. By the same token, the creation of social cooperatives and enterprises is a case in point related to the introduction of a new organizational form that has increased the supply of public services and reduced

⁶ In Italy, cooperative shares without voting rights and financial members with minority voting rights were introduced by Law no. 59 in 1992.

⁷ Law no. 381/1991 on the *Impresa Sociale*.

⁸ By 2009, at least fourteen European and North American countries have approved laws on social cooperatives, as have Japan and South Korea.

poverty and marginality. Other examples involve the social nature of goods and services, as in the case of micro-credit, ethical finance, and fair trade. The process of establishing entrepreneurial ventures with a social character has been reinforced by the legal recognition of the communitarian role of enterprises in some countries.

A general consequence of these processes is that all organizational and ownership types tend, with time, to shift rightwards on the continuum because of the stress placed by the new laws on the public-benefit objectives of social enterprises. The introduction of a suitable legal framework may persuade many companies, including some that are investor-owned, either to assume the new legal status or to imitate non-profit oriented firms by pursuing private goals less intensively than they otherwise might do. Legal reforms and cultural change are the basic drivers of a re-orientation in the objectives of a growing share of productive activities.

Moreover, the complex picture that emerges can be interpreted in terms of institutional complementarities (Pagano 1992; Aoki 2001; Gagliardi 2008). Different institutions can be complementary because the presence or effectiveness of one mechanism is reinforced either directly or indirectly by the presence of other arrangements denoting the same or an embedding institutional domain. In the case of social enterprises, institutional complementarity refers to the relationship among different coordination mechanisms, since these can be functional to the growth of for-profit firms by supplying collective services or by improving their social standing. At the same time, however, social enterprises are not likely to be a viable organizational form for the conduct of traditional commercial activities and the production of private goods, which they will therefore buy from for-profit firms.

6. Advantages of social enterprises and implications for the social wellbeing

The described characteristics of the diverse types of firms also helps explain their different levels of efficiency and effectiveness. As asserted when criticising the simple assumption of the orthodox theory, efficiency must not be only interpreted in terms of costs minimization, for it is the comprehensive result of an input-output efficiency problem. On the other hand, organizations pursuing social aims can be defined as efficient when they achieve their main goal: the maximization of the stakeholders' well-being, and therefore the effectiveness of their activities is also measured in terms of quality achieved. This approach to the evaluation of the implications of organizational activity affords a better understanding of the efficiency of the complementarity among institutions and the possible advantages of enterprises of different types; advantages which also explain the economic pluralism on the market and the non-emergence over time of a unique efficient solution to the production of goods and services.

By specifically analysing social enterprises, we have claimed in the previous sections that the social aim supports the consistency of a mix of incentives which are a focus for the organization's stakeholders and involve most of them in the governance. This implies that social enterprises are more closely embedded in the local community, enhance cooperative behaviours among stakeholders, and enjoy higher trust and reputation in the community. For example, in the vast majority of cases they are created and governed by local actors, who develop and utilize local knowledge and resources with a personal and relational character. These traits are particularly important in at least three ways: in the achievement of the organizational goal, in the

production of externalities and enlarged well-being, and in the strictly economic efficiency of the organization.

As regards organizational goals, a governance structure consistent with the social aim of social enterprises facilitates the provision of community services, since the memberships of social enterprises aim to satisfy localized needs, which have idiosyncratic features linked to a specific community and may not be satisfied in the same way in other contexts. Hence, for example, where the negative effects of de-industrialization, such as alcoholism and unemployment, spread in particular communities, social services are best delivered by those who have deep personal knowledge of the people affected and a local understanding of the issues and resources. By enhancing the well-being of marginal classes of citizens, social enterprises reduce negative spillovers. Negative social effects linked to poverty and marginality can be mitigated by the ability of social enterprises to solve social dilemmas within their boundaries without resorting to imperfect and often unusable contractual relations, which would inflate transaction costs, limit the circulation of information, and exacerbate contrasting interests. Inclusive and multi-stakeholder governance serves the purpose of coordinating the various participants in solving social dilemmas. This is possible when the motivations of the actors involved interact proactively with the public-benefit objectives (Borzaga and Tortia, 2009). Multi-stakeholder membership and participation is part of the process of developing strong personal and local ties, since common aims are shared more than is typical of other organizational types. Furthermore, the governance structure and social aim guarantee better alignment of services and clients' needs, as well as prevent the inefficiencies of other organizational types, especially public agencies, because they are less bureaucratic and more flexible.

A second implication for social enterprises is that their distinctive features (governance structure, embeddedness in the local community, enjoyment of trust and reputation) increase the welfare effects of the productive activity. The allocative and distributive mechanisms of social enterprises are unique and well-adapted to increasing the production of socially beneficial goods and reducing poverty (Tortia, 2010). Specifically, it is possible to claim that social enterprises perform an important distributive function, i.e., they often supply free services to people in need. Specifically, social enterprises introduce a new main allocation mechanism by distributing resources without the equivalent of the equilibrium price. The pursuit of social aims may require the delivery of goods and services to persons unable to pay for them, as in the case of meritorious goods; while when break-even is not possible with homogeneous prices, social enterprises can rely on the trust and altruism of their clients for acceptance of price discrimination. These mechanisms of allocation are consistent with a distributive function of social enterprises.

