Chapter 1.

Social Economy Organisations in the Theory of the Firm

by
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Social economy organisations are growing in number and relevance in advanced, developing and transition economies. Whilst their relevance for balanced social and economic development is now widely recognised, economic theory is not yet able to explain their existence properly, reducing it to the presence of market and state failures. The development of an explanation is attempted here in two steps: first, it is necessary to overcome the traditional paradigm of exclusively self-seeking individuals. Economic actors are motivated by a variety of preferences over and above purely extrinsic and monetary ones: on the one hand, relational and reciprocal preferences exert a major influence inside organisations, mainly in terms of procedural fairness; on the other hand, intrinsic and social preferences are often drivers of entrepreneurial activities. The second step is the consideration of a new conception of the firm, near to the evolutionary tradition, which sees production organisations as governance structures not geared necessarily to the maximisation of the net economic result (profit). Instead, the working of firms requires simpler economic sustainability and needs to take into consideration the motivations and needs, including the social ones, of all the involved actors, which, generally, are locally embedded.

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Introduction

Economic theory has devoted little attention to forms of enterprises, other than for-profit or investor-owned, and even less attention to the forms of enterprises not interested in making or maximising profits. The view of economic systems which result from the traditional approach is narrow and simplistic. By failing to consider organisations other than investor-owned ones, there is an underestimation of the contribution that these organisations can make to the functioning of the economy. Hence, two main inconsistencies on which mainstream economic analysis has so far relied upon can be identified. The first is the inconsistency between the exploration by economic theory of, mainly or solely, one typology of enterprise – namely the for-profit enterprise – and the economic reality, which has instead always been populated by enterprises characterised by different ownership assets (such as employee-owned, consumer-owned, farmer-owned assets and non-profit). More specifically, traditional economic analysis tends to consider investor-owned enterprises as the sole efficient form of enterprise, and alternative organisations as an exception doomed to be abandoned through the evolution of the economy and the completion of markets. As noted by Hansmann in his major work on the ownership of enterprise, economists tend to use the term "capitalism" to portray the overall system of economic organisations that may be found in advanced economies (Hansmann, 1996), thus ignoring the specificity and fundamental contribution by organisations that pursue goals other than profit to economic development. Two different trends deny these presuppositions: on the one hand, a recent growth in numbers and economic relevance of organisations pursuing goals other than profit; and, on the other hand, an increase in the number, and economic relevance, of non-profit organisations producing goods and services with entrepreneurial behaviour. Empirical evidence indeed provides confirmation of the persistence of not-for-profit initiatives and their re-emergence in countries where they have been historically persecuted and oppressed.

The second inconsistency refers to the incapacity of mainstream economic theory to explain the existence of enterprises that explicitly pursue a social aim, despite the fact that they are often recognised by law. They are a subset in the whole landscape of organisations pursuing objectives other than profits. However, their presence and diffusion signals a possibility that has always been excluded by traditional "invisible hand" explanations, that is that productive activity (and economic development) can also be sustained with allocation patterns not based on the mere exchange of equivalents. Beyond the traditional equilibrium based on self-seeking preferences and "unintended consequences" the explicit definition of a social aim is connected to the possibility of different allocative and distributive patterns, even if it does not exclude market exchanges *per se*.

Despite the disregard and incapacity of economic theory to explain organisational pluralism, increasing attention has recently been paid to a number of economic initiatives, which were little more than new expressions of the social economy, non-profit or third sector social enterprises. This can be seen, for instance, in the micro-credit initiatives that are spreading in both developing and transition countries to address the needs of impoverished people who are judged un-bankable by traditional credit institutions (Becchetti and Costantini, 2006), or of new forms of enterprises providing social and communal services and re-integrating disadvantaged people into the workplace. In these cases it is clear that something needs to be added to the traditional idea of market exchanges and equilibrium patterns (Borzaga and Defourny, 2001; Nyssens, 2006). Nevertheless, when dealing with similar phenomena, most economic theories limit themselves to recognising the buffer-role allegedly played by these organisations. Contrary to this constrained approach, an analysis of economic systems must include all the different typologies of economic organisations, where the differentiation on the basis of their social content is a qualitative matter that cannot be dealt with just on the basis of the presence/absence dichotomy. A more flexible scheme is needed that is more likely to put organisational typologies on a continuum, where at some point non-profit seeking organisations are also found.

Hence, this chapter will pursue a twofold goal:

- To understand both the rationale of enterprises whose objective is not the maximisation of the profit and the economic value of the organisation.
- To verify the relevance of the social content of the objectives pursued by non-profit seeking organisations.

This is ultimately aimed at grasping the potential of non-capitalistic organisations as vehicles for economic development, especially at a local level.

The fact that economic theory devotes little attention to enterprises that are not investor-owned, as well as to enterprises which pursue social aims, can be traced back to the underestimation of certain phenomena which have recently enjoyed more attention. In particular, such phenomena include the diffused presence of market failures that can be managed by these forms of enterprises; the systematic presence (demonstrated by experimental and empirical research) of behaviour that is not self-interested in economic agents, and; the capability of enterprises to co-ordinate the action of different agents and steer them towards the solution of specific, not solely economic, problems. All these facts seem to undermine the traditional conception of the firm as a mere profit-maximiser, and to support instead a wider conception that sees firms as governance structures geared to co-ordinating economic actors.

Firms display adaptive behaviour and their objective is not necessarily profit, but more generally the creation of economic and social surplus. They look for opportunities to survive and expand, usually at the local level, but in some cases at the national and international levels. The dynamic of the system is steered by their surplus creating ability, which does not refer exclusively to profit, but also the remuneration of other factors of production, to the welfare-increasing potentials for stakeholders other than investors, and for society at large.

Generally speaking, firms can be seen as complex economic actors and problem-solving mechanisms able to adapt to local conditions, which draw their survival and growth potential from localised knowledge and motivations, and embody stakeholders' contributions to firm operation. At the same time, for-profits move from a self-interested approach in which agents maximise only their revenues towards a new and more complex approach which considers the existence of, at least partially, not-self-interested behaviour that is characterised by greater fairness and reciprocity with agents that are not interested only in monetary remuneration. The latter reflects a number of key elements of firm organisation and is better able to explain the development of organisations characterised also by a social aim, which may be explicitly articulated in the organisation's statutes or articles of incorporation.

A definition of the field

Organisations different from investor-owned/for-profit enterprises cover a wide range of organisational forms, which are regulated in various way, usually by national laws. National differences exist as a result of these different legal forms. The socio-political and cultural environments, economic circumstances, and the different degrees of development, all explain the specific organisational forms, namely co-operative, associative and foundational forms, as well as the remarkable increase in commercial enterprise characterised by a social concern (Galera, 2004).

Often, the historical origin of these organisations clarifies their social role. Many co-operatives have been created in the presence of a concentration of market power in order to reduce the damage undergone by the weak stakeholder. Situations of monopoly on the labour or product market, or of rationing on financial markets, are often the basis of co-operative experiences. The existence of non-profit organisations is also usually traced back to the presence of market and state failures in satisfying the demands of social and collective interests, within the criteria of reasonable cost and quality.

The main legal frameworks regulating non-profit organisations are the following:

Associations

Organisations of this kind are the result of a free decision of a group of people who decide to join together to collaborate in seeking a solution to a specific social problem, for example, to advocate either against the market (such as consumer associations), or against the state (such as associations of people asking for welfare benefits and services). Associations can be either general-interest (the class of beneficiaries differs from the one of promoters) or mutual-interest organisations (solidarity among the members is decisive) (Evers and Laville, 2004). These organisations have a variety of names (associations, voluntary organisations, non-governmental organisations, charitable institutions, etc.) in different countries. In countries where associations have been characterised mainly by advocacy and idealistic purposes (such as in Italy, Spain and Germany) they are often prevented from carrying out economic activities in a stable and continuous way. In countries where associations are allowed to produce and sell goods, they have increasingly turned into welfare providers (for example in France, where the associative form is committed to the provision of social and health-care services).

Foundations and trusts

Foundations and trusts are entities underpinned by an endowment from an individual or a group of people, often with the financial support of public bodies and private companies. Their aim is to accomplish specific goals decided by the founders, either for the benefit of a specific group of people or for the community at large. They developed mainly in Anglo-Saxon countries and are, above all, committed to the patronage of social, religious and educational activities, as well as general-interest activities. The main classification is between operating foundations and grant-making foundations. The former pursue their goals through the execution of activities; the latter are committed to grant support for the activities of other organisations.

Co-operatives

Co-operatives are enterprises where ownership rights are assigned to a specific category of agents other than investors (consumers, workers, or producers). They were historically capable of enhancing the ability of certain groups of people to protect their own interests and improve their standards of living. Under the co-operative heading various initiatives that are not explicitly called co-operatives, but which adopt closely related rules and practices may be included (for example, the Spanish *sociedades laborales).* Co-operative organisations developed in different sectors almost everywhere. Traditional co-operatives are mainly committed to members' promotion, while new co-operative forms are devoted also to the pursuit of general-interest goals (for example, the Italian social co-operatives, French *société cooperative d'intérêt collectif,* and co-operatives of social solidarity in Portugal).

Mutual aid societies

Mutual aid initiatives can be likened to a special case of co-operative organisations since they are owned by clients that are usually users of the services of the organisation (like mutual insurance). They were launched in the early nineteenth century to insure workers against work disability, sickness and to make provision for old age.[1] With the introduction of public compulsory insurance schemes, mutual societies were marginalised or institutionalised. Recently, new mutual aid societies have emerged in areas where public insurance schemes did not spread.

Whereas the associative form is equally widespread in civil and common law systems (although with changeable roles, such as advocacy in some cases and productive activities in others), other organisational forms show a more specific geographical diffusion. Foundations, charities and trusts are mostly found in the USA, the U.K. and Australia; whereas co-operative organisations and mutual companies have a stronger tradition in continental European countries. These organisations all pursue a goal other than profit; what distinguishes them are their specific organisational characteristics. The non-profit distribution constraint characterises foundations; member participation and a democratic nature are distinct features of both associations and co-operatives.

As far as co-operatives go, they can be regulated as for-profit or non-profit organisations. A main difference can be found between a number of European co-operative systems and the system in the USA. In Italy, for instance, co-operatives are regulated as quasi-non-profit organisations, whereas in the USA co-operatives are not regulated by any special legislation.

The aforementioned differences hamper the adoption of a common definition encompassing all these types of organisations acceptable at an international level. Different attempts have been made to define this multiplicity, including the following:

- In the USA the "non-profit" concept[2], is centred upon the criterion of the non-profit distribution constraint that underlines the American configuration of the sector. Attention has been paid mainly to organisational forms, other than co-operatives, especially foundations.
- In Europe the "social economy" concept has traditionally been focused on both associations and co-operatives. This approach has taken an analytical perspective which mainly considers organisations' modes of action like participation, democracy, centrality of the members' needs (Evers and Laville, 2004)[3].
- In scientific literature the "third sector" concept (or, by the EU commission, the "third system") serves to overcome the differences between the many national models and to distinguish those organisations from publicly owned (the "state") and private for-profit (the "market") ones.

The two definitions mainly used in Europe and in the United States – social economy and non-profit sector – reflect different rationales. The institutional and normative approaches contributed to shaping the social economy concept, whereas the non-profit definition relies on tax exemption. Both approaches show a number of deficiencies, owing to their tendency to exclude some specific organisational forms from the realm of those taken into consideration.

Nevertheless, the current trend is towards a general convergence of the two approaches that have been recently favoured by structural changes and by the influence exerted by each tradition on the other one. It seems possible to utilise a unifying term for a concept capable of comprising the multiplicity of these organisations. Social economy is an appropriate term, for it is more comprehensive (it includes co-operatives) and underlines the productive aspect (it includes the term "economy").

Moreover, social economy organisations used to be defined in the negative as "not-for-profit" organisations, underlining the exclusion of the profit motivation. However, the negative definition is too narrow and incomplete. The main difference between social economy organisations and for-profit enterprises is the overall aim of their activities, which in the case of social economy organisations has an explicit social dimension, rather than simply the pursuit of profit, and its distribution to owners, being the ultimate goal.

Roles and evolution of social economy organisations

The development of initiatives characterised by a new entrepreneurial spirit focused on social aims has recently contributed to the scientific and political debate on the social economy. Nevertheless, the social economy and the actors inside it have not yet reached a stable role and dimension (OECD, 1999). Indeed, a limited understanding of both the role played by these organisations, and their economic potential, still prevails.

As already emphasised, not all social economy organisations have an economic interest. The roles displayed can range from advocacy to income re-distribution or to production of goods and services. The advocacy action can be either directed at the state (normally welfare institutions), or at the market (as it is in the case of consumers' associations), whereas the re-distributive role (of monetary resources and others), which is especially displayed by foundations, allows for the collection and exploitation of resources which would not otherwise be allocated to public-benefit issues. The productive role consists mainly of the provision of communal services, often allocated to people unable to pay, as a result of donations, volunteers and public financial support. In the case of the advocacy or re-distributive roles, the most common organisations are traditional non-profit ones (especially voluntary organisations, associations and grant-making foundations). Whereas the productive role has been traditionally covered mainly by co-operative organisations, especially in contexts in which they are constrained profit distributors, although foundations, associations, and non-profit companies may also play this role to a lesser extent.

These three functions are not mutually exclusive; an organisation can indeed cover more than one function. Nevertheless, the trend is towards specialisation, specifically in consideration of the high costs connected with the management of different functions and the internal conflicts that can be generated. Until the 1970s, political organisations (such as trade unions, professional associations, local community groups, political parties and movements for human rights) were proportionately more important than social organisations operating in the economic area (organisations that provide social and personal health services, recreation, entertainment, etc.). In contrast, the former have increased much less than the latter in recent years (Schmitter and Trechsel, 2004). According to Schmitter and Trechsel, there is reason to believe that "traditional" organisations representing the interests of specific groups are merging and therefore decreasing in number. In this view, the dynamism can only be coming from entrepreneurs committed to new interests such as the production of cultural, educational, social and recreational services. Moreover, the increase in "unconventional" collective action by environmental, human and animal rights, feminist, anti-globalism and democracy movements – such as protests, petitions, boycotts and demonstrations – have transcended the boundaries of national policies (Schmitter and Trechsel, 2004).

This evolution in the role of organisations consists, on the one hand, of the shift of associations and foundations towards a more productive and entrepreneurial stance, resulting from the engagement of those organisations in the direct production of goods and services. This shift has assumed different patterns in different countries, depending on the role previously played by the sector, its size, and its relationship with the public sector (Bacchiega and Borzaga, 2003). On the other hand, a parallel evolutionary trend has involved co-operatives. Traditionally, the co-operative solution has been strongly related to the conditions of disadvantaged groups, such as in response to the needs of workers, consumers, and craft workers (Monzòn Campos, 1997; Borzaga and Defourny, 2001). This common condition of necessity induced groups of citizens affected by similar needs and interests to gather in order to find a common solution to a shared problem. This explains the creation of single-stakeholder co-operatives.

From the 1970s on, the change in the socio-economic conditions of advanced economies contributed to transforming the context in which the co-operative movement developed (Demoustier and Rousselière, 2005). The completion of markets gradually rendered the existence of co-operative organisations in a number of traditional fields less pressing than in the past. Moreover, the emergence of new needs which the market and the state have not satisfied has prompted the co-operative expansion into new fields of activity. This move stimulated the development of new co-operative models, characterised by the mixed nature of its membership, which are more suited to the production of welfare services (Borzaga and Mittone, 1997) and more similar to non-profit models.

Because co-operatives are progressively less centred on the interests of the members, and associations and foundations are becoming more entrepreneurial, traditional co-operative and associative models have begun to draw together. Furthermore, the peculiarity of the traditional co-operative solution started to re-emerge in transition countries, following 50 years marked by an approach that turned co-operatives into quasi-public enterprises. These developments stimulated the regrouping of the major traditional actors of the social economy, in addition to the diversification of approaches to understanding the nature and role of these organisations. In this respect, the new concept of the "social enterprise" has developed to encompass these changes.