Moreover, social enterprises seem to produce higher levels of positive externalities at the local level. They increase local well-being, enhance the production of social capital, and enable the distribution of resources in favour of people in need. As regards local economic development, social enterprises help increase the employment level by also offering work opportunities to those who are disadvantaged in the labour market. Regarding social capital, social enterprises increase voluntary work, enhance the diffusion of knowledge and social norms within the community, diffuse trust and cooperation, and increase relationships and social cohesion. Finally, the competitive advantage enjoyed by social cooperatives in supporting these diverse functions derives in part from their ability to cover their costs with alternative sources of

financing, such as voluntary work, donations, and also a higher level of non-remunerated effort on the part of workers.

The features of social enterprises also allow them to generate stronger relationships with external actors and to play a specific role in local development and local welfare systems, made possible by personal ties with public authorities, other firms, and civil society organizations. Relationships with the local community strengthen fairness principles, collective actions, and altruistic behaviour. At the same time, networking relationships and external ties can influence the internal equilibrium of the organization, because internal norms develop in connection with the social values prevalent in the community of reference. Furthermore, deviant behaviour can be sanctioned materially and normatively not only by the organization but also by other stakeholders; and it is also reduced by networking relationships among constituent firms and with external actors. Therefore, adherence to general community ideals influences the social norms within the network and the behaviour of all parties.

Moreover, a third important implication is that the nature and characteristics of social enterprises make it possible to reduce transaction costs with internal agents (Depedri, 2010). In general, they increase non-self-interested behaviours and cooperation among peer members, as well as the sharing of rules and sanctions, which are fundamental ingredients in the ability to manage common resources in a self-organized way (Ostrom, 1994) and to pursue collective objectives without the intervention of external decision-makers. Firstly, the strength of the relationships among their stakeholders brings social enterprises several direct advantages in the management of exchanges with their constituent parties. The self-regarding preferences and opportunistic behaviour which usually hamper organizational performance and the achievement of the organization's goals tend instead to be reduced in social enterprises through the implementation of self-managed organizational processes. The reduction of opportunistic behaviour and the sharing of the organization's goals are particularly important in the management of employees. Several studies have shown that three main features distinguish social-aim organizations (in the literature mainly non-profit organizations) from other organizational types: the ability to select altruistic and intrinsically motivated employees; the provision of incentives different from standard economic rewards; and the presence of managers who internalize the social aim of the organization (Leete 2000; Borzaga and Depedri 2005; Benz 2005). The behavioural approach to organizations presented in the previous sections can also be applied to human resources, because intrinsic motivations and social preferences (altruism, reciprocity, donation) among employees increase the level of cooperation, peer monitoring, the quality of relationships, and finally performance. In order to attract people who are intrinsically motivated and interested in the social dimension of the job, social enterprises firstly tend to offer wages lower than the market level, which therefore exclude applications from indifferent employees and managers and only attract dedicated people (Handy and Katz 1998). Secondly, the characteristics of the job (mainly its social usefulness) and human resources management practices (mainly focused on autonomy, personal growth, social support, fairness) create a mix of incentives that attract employees particularly interested in such dimensions of the work. While monetary remuneration works only as a threshold that can induce workers to accept or refuse employment (Borzaga and Depedri 2005), the greatest influence on effort and satisfaction is exerted by non-monetary incentives like participation in decision-making (Michie and Sheehan 1999), low stress, perceived autonomy, and creativity (Mirvis and Hackett 1983). The importance of these process-regarding factors is supported by the governance and organizational system of social

enterprises. Finally, the working environment (relationships with colleagues and internal social norms), other employees (mainly intrinsically motivated people) and managers (especially attentive to employee involvement, fairness, democracy, and communication) improve the 'sense of group' linked to the social dimension of the activity, and they internalize the organization's mission in a process of integrated regulation (Gagnè and Deci, 1998). The advantage for employees is high job satisfaction (e.g. Borzaga and Depedri, 2009). The advantages for social enterprises are a reduction in the costs of control and in the turnover of employees (e.g., Almond and Kendall 2001; Borzaga and Tortia, 2006) and an increase in performance, because employees develop closer relations and enhance the quality of the services provided, but they also donate part of their effort (e.g. Preston 1989).