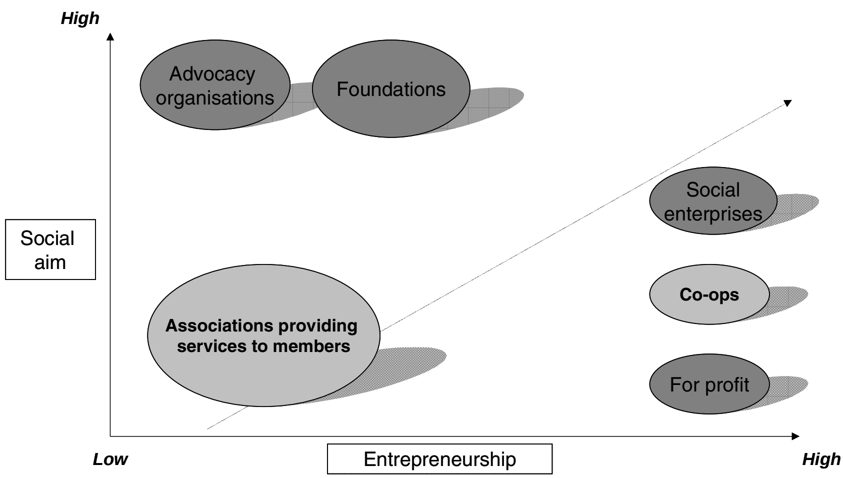
The definition of social enterprise, which refers to both newly created and existing entrepreneurial organisations with a social dimension (Borzaga and Defourny, 2001), has come into use to distinguish the entrepreneurial forms characterised by a relevant degree of public benefit connotation from more traditional non-profit organisations. Social enterprises, which began to develop in the 1980s, are not normally engaged in advocacy activities as a major goal or in the redistribution of financial flows, rather they are primarily involved in the production of goods or the provision of services to people on a continual basis, with a social aim and normally with a non-profit distribution constraint.

In conclusion, considering the marked differences amongst organisations (in terms of goals and economic value of the activities carried out) a classification synthesised along two different axes is provided (Figure 1.1). This classification allows for the positioning of social economy organisations also in relation to for-profit organisations:

- The horizontal axis measures the level of entrepreneurship from low to high: some of these organisations carry out entrepreneurial activities, even if they are not-for-profit; others pursue different functions, such as the aggregation of preferences and needs, re-distribution and advocacy.
- The vertical axis, from low to high, signals the degree of social vocation by ordering the organisational goals from mutual to public benefit: some not-for-profit organisations benefit the founders and the owners, providing them with goods and services, whilst others benefit people or groups, excluding the founders; a combination of the interests of founders/owners and external individuals may be found in still others.

The recent tendency shared by most not-for-profit organisations is to move right up toward a higher intensity of both entrepreneurship and social content. From a dynamic perspective, associations and foundations tend to strengthen both their entrepreneurial approach as well as their commitment towards the pursuit of general-interest goals. They do this as a result of the production of a wide range of services (hence the move right-up); co-operatives tend to move from the pursuit of the interests of members to the pursuit of more general-interest goals when they provide services also to stakeholders that are not part of their membership. For-profit enterprises are positioned on the bottom-right side of the graph, as they are characterised by a high level of entrepreneurship and self-interest orientation, aimed at benefiting shareholders. Nevertheless, the integration of social and environmental concerns in their business operations, resulting from new social and market pressures, tends to enhance their social responsibility. (Hence, the adoption of corporate social responsibility practices by for-profit enterprises and of accountability schemes by the managers of enterprises to their stakeholders).

Figure 1.1. Classification of social economy organisations



The framework resulting from the intersection of the aforementioned axes, complex in itself, is rendered even more varied by the different national and regional cultures and traditions that have contributed to shaping different approaches (Borzaga and Defourny, 2001). This evolutionary pattern, signalling the endorsement of a more and more pronounced economic and productive role, requires a renewed theoretical elaboration directed at providing a sound interpretation of this phenomenon.

The functioning of social economy organisations

To understand the functions of social economy organisations it is useful to clarify the principles on which they are based and how they are organised. The pursuit of public interest objectives determines organisational principles, and social economy organisations differ from for-profit firms in at least four respects.

Firstly, the founding aim (the principle underlying the start-up of social economy initiatives) is a response to an emerging need in society. Many organisational forms have appeared during the last two decades as a response to new social needs linked to the crisis of traditional family and social ties and to the difficulties public welfare institutions have in answering some of these needs. From the 1970s onwards, local groups and social activists gave rise to social economy initiatives mainly to serve the needs of the wider community. Examples include France's companies specialising in labour market re-entry, special-interest associations and local neighbourhood councils; Italy's social co-operatives and social enterprises; Germany's employment and training corporations; Belgium's on-the-job training companies and workshops; the United Kingdom's community businesses and community interest companies; and, Canada's community development corporations (Borzaga and Defourny, 2001; Nyssens, 2006). Common social, political and ideological goals can contribute to different extents to enhancing collective identity and the cohesiveness of a group. More specifically, a number of experiments – primarily of the co-operative type – have often been part of vast politically inspired undertakings (Defourny, Develtere and Foneneau, 1999).

Secondly, the presence of allocation principles based on solidarity and reciprocity. As already emphasised, social-economy initiatives operate at least in part according to the principle of solidarity and reciprocity. Therefore, exchanges among different agents also take place when the exchange does not comply with an equivalence relation. This aspect characterises social economy organisations as opposed to for-profit enterprises that are, in contrast, structured so as to prevent third parties from gaining net advantages and to ensure the allocation of the residual gain to the owners. Through social economy initiatives, social relationships based on a non-contractual principle of economic action are established. The exchange, which results from this allocation system, generates benefits also in favour of beneficiaries external to the owners. Hence a distributive function is displayed (Bacchiega and Borzaga, 2003).

Thirdly, the inclusion of participation modalities and a democratic decision-making process in the organisational structure. Democracy in the decision-making process refers theoretically to the rule of "one person, one vote" as opposed to "one share, one vote", or at least to a strict limit on the number of votes per member in self-governing organisations. This principle implies the primacy of workers or consumers over capital. Only foundations – less dynamic in recent years – do not adhere to this principle. By contrast, new organisations tend to enlarge the participation by a multi-stakeholder membership.

Fourthly, a plurality of resources. Operating differently from for-profit and public organisations, social economy organisations must rely on different sources of revenue originating from the market, non-market and non-monetary economy. In other words, social economy organisations generally rely on a mix of paid and volunteer human resources and on a mix of financial resources generated by the sale of goods and services, by public support (in the form of contracts, fiscal advantages and direct subsidies) and by private donations (Evers and Laville, 2004).

Since social economy organisations follow these principles, they and their recent development are widely acknowledged as an effective way to channel social creativity and to enhance democracy, as they have been proven to contribute to innovative service delivery and social cohesion enhancement. Social innovation initiatives have been shown to be particularly suited to addressing new and urgent social concerns affecting a number of vulnerable social categories. Moreover, they have also contributed to giving shape to the aspirations of social movements (for instance environmental groups and feminist movements). Empirical studies provide evidence of the dimensional growth of social economy initiatives in many European countries (Demoustier and Rousselière, 2005). From a political perspective, social economy organisations have proven to be successful in promoting new forms of local democratic participation and empowerment, owing to their capacity to contribute to a participatory democracy wherein citizens can actively express their commitment to economic and social development and civic life in their country.

What is still controversial is the economic rationale of these organisations. Hence, the need for an explanatory key, capable of grasping on the one hand the economic strength and potential of organisations placed in this category, and explaining, on the other hand, the different roles played by these organisations in the economic system.

After the description of social economy organisations' features, it is now time to ask if economic theory is able to explain those features. To understand the economic role played by organisations explicitly pursuing a social goal, such as social economy organisations, one should introduce two extensions with respect to the mainstream approach. They concern the theory of the firm and the interpretation of economic behaviour and will be presented in the following sections.

The social economy and the evolution of the economic theory of the firm

Until 20 years ago, economic theory described firms as production functions aimed at maximising profit; there was no room for the explanation of these organisations. It claimed that social economy organisations, such as co-operatives and non-profits, had a marginal and residual role in market economies. This point of view was supported by counterfactual deductive results, such as in the case of the Ward (1958) model for co-operatives. However, counterfactual results have never been supported by empirical evidence (Bonin, Jones and Putterman, 1993) and the residual role of social economy organisations is an assumption that lacks empirical confirmation.

A synthetic review of the literature so far will contribute to a new and more comprehensive perspective. The first step in reconstructing a theory of social economy organisations was made possible by the development of new institutional economics and the transaction costs theory (Williamson, 1975; 1985). The development of the theory of the firm within the realm of new institutional school can be traced back to Coase's 1937 article "The Nature of the Firm" and was subsequently developed by Alchian and Demsetz (1972) and Jensen and Meckling (1976; 1979). Starting from standard assumptions on maximising behaviour by self-seeking individuals, it tries to "open the black box" constituted by the conception of the firm as a production function and to explain in positive terms the reasons why hierarchical organisations (firms) constitute a better solution than market exchanges on efficiency grounds. Coase (1937) points out that market transactions are not necessarily the most efficient way to co-ordinate agents interested in a particular transaction. He shows how, in a number of cases, it should be preferable to replace markets with a complex organisation. Production inside a hierarchical organisation may incur lower total costs than market costs (transaction costs), justifying the abandonment of free exchanges.

Different authors developed this intuition further, albeit in different directions. Alchian and Demsetz (1972) ascribe the major motivation underpinning the creation of firms (which they identify with for-profit enterprises), to problems connected with the assessment of individual effort in teamwork and the connected spread of free riding. Teamwork may be the most efficient solution when production processes are not divisible. However, it becomes possible only when adequate controls are put in place. In order to prevent controllers from free riding, they should be given the right to gain the residual earnings, spurring their willingness to run the firm efficiently. This incentive is at the heart of property rights, which assigns the right to take strategic decisions and to decide on all the other non-contracted issues, like the destination of its benefits, to a strict minority. In this sense, the assignment of the ownership of the enterprise to investors is implicitly the most efficient solution. Consequently, social economy organisations will find no room to strive and prosper.

Further developments of the theory of the firm came with the property rights school, which deepened the understanding of the role of ownership in defining incentives for economic actors and in supporting efficiency.

Authors such as Grossman and Hart (1986), and Hart and Moore (1996) focused on the causal relation between factor specificity and ownership rights. Ownership rights are assigned to the most specific factor, which, were it not the controlling factor, would be the most likely to undergo morally hazardous behaviour by the other factors of production, since it is the least likely to leave the firm.

The recognition of ownership rights as a pillar in the study of the nature of the enterprise was the starting point of a new theoretical scheme, which was capable of explaining the emergence of different kinds of enterprises in market economies. In this respect, the approach mainly linked to Hansmann stands out. His model, put forward in *The Ownership of Enterprise* (1996), starts from the acknowledgement that the sum of transaction costs (the costs of contracting with non-controlling stakeholders plus the costs connected with the ownership of the firm) defines the emergence and the relative survival rate of different organisational forms in market settings. Surviving organisations incur lower total costs (a brief technical overview of the Hansmann's scheme is in Appendix A).

In this way, the new institutional tradition delivered the most relevant interpretations of the nature and role of firms operating in the social economy. In Hansmann's view, organisations, other than for-profit enterprises, emerge because they are able to minimise costs more efficiently, reaching a superior second best solution. The emergence of co-operatives and non-profits happens because of efficiency criteria. Hence, the Hansmann model emphasises a peculiar mode of organising production, which can be the most efficient when a number of conditions occur. These conditions relate to the level of development of markets and their failures, as well as to the typology of incentives required to render exchanges efficient.

However, in Hansmann's view, the role of social economy organisations is supposed to lessen when markets become more competitive and failures become less frequent, since in the absence of market failures the only organisational form considered capable of reaching efficient solutions is the for-profit firm. Therefore, co-operatives and non-profits are considered transitional organisational forms, which spread when market imperfections are sufficiently severe and tend to disappear when market exchanges are better regulated and competition tends to become perfect. The reason is to be found mainly in the high grade of complexity, which characterises their decision-making processes (Borzaga and Tortia, 2006). Governance costs are low only when members have homogeneous preferences, but this condition will not suffice in the general case, and will stand as an exception. Generally, co-operatives and non-profits are characterised by higher governance costs than for-profit enterprises, incurring a conspicuous competitive disadvantage. Firms operating in the social economy can succeed in reaching high efficiency standards only when the stakeholders of the enterprise share homogeneous characteristics and preferences, this being due to the lessening of ownership costs. Whilst, on the contrary, capitalist members in for-profit enterprises have more homogeneous and well defined objectives (mainly profit) and are able to reach quicker and effective decisions.

Hansmann's theory succeeds in explaining the birth and development of a relevant number of co-operatives and non-profit organisations, highlighting their ability in specific cases to minimise the costs inherent in market contracting and ownership. Nevertheless, his analysis is not exhaustive, for it is not capable of explaining social economy evolution at least with respect to the last two decades. His investigation fails indeed to explain the revitalisation of co-operative social commitment and the efficient and competitive development of some co-operatives and co-operative groups, which were born within contexts of market failures. Moreover, when applied to traditional experiences, this approach fails to explain the development of those co-operatives and non-profits driven by idealistic and ideological motivations, and not simply prompted by severe market failures.

Another critique of Hansmann's approach is that organisational forms tend to be taken for granted and the importance of organisational dynamics is underplayed. The only criteria taken as relevant in explaining organisational survival are market exchanges but this seems to be a limited perspective since the plurality of organisational objectives and actors' motivations deserves a far richer picture than that which Hansmann offers.

Furthermore, his conclusions are denied by a number of limitations inherent in for-profit, investor owned enterprises which cannot be simply overcome by the completion of markets. The possibility to discriminate over prices is one example, since, in the presence of asymmetric information, it will be made possible only by the strong involvement of the beneficiaries and clients in the management of the enterprise (Borsio, 1982).

Hansmann also understates the fact that co-operatives and non-profits can show superior characteristics of efficiency connected to the nature of the production process implemented, even when product and factor markets do not show pronounced imperfections, as it happens when labour is the strategic and most specific factor of production (such as in professional partnerships).

The existence of organisations characterised by the non-profit distribution constraint derives from the existence of market failures due to the presence of asymmetric information on the product market according to Hansmann. Non-profit organisations would be better able to reinforce trust relations with their clients in the presence of market failures than for-profit firms. However, Hansmann never comes to terms with the possibility that the actors governing non-profits, but also co-operatives, are led by motivations other than self-interested ones. In many cases, asymmetric information can be counteracted by reputation and the non-profit distribution constraint is an imperfect indicator of the firm trustworthiness. Indeed, it is not able to halt morally hazardous behaviour, for example, by managers and workers. An improvement of the explanation of the existence of social economy organisations must focus on internal agency relations (Borzaga, 2003).

Labour contract incompleteness is particularly evident in the sector of social services, where social economy organisations usually operate. The relational and non-standardised nature of services provided requires worker involvement and makes hierarchical control and monetary incentives ineffective. Worker participation and autonomy can improve service quality. The social nature of social economy enterprises, and the presence of the non-profit distributing constraint, would allow a different form of worker involvement that is based on the limitation of hierarchical control and of the weight of monetary incentives, which are dominant in more traditional organisational forms like for-profit ones. It is clear, however, that the distinguishing elements are not found in asymmetric information, but in the particular characteristics of the services provided: multidimensionality, high relational intensity, and labour contract incompleteness (Borzaga, 2003).

These features are hard to define as mere market failures insofar as they simply define a specific class of services. The completion of markets does not seem sufficient to ensure the dominance of for-profit firms. More fundamentally, the spread of non-profit organisations in sectors in which for-profit firms do not reach efficient solutions shows the emergence of "not-for-profit" markets, justifying the ontological distinction between the very concept of "the market" and the for-profit firm (Zamagni, 2005). This is why it is necessary to improve the explanation of the reasons why social economy organisations emerge, and why they are able to reach efficiency and counteract free-riding and moral hazards. The new institutional theory of the firm is deficient insofar as it does not take into consideration non-self-interested behaviour and motivations other than purely egoistical ones. It is not able to go beyond the assumptions in which the for-profit economy is founded.

Important contributions to the theory of the firm, which can be used to understand social economy enterprises, came also from the evolutionary stream. Starting from the pioneering works by Penrose (1958), Cyert and March (1963), Simon (1951), and Nelson and Winter (1982), the evolutionary stream stresses the importance of bounded rationality, routines and dynamic capabilities as the crucial elements supporting organisational evolution, survival and competitive potentials. This research tradition views the firm as a problem solver, adapting itself to the environment in order to increase its survival potentials. The stress put on the necessity to develop adaptive capabilities is worth mentioning, since it opens the door to the study of organisational embeddedness and local development. The localised character of knowledge and dynamic capabilities prevents firms from maximising overarching objective functions, but allows them to define their survival niche, that may not be endangered by intense national and international competition. Hence the maximisation of profits and the minimisation of costs are not necessary any more as objectives of the firm. Survival is the key explanatory concept, but the objectives may differ in different kinds of organisation, and the production of economic and social surplus is compatible with very different degrees of net surplus (profits) and costs.[4] Embeddedness (Granovetter, 1985) and localised knowledge (Polanyi, 1967; Antonelli, 1999) become cornerstones in the explanation of why new organisational forms can strive and spread even when they undergo severe competition by traditional forms. This side of the firm behaviour was hardly ever taken into consideration by traditional theories of the firm. It constitutes a research field still in its infancy, whose development potentials are important.