Thanks to better relations with clients and the ability to collect higher resources from donors and volunteers, and also thanks to improved management of the workforce, the entrepreneurial aspect of social enterprises is designed to encourage innovation in the organizational and production domains in terms of both new services and new organizational solutions. Furthermore, differences in the inputs used and in the outcomes achieved support the efficiency of organizations, and hence the ability to respect the financial constraint and pursue the long-run existence of the organization. Three main factors specifically increase output. First, the services produced by social enterprises tend to be more flexible and innovative, and they can satisfy a greater number of clients and a larger proportion of local needs. Second, the employees of social enterprises make more effort and ensure the stability of production, despite the lower wages that they are often paid. Third, the mobilization of local resources and the transmission of social norms to the community (specifically to agents belonging to the community) create a virtuous circle: it enlarges relationships, increases cooperation and trust, diffuses knowledge and ideals, and reduces the opportunism of the people involved. Specific to inputs, social enterprises seem to have four main advantages in achieving savings by reducing costs. First, they benefit from free resources and enjoy advantages in collecting financial resources in the market. Second, social enterprises enjoy lower transaction costs (e.g. in the collection and transmission of information) and less wastage of resources (e.g. because of less bureaucracy and greater flexibility). Third, they incur lower costs also in controlling the performance of managers and employees by utilizing mechanisms of control and punishment that are different from those of used in other organizational types. Fourth, their mix of incentives provided to employees is less costly than for other organizational types. Efficiency seems therefore theoretically sustainable for social enterprises in an input-saving and output-increasing analysis.

A final conclusion concerns the evolutionary approach to social enterprises. The economic analysis of the processes that steer the formation and dissemination of social enterprises and of their networks is important for understanding the feedback loop of cumulative causation that extends from the establishment of social enterprises to their spread throughout the system at large because their organizational routines need to satisfy economic sustainability in the medium and long run. Given their social orientation and their self-organized nature based on the spontaneous initiative of private citizens in the absence of monetary incentives, social enterprises usually undergo intense adaptation of their internal equilibria, establishing new governance solutions and allocative mechanisms (Tortia, 2010). When new solutions prove feasible and sustainable, they are reinforced and they tend to spread by imitation. The recent growth of organizational forms with a social character—not necessarily in contexts where specific legislation exists—demonstrates the viability of this evolutionary pattern. The theoretical framework developed in this study suggests that

social enterprises may increase their weight in contemporary economies, not only in the production of social and welfare services, but also in the production of private goods, as often happens in the case of cooperative firms. The above-described continuum is also important because these different kinds of firms pursue different goals, exhibit different institutional features, and develop different competitive abilities. Different types of organizations will emphasise different abilities and/or limitations, supporting institutional and organizational diversity at the macro level. They are likely to achieve efficiency by following different organizational routes, ones which are more oriented to hierarchy, control and monetary incentives when their goals are private and monetary, while inclusion and non-monetary incentives will prevail in the case of mutual-benefit and social orientation.

7. Conclusions and policy implications

The study of social enterprises is relatively new in the social sciences, although various strands of theoretical inquiry have already attempted in-depth analysis of entrepreneurial non-profit organizations and cooperative firms (Weisbrod, 1977, 1988; Hansmann, 1996), which exhibit many features in common with social enterprises. Definition of a coherent scheme for the correct interpretation of the working mechanisms and behavioural responses of social enterprises is under way, but with both methodological and conceptual difficulties. Many scientific and political approaches in fact deny social enterprises their entrepreneurial nature, their autonomy, and their ability to survive in the long run. This study has been an initial attempt to devise a new framework of analysis by using tools from evolutionary and behavioural economics and by conducting more in-depth analysis of the institutional features of social enterprises. Furthermore, it has explained certain competitive advantages of social enterprises, their ability to achieve social goals while respecting financial constraints, and their significant impact on welfare systems and local development.

Social enterprises have recently taken over the heritage of entrepreneurial non-profit organizations. They exhibit important potential for the development of new and more advanced welfare systems in which the production and delivery of public and quasi-public goods is decentralised. Further research is needed to support the development of more advanced entrepreneurial models for mutual-benefit and public-benefit firms. Legislative reforms are also needed in most countries because, for example, to date, only a few countries have introduced dedicated legal frameworks for firms undertaking public-benefit activities. These reforms are made urgent by the crisis of both financial markets and public finance, but social enterprises are among the social actors that have been least affected by the crisis and, for this reason, have important development potential in the medium and long run.

The study has highlighted the strict interconnection in social enterprises between individual motivations and objectives on the one hand, and organizational goals on the other. It has also stressed that external factors play a crucial role in the development of these entrepreneurial forms. A first external condition is the evolution of markets and welfare systems towards service-led activities, which are often undertaken jointly with the delivery of social and personal services. A second external condition consists in the tighter financial constraints imposed by the public actor. Third, the crisis of many private firms opens up new possibilities for the development of social enterprises in the production of private goods and services.

Of course, the limitations of the production abilities of social enterprises should not be undervalued. Social enterprises are often disadvantaged in the accomplishment of large-scale production processes delivering standardised goods and services. They also incur more stringent financial constraints. Specialisation of work among different types of organizations should ensure that comparative advantages are respected in the creation of a new and vital sector of the economy lying in-between the public and the commercial sectors. Radical reforms of welfare systems have been recently envisaged in many countries, most prominently the reform of health care in the United States and elsewhere. Most reform projects have concerned social enterprises to varying degrees in the political arena as well. Given the strong social and political implications of these legislative endeavours, higher priority should be given to the study of these organizational forms.

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