A further consequence is that the choice between different organisational forms is more complex than what is granted by transaction costs theory. Cost minimisation is a crucial criterion, but market failures are not the only factor explaining the emergence of co-operatives and non-profit organisations. In many instances, different potentially competitive solutions are available. Organisational objectives, product characteristics, factor specificity, scale and governance arrangements play a central role. Therefore, organisations need to be autonomous in their choice of the best solutions to pursue their objective, keeping in mind that stakeholder preferences cannot be outplayed from economic explanations. Survival can be explained by different criteria, which favours the complexity of institutional and organisational evolution. Different organisational forms can work out different modalities favouring survival potentials. Hence, different organisational forms will develop different incentive mixes suitable for the pursuit of their own specific goals (Bacchiega and Borzaga, 2001; 2003).

This more complex and flexible vision, putting surplus production centre stage, focuses on production objectives, actors' motivations and governance forms far more than traditional approaches. A new perspective is thereby developed which accounts for the existence of social economy enterprises. However, it needs to be complemented by further critical reflections on the traditional economic approaches. The characterisations of the economic agents participating in entrepreneurial ventures have to be deepened, highlighting their motivational complexity, which cannot be reduced to the influence of monetary incentives. The role of monetary incentives itself needs to be better defined and put in the right context in comparison to other typologies of motivation. The motivational complexity then needs to be studied in relation to the governance of the organisation and the nature of the production activities that are carried out (for example, commercial versus social and/or welfare activities).

Social economy organisations and the relevance of not-self interested motivations

Traditional economic explanations of the existence of complex organisations such as firms, including the one provided by Hansmann and by a part of evolutionary economics, are all based on the assumption of self-seeking individuals. This approach used to be criticised by other disciplines outside economics, and more recently also by experimental economics. Recent developments in economic analysis have started to overcome this major limitation. The inception of the change was triggered by experimental developments (Fehr and Schmidt, 2001) concerning, for example, the ultimatum game[5] and the investment game[6], but also many other experimental settings, and showing that the traditional assumption of self-seeking individuals is utterly unrealistic. Human behaviour is driven not only by the aim to maximise expected utility without any regard to the rules of the game and to the fairness of realised results. Rules exert a crucial influence on results, and a high percentage of players put a very high value on the equity of outcomes. Self-seeking behaviour appears to be a special case, rather than the rule followed by the individuals, and actual outcomes of strategic interaction are hard to predict at the micro-level, showing important variations also when pooled at the population level. Different conceptions of procedural and distributive justice can lead to different outcomes. Culture plays a crucial role as well since the same experiments, most typically the ultimatum game, lead to substantially different results in different ethnical and cultural environments. Given these new robust results, the premises of the traditional economic theory and the theory of the firm seem to be either ill-grounded or at the very least too restrictive.

A new and rich theoretical literature was born with experimental results and the interpretation and rigorous explanation of them. Theories concerning fairness and reciprocity tried to explain fair behaviour based on altruism (Becker, 1974), psychological games and kindness (Rabin, 1993), and inequity aversion (Fehr and Schmidt, 1999). More recently, other authors (Grimalda and Sacconi, 2005) described ethical preferences as conformism to an ideology or a code of conduct. The acceptance of a certain set of rules will have relevant behavioural consequences only if actors expect other players to comply as well. A further and more traditional stream of research focuses on the prescriptive nature of moral norms: the Kantian categorical imperative underpins moral behaviour, which can overcome inferior Nash equilibriums and reach Pareto-optimal outcomes (Sen, 1977).

Indeed, a long list of contributions in economics have tried to explain why experiments modelling the ultimatum game and the prisoners' dilemma often see the players co-operating, while traditional economic theories predicted non-cooperative behaviour, as represented analytically by the Nash equilibrium.[7] On the one hand, the Kantian argument, based on the idea of the categorical imperative that would induce the agents to co-operate also in one-shot games when it would not be in their interest to do so, is one possible solution. On the other hand, the concept of reciprocity helps as well: people co-operate even when it is not in their interest to do so if they expect the other interacting party to co-operate as well. Free-riding when the other party co-operates would inflict a moral cost that can be more painful to bear than the simple economic cost. Hence, it does not come as a surprise to find many players in experimental settings who punish free-riders even when this strategy is costly to them, Pareto inferior in terms of traditional economic theory. The inability of traditional theory to explain actual economic behaviour requires a restart in the study of individual behaviour.[8]

A first synthesis of the new results is found in Ben-Ner and Putterman's (1999) description of individual behaviour as led by three different types of preferences: self- regarding, other-regarding and process regarding. *Self-regarding preferences* characterise the self-seeking economic individual; they concern the individual's own consumption and other outcomes. *Other-regarding preferences* concern altruism and the identification between individual motivations and aims with collective or social aims. *Process-regarding preferences* concern the manner in which the individual in question, and others, behave, including the way in which they attain outcomes of interest. Process regarding preferences may be thought of as values or codes of conduct. Individual preferences and behaviour co-evolve with organisational processes: organisations cannot be thought of without an individual initiative, actions, participation, compliance, etc.. At the same time, organisational values mould individual behaviour and influence preferences. The emergence and sustainability of institutions grows with the degree of matching between individual motivations and organisational behaviour and aims. Indeed, the stricter the correspondence between individual preferences and organisational objectives the higher the probability of survival and dissemination. Also institutional design can help improve the correspondence between individual motivations and institutions that mediate organisational behaviour. Even if it is not possible to predict the overall systemic equilibrium induced by new institutions, equilibrium will be reached thanks to the "invisible hand" of social processes, while individual initiative and explicit design will set new starting conditions.

This strand of the economic literature is relevant for the development of the theory of social economy organisations also because it was linked to the study of non-profit organisations. The relevance of intrinsically motivated and ideological agents in the setting-up of non-profits has been examined by Rose-Ackerman (1996) and by Young (1983, 1997). They deepened the role of ideological motivations in non-profit entrepreneurship highlighting the features of many initiatives with a clear economic content, but harshly at odds with the more orthodox economic doctrines. At the empirical level, the role of not-self-interested motivations has been evidenced by various contributions which have taken into consideration both non-profit organisations and for-profit firms. Leete (2000) shows that wage dispersion in American non-profits is much lower than in for-profit firms, though the average wage level is similar between the two ownership forms. Benz (2005), studying both the American and the UK economies, shows that workers in non-profit organisations are on average more satisfied than workers in for-profit firms.

Toward a new explanation of social economy organisations

These developments, concerning the theory of the firm and organisational behaviour, together with the richer description of individual motivation, can support a new conception of the firm able to explain satisfactorily the emergence of social economy enterprises. It relies on the idea of the firm as an *incentive structure*. An incentive structure can be defined as a mix of constraints and rewards offered to the relevant stakeholders of the organisation. Constraints can be established by law and differ according to the legal form adopted, or they can be voluntarily determined by the organisation itself. Rewards may be of different kinds: economic and non-economic, monetary and non-monetary. In this context, incentives are not understood only in the classic way, as a way to induce agents to follow the decisions of the controlling group even when they are moved by contrasting interests. Instead, incentives, which can be monetary but also non-monetary such as in the case of participation, can also be viewed as supporting co-operative attitudes like the ones that clearly emerge from the new experimental and theoretical literature. Fairness can be interpreted as meta-criteria, or a synthesis of the different incentives, which serves to measure the "goodness of fit" of the organisational setting with respect to individual motivations and objectives, and with respect to their interaction. According to this view, different incentives, both monetary and non-monetary, act together in creating an organisational setting that is perceived to be fair by the actors involved. This way, increased well-being (Tortia, 2006) favours the spontaneous acceptance of the organisations' goals and proves effective in reducing the risks arising from asymmetric information and opportunistic behaviour.

Organisational forms differ because they are characterised by different goals and, as a consequence, by different incentive mixes. For-profit enterprises tend to stress the importance of monetary rewards and need a hierarchical organisation in order to implement them, while co-operatives and non-profit organisations derive their strength from the social goal pursued, inclusiveness, and the democratic nature of the governance structure. Relational and intrinsic components of the incentive mix are added to the more traditional – extrinsic and monetary – ones. Different ownership structures and organisational goals tend to attract agents driven by motivations coherent with organisational objectives. At the experimental and theoretical levels, economists have studied a wide array of different incentive structures. For example, hierarchical relationships and monetary rewards have been studied in the milieu of ultimatum games and gift-exchange games[9], while democratic and flat governance structures often pose problems near to the private production of collective and common goods. In this case, public good games, prisoners' dilemmas and trust games are used in experiments to understand the conditions for the sustainability of co-operation in the short and in the long run (*i.e.* in one-shot versus repeated games). In general terms, experimental results are coherent with the new conception of the firm defended in this study, since co-operation, fairness and reciprocity are widespread features of the final outcomes, contradicting the individualist paradigm of self-interested individuals that would more often lead to non-cooperative results. Also, some empirical studies have led to important results favouring the same conception of the firm.

Organisational behaviour cannot be studied at the experimental level, but important results have been reached by means of surveys specifically designed to study incentive mixes used by different organisational forms. Happiness research has demonstrated that self-reported satisfaction scores and other subjective evaluations can be used as a proxy for the performance of organisations in affecting (improving or decreasing) the welfare of stakeholders directly linked to its operation (such as workers, managers, clients and donors) (Oswald, 1997; Frey and Stutzer, 2002). This methodology was applied in various research concerning non-profit organisations. In this context, the behaviour of non-profit managers and volunteers and donors represented a new and fruitful field of enquire (Marino, 2003; Marino, Michelutti and Shenkel, 2003; Cafiero and

Giannelli, 2003). Volunteers' motivations show a high level of complexity too, where idealistic motivations co-exist with more self-interested objectives. Some of these studies analysed managerial pay structures, finding quite strong differences between managers of different ownership forms. The lowest paid were managers in non-profits who were not, however, less satisfied than those equally ranked in other organisational forms.

With regards to workers, data from the Italian social service sector evidenced a lower wage level, but this result may be due to the younger average age of non-profit organisations, first and foremost of social co-operatives. When workers' motivations, incentive mixes, and well-being are taken into consideration, the recent results go in the direction that is being highlighted. Borzaga and Depedri (2005) and Borzaga and Tortia (2006) worked on a dataset concerning the social service sector in Italy. Self-reported worker satisfaction scores were used to proxy the incentive structures put in place by different organisational forms (public, non-profit, and for-profit). Worker satisfaction was also influenced by elements different from monetary rewards. Self-regarding objectives are an important component of individual satisfaction, but other-regarding objectives, the processes of decision making and individual growth played a crucial role as well. The fairness in the distribution of resources and in the procedures followed appeared to influence crucially the organisations ability to motivate its members and employees, and to improve performance. They show also that the incentive structures and control modalities found in social economy organisations (social co-operatives and other non-profit organisations) are different from those adopted by for-profit enterprises and public bodies. Co-operatives and non-profit organisations base their incentive structure on intrinsic and relational aspects, together with a focus on democracy and involvement in the governance structure of the firm. For-profit firms seem to privilege professional growth and incentive schemes based on monetary incentives and career advancement. Public bodies rely instead on monetary incentives, while involvement processes appear to be weak. Overall, workers in non-profit organisations and co-operatives are the most satisfied, even if differences with for-profit firms are not strong in many dimensions, while workers in public bodies are the least satisfied, and negative differences are often conspicuous and significant. Finally, Tortia (2006), working on the same dataset, shows that the perception of fair procedures is the main determinants of well-being at work, implying a relational component in worker well-being that is absent in traditional economic theorising. Perceived procedural fairness is higher in social co-operatives than in the other ownership forms. More traditional non-profit organisations (foundations and associations) show values of perceived fairness that are in between the ones of social co-operatives and for-profit firms, while the public sector records the lowest scores.

A second important finding was that workers' overall satisfaction with their job was crucially influenced by their motivation. More motivated workers, mainly at the intrinsic and relational level, are more satisfied with their job, while workers driven by mere economic motivations tend to be less satisfied. The motivational factor therefore emerges as crucial in defining the relation between the worker and the organisation. Incentive mixes are more likely to be successful when workers are driven by motivations coherent with the firm objectives and mode of operation. However, the results concerning motivation cannot be generalised, since workers in the social service sector are likely to be driven by motivations that are markedly different with respect to other sectors. The low wage level is likely to frustrate economic motivations, while intrinsic motivations, and the social character of the firm, strengthens relational motivations.

Good incentive mixes are likely to strengthen the relationship between the workers and the organisation: workers satisfied about the way the firm behaves tend to be more loyal. In this field, the key variables appear to be connected with relational aspects, worker involvement and remuneration. The overall emerging picture is that intrinsic motivations are important in attracting workers towards a specific organisation, making them "happier" about organisational behaviour, but are not sufficient to make them more loyal if other, more extrinsic elements, such as pay levels, are not satisfactory.

In addition, perceived fairness of organisational processes exerts a strong positive effect on worker job satisfaction. Procedural fairness, in terms of transparency and equity of decisions taken by the management and in terms of the quality of information given to workers, is the most significant variable influencing worker satisfaction. In addition, distributive fairness, that is the equity of worker remuneration in absolute and relative terms, is important in explaining workers' welfare on the job, though to a lesser degree than procedural fairness. Fairness, both procedural and distributive, plays a central role in explaining loyalty: workers perceiving higher degrees of fairness tend to be more loyal. Hence, the key explanation of loyalty appears to be satisfaction and fairness, while motivations do not play a relevant role. These results highlight that many elements beyond mere self-interested behaviour are at play in explaining workers' welfare on the job and their loyalty. Once again, the exclusive focus on self-seeking behaviour by traditional economic theories appears not to be sustained empirically.

The first normative conclusion emerging from these results is that organisations focusing exclusively on self-interested and extrinsic motivations, with no regard to involvement, relational and intrinsic motivations, are likely to fail to obtain valuable behavioural responses from the different stakeholders. When intrinsic motivations are crowded out by monetary incentives (Frey, 1997) the willingness of managers and workers to exert effort and fulfil the organisations' objectives is likely to decrease, not to increase. The second normative conclusion is that the conception of the firm as a problem solving device that works out suitable mixes of incentives, both monetary and non-monetary, and is able to motivate its stakeholder starting from their motivations is confirmed by empirical research and represents a richer depiction of its nature and operation than more traditional approaches.

Social economy organisations exist because they seem able to mix goals and incentives, giving rise to a variety of organisational and governance forms. Thus, when the activity involves allocative rules favouring disadvantaged clients and users, a re-distributive component is implied and the incentive structure is designed to enhance the loyalty of donors and volunteers. In contrast, when the productive stance prevails, a more mutualistic solution is expected and controlling rights tend to be allocated to the group of stakeholders mostly affected by contractual failures (workers, managers, volunteers).

However, most social economy organisations often combine a redistributive aim with the necessity of coping with market and organisational failures. They expect to operate efficiently if they implement incentive structures capable of both reducing contractual costs and guaranteeing essential resources from a mix of different sources: public subsidies or contracts, donations, voluntary work, but also "labour donations" from workers and managers. Accordingly, control rights in these organisations are often allocated not to a single group of stakeholders, but to a plurality of them, as workers and volunteers, workers and consumers, workers and donors.

The overall picture that emerges from recent experimental and empirical tests is one of a theory of the firm in need of profound restructuring, aimed at rendering it both more general and more realistic. Research concerning social economy organisations has paved the way for this restructuring and constitutes a privileged field of inquiry, providing evident observations of the departure from traditional schemes. Hence, it is a research field worth pursuing to obtain valid policy recommendations, for example, in the field of institutional design.

Social economy organisations and economic development

The evolutionary perspective leads to a conception of the firm as a problem solving device, which adapts itself to its surrounding environment and uses localised knowledge in order to pursue specific production objectives. Added to this picture, is the idea that firms devise specific incentive mixes that motivate the actors involved (stakeholders) to pursue organisational objectives. Firm competitive potential and survival possibilities will increase together with the ability of incentive mixes to strengthen the relationship between the organisation and its stakeholders. Incentive mixes emerge as the key link between stakeholders and an organisation, and represent the main adaptive modality used by the firm to pursue its objectives.

Economic theory can now include the role of social economy organisations in economic development, both at a general level and also locally. Generally speaking, following the interpretation defended in this chapter, the existence of social economy organisations and their dissemination should secure a reduction in transaction costs. There will be a maximisation of exchanges with a reduction of economic production costs, thus supporting economic development. First of all, social economy organisations contribute to lower transaction costs in the presence of market failures, which are particularly pronounced when markets are still under-developed and not competitive, and when they are very high due to product specificities, often in the presence of asymmetric information. The multi-stakeholder governance of production can reduce transaction costs by reducing asymmetric information and reducing confrontation between contrasting objectives. Social economy organisations, by renouncing the profit motive, are in a better position to reconcile the interests of stakeholders which are different from investors. They can also help to reduce monetary costs of production by acting on motivations different from purely economic and monetary ones. By giving a place back to intrinsic motivations in production (Frey, 1997) they consent to lower prices. Furthermore, they allow exchanges without equivalents (in the presence of redistribution of resources) and favour production and exchanges taking place in situations where for-profit firms would not be able to operate (social services, collective goods, etc.). Finally, they favour the creation of trust relations and the accumulation of social capital. Horizontal co-ordination and participation inside the organisation are also likely to have positive spill-over at the social level.

The role of local interaction between the firm and its surrounding environment cannot be downplayed any more as a mere casual and unnecessary contingency. The study of the interaction between the firm and the territory is a necessary extension of a new theory of the firm. Motivations and demands for development coming from the locality will influence the behaviour of stakeholders in the realm of the operation of the firm. Hence, there will be a need for the firm to take into serious consideration localised knowledge and the motivations of the actors approaching the firm if it is to be able to adapt its incentive mix suitably, and therefore reinforce relationships with its stakeholders.

The most suitable concept of local development usable in this context is one in which development is not merely the growth of aggregate variables, such as production and employment, but is the composite result of demands and needs coming from social actors (to which the firm needs to find an answer). A bottom-up approach to local development, where development is the endogenous result of objectives expressed at the local level, has been recently put forward by some authors (Sugden and Wilson, 2002; Sacchetti and Sugden, 2002). Its integration in the conception of the firm and in the role of social economy organisations is now required.

Social economy organisations seem able to interpret this new perspective, since they are likely to put a stronger stress on motivations and demands (both self-interested and other-regarding) coming from actors present in the locality. This kind of sensitivity seems to be rarer in organisations strongly based on hierarchical control, where motivations and demands coming from local actors remain widely unexpressed.

Conclusion

The chapter has been devoted to highlighting the historical and theoretical elements that support the idea that social economy organisations are not just a marginal phenomenon observed in the presence of state and market failures, but are instead innovative governance solutions that add social content to the traditional forms of social interaction. It has been demonstrated that the inability of economic theory to explain the emergence of these organisations is to be attributed to the limitations of the theory itself. More recent theoretical and experimental results are contributing to overcoming these limitations. Among them, the most notable and relevant to explaining the observed plurality of ownership and organisational forms are to be found in the evolutionary theory of the firm, and in a different way of stylising individual behaviour. The limitation of the profit motive is, in this sense, instrumental to the introduction of new and wider objectives which favour the flourishing of individual and group behaviour based on intrinsic and pro-social motivations, effectively bypassing the narrow maximisation of the economic value of the organisation.

This new scheme is relevant both to advanced economies, where a lack of social involvement by production organisations has been stressed by diverse research approaches (just think of the literature on corporate social responsibility or the growing literature on local development and multi-stakeholder organisations), and in developing and transition economies, where market and state failures are particularly pronounced. In such economies information is all the more imperfect and social economy organisations can represent a vector of development insofar as they can overcome such failures, re-distribute resources in favour of disadvantaged social groups, and produce meritorious goods favouring the strengthening of social cohesion and the accumulation of social capital.

Annex 1. A brief resumé of the Hansmann model

In Hansmann's (1996) scheme, firm specific transactions are amenable to different categories of stakeholders or patrons, who can interact with the firm via contractual (market) relationships, or ownership (control) rights. Non-controlling stakeholders will incur contract (market) costs in their transactions with the firm, while controlling stakeholders will incur ownership (control) costs. Contractual costs originate from ex-ante market power (monopoly and monopsony), ex-post market power (lock-in) and asymmetric information. Ownership costs are linked to monitoring activities, collective decision-making mechanisms and entrepreneurial risk taking. Given these hypotheses, Hansmann states that the efficient allocation of property rights is the result of a process of cost minimisation, where total costs are the sum of contract and ownership costs. Given N and the different classes of stakeholders, the efficient solution happens when ownership is enjoyed by the category of stakeholder minimising:

$$OC_j + \sum_{i=1}^{j-1} CC_i$$

Where OC_j are ownership costs for the j stakeholder class, and CC_i are contract costs for all the other stakeholder classes.

The existence of different organisational forms depends on some organisations minimising costs when capital suppliers enjoy control rights, while in other organisations costs are minimised when other categories of patrons (such as workers, clients, savers or producers) enjoy control rights. In the latter case we observe the development of co-operative organisational forms. When the organisation undergoes severe information asymmetries on the product or labour market and contracts are highly incomplete, it can be convenient not to assign control rights to any category of stakeholder. This is the case of non-profit organisations.

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Notes

1. One of the most typical examples is represented by the Italian *società di mutuo soccorso,* which used to deliver traditional welfare services to disadvantaged social groups and were quite widespread before the Second World War when the national welfare system had not yet been created.

2. This is embodied in the John Hopkins University studies of the non-profit sector's synthetic dimension.

3. Concerning the second definition, the combination of the two terms *social* and *economy* witnesses the attempt, made by a minor component of non-traditional economics, to re-embed the economy into society, following its separation by mainstream economics from the 18th century onwards. Historically, this term first appeared in France in the 19th century both as a concept and as an ensemble of practices and institutions. It was understood either as the enhancement of political economy by liberals like Charles Dunoyer (1830), as the substitute for political economy (by socialists and Christians), or as comprising political economy (Proudhon's social science) or, finally, as a complement to pure economics, identifying with the overall rise of public economics (Walras, 1896; Gide 1905; Demoustier and Rousselière, 2005). Thus, in Europe the modern social economy was actually forged, not by any single 19th century current of thought but, rather, by the interplay of its leading ideologies (Defourny, Develtere and Foneneau, 1999). The concept almost disappeared in the 20th century because of the implementation of the welfare state, which reached its peak during the period 1945-1975. The term re-appeared in the 1970s, interacting with the other two definitions of Third Sector and non-profit sector (Demoustier and Rousselière, 2005). This re-emergence occurred, by co-incidence, with the decline in the rates of economic growth and the rise of unemployment, which were the origin of the difficulties in European welfare systems (Borzaga and Defourny, 2001).

4. Higher costs can be compatible with a higher surplus if revenues grow more than costs. Conversely, net surplus (profits) are a bad indicator of the survival potential of an organisation, since different organisations may have to meet very different constraints in terms of investments, while the total surplus (net surplus plus labour and capital remuneration) is a much better proxy of the health of an organisation and of its ability to satisfy the stakeholders' needs, and therefore to survive and prosper.

5. In the ultimatum game two players decide about the division of a certain amount of money. The first mover (the proposer) can choose the share they prefer. The second mover (the responder) can only decide to accept

the division proposed or refuse. In the latter case both players get nothing. Orthodox economic assumptions require the responder to accept any offer higher than nothing, even when it is very low. Many experimental observations show that too unequal divisions are often refused by responders, contradicting orthodox assumptions concerning self-regarding preferences. Experimental evidence has been explained mainly by admitting that economic agents do not care only about the absolute amount of the pay-off received, but also about the fairness of distribution. Proposers may fear retaliation if the responders feel humiliated, but they may also consider a fair distribution desirable in itself. Hence, players take into consideration also the procedures followed and the choice made by the other players.

6. In the basic version of the investment game there are two players who interact sequentially. The first mover owns a certain amount of money; they can decide to keep it for themselves or to give all or part of it to the second mover. The part donated to the second mover (the investment) increases its value making it Pareto-optimal to invest the whole amount of money. However, the second mover does not need to pay back the sum they receive. Standard assumptions on self-seeking individuals would predict zero investment, because the first mover anticipates the choice of the second mover, who would retain the whole amount donated. Experimental evidence is again in stark contrast with this prediction since players usually invest a significant amount of money, and get back sums that, on average, are equal or higher than the sums invested. Fairness and reciprocity are likely to play a key role in this case too.

7. For a good review of the literature the reader can consult, for example, Hargreaves-Heap and Varoufakis (2004).

8. While in a static setting experimental results are harshly at odds with economic theory, dynamic and evolutionary models provide a more flexible tool, though the formal and conceptual complexity of the analysis has not yet allowed definite results to emerge. For a very recent contribution in the field of evolutionary game theory showing that co-operation in sequential prisoners' dilemma or trust games is the only stable equilibrium the reader can consult Andreozzi (2007).

9. Gift exchange games are usually interpreted to describe a contractual exchange between an employer and an employee. The employer has to fix the employee's salary within a predefined range. After the wage has been fixed, the employee decides autonomously what level of effort to deliver. They could deliver the minimum level of effort and the wage would not be reduced, since it is fixed in advance of the choice. Experimental evidence shows a strong positive relation between the wage offered by the employer and the level of effort delivered by the employee. Orthodox

economic models would predict that employees always deliver the minimum level of effort, since they do not undergo any risk of wage reduction. Predicting this reaction, the employer would fix the minimum wage.

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Carlo Borzaga is the Dean of the Faculty of Economics at the University of Trento, where he is also a Professor of Economics. Since 1997, he has served as President of the *Istituto Studi Sviluppo Aziende Non-Profit* (ISSAN), a research and training institute of the University of Trento that focuses on non-profit research and, since 2002, he has been the Vice-President of the EMES (The Emergence of Social Enterprise in Europe) Network. He is currently the scientific co-ordinator of the OECD LEED Centre for Local Development on social economy research. Professor Borzaga has worked with the European Commission (DGV), as a member of the Capitalisation Committee and also as an advisor to the Italian government in the development of a number of bills focusing on the non-profit sector. Professor Borzaga has authored and co-edited numerous works on the theory of non-profit enterprises and social enterprises.

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Prior joining ECNL she co-founded and managed the Human Rights Students' Organisation at the Central European University in Budapest, when she initiated courses to supplement the curriculum of the Human Rights Program of the University and developed human rights awareness raising and capacity building projects. Also, she volunteered for the Civil Society Resource Center in Macedonia, during which time she worked on projects aiming to raise awareness about the rights of pre-trial detainees and refugees, and has conducted comparative legal analysis in these fields.

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At the OECD, Ms Noya has developed new areas of work, including: the role of the non-profit sector in local development, the role of culture in local development, asset-building for low-income people, social innovation, and community capacity building. Within this framework she has organised international conferences and study missions and coordinated studies and international reports. She is the editor and co-author of several OECD publications.

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After graduating in economics at the University of Turin in 1995, Ermanno Tortia pursued Masters degrees in London and Rotterdam in institutional economics and the philosophy of economics, before completing his doctorate in Bologna, on labour managed firms. Since 2001 his research interests and activities have been in the field of industrial relations, human resources management and organisational innovation. From the beginning of 2004 Dr Tortia has been employed at the University of Trento as a researcher working on governance and labour relations in non-profit organisations and co-operative firms.

Glossary

Civil society

Civil society may be defined as a space or arena between households and the state, which affords possibilities of concerted action and social organisation. Thus, it encompasses all voluntary associations of citizens, whether politically motivated or active or not (although the term carries an implication of political consciousness and activity): business, labour, non-governmental organisations, churches, special interest or purpose groups. These elements are the constituents of civil society, but none can individually be representative of it. Business is often excluded, although the OECD does include it, given that channels of communication between traditional organised business and labour and government are generally well established. Most frequently the term is used interchangeably with "NGOs" where the term "NGO" refers specifically to activist groups, although these are simply one category of civil society as a whole.

Co-operative

A co-operative is an association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise. Examples of co-operatives in Europe can be traced back to the 19th century. The International Labour Organisation has recently (2003) suggested that co-operatives should be based on the values of self-help, self-responsibility, democracy, equality, equity, and solidarity and share the principles of: voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training and information; cooperation among cooperatives; and, concern for the community, which were identified by the International Co-operative Alliance in 1995. A co-operative includes one or more kinds of users or stakeholders: 1) consumers who use the enterprise to acquire products or services (such as a retail co-operative, housing, healthcare or day-care co-operative); 2) producers (such as independent entrepreneurs, artisans, or farmers) who use the enterprise to process and market the goods or services they produced, or to buy products or services necessary to their professional activities; and 3) workers who use the enterprise to secure their employment and control their working conditions. Co-operatives operate democratically (one person, one vote) through two bodies (general meeting of the members or delegates, and the board of directors, which is composed of members elected at a general meeting). The delegate structure may be required to reflect the size of the organisation or the distance covered by the co-operative. The co-operative's start-up capital usually comes from co-op shares purchased by members. Since 1980, special co-operatives, known as social co-operatives, have become more widespread in OECD member countries.

Foundation(s)

Foundations are philanthropic organisations, organised and operated primarily as a permanent collection of endowed funds, the earnings of which are used for the long-term benefit of a defined geographical community or non-profit sector activity. Foundations operate as grant-making institutions, and also as providers of social, health and cultural services. It thus provides a significant link between the private and non-profit sectors, acting as a recipient of private capital and a funder of non-profit organisations. Foundations are tax-exempt, incorporated, not-for-profit, organisationally autonomous, and cannot be controlled directly or indirectly by government at any level, corporations, associations and their members, or individuals). Because they occupy a unique and central place in the non-profit sector, the development of foundations will strongly affect the future of the sector as a whole.

Mutual organisations/societies

A mutual organisation is an organisation owned and managed by its members and that serves the interests of its members. Mutual organisations can take the form of self-help groups, friendly societies and co-operatives. Mutual organisations exclude shareholding as they bring together members who seek to provide a shared service from which they all benefit. They are widely represented in the insurance sector.

Non-profit sector

The best known definition, while not commonly shared, particularly in European countries, is undoubtedly that supplied by the Johns Hopkins University in Baltimore (*www.jhu.edu/~cnp/*). According to this definition, the sector includes organisations which are voluntary, formal, private, self-governing and which do not distribute profits, such as hospitals, universities, social clubs, professional organisations, day-care centres, environmental groups, family counselling agencies, sports clubs, job training centres, human rights organisations and others. In fact, entities belonging to the non-profit sector can vary from country to country according to national history and tradition. The term non-profit, born in the USA, refers mainly to the absence of profit distribution. This is substantially different to the European approach of "social economy", which includes co-operatives. However, this difference is less significant when investigated through empirical research. C. Borzaga and J. Defourny (*The Emergence of Social Enterprise*, 2001, Routledge, London) argue that the distribution of profits is in any case limited by internal and external regulations in co-operatives and mutual organisations in European countries.

Social economy

The term "social economy" first appeared at the beginning of the 19th century in France. It was, nevertheless, only at the beginning of the 20th century that it began to be employed to indicate various entities aimed at improving collective working conditions and individual lives. This concept is now also used by Anglo-Saxon countries to refer to the production of goods and services provided not solely by the non-profit sector, but also, in some cases, by private enterprises with shareholder agreements that force the majority of shareholders to agree to social objectives undertaken by the firm. Among the organisations belonging to the social economy, one can find associations, co-operatives, mutual organisations and foundations. This type of economy is essentially regulated by the stakeholder principle, which stands in stark contrast to the notion of shareholder capitalism. The "social economy" is a broader concept than the non-profit sector, as it is less strictly bound to the non-distributional constraint, according to which organisations cannot legally redistribute their surplus to their owners (see also "Third sector").

Social enterprise

An organisation form which has flourished in recent years, many definitions of social enterprise exist. Apart from academic definitions, and those elaborated by international organisations, which are built around general criteria, definitions used within countries are specific to the national understanding of the phenomenon of social enterprises. Increasingly countries are developing legal definition of social enterprises. Generally, this concept refers to any private activity conducted in the public interest, organised with an entrepreneurial strategy and whose main purpose is not the maximisation of profit, but the attainment of certain economic and social goals, and which, through the production of goods and services, brings innovative solutions to problems such as social exclusion and unemployment (see *Social Enterprises,* OECD, 1999). In this way, social enterprises combine the entrepreneurial skills of the private sector with a strong social mission that is characteristic of the social economy as a whole. Social enterprises are part of the thriving and growing collection of organisations that exist between the private and public sectors. They come in a variety of forms including employee owned businesses, credit unions, co-operatives, social co-operatives, development trusts, social firms, intermediate labour market organisations, community businesses, or charities' trading arms. They mainly operate in two fields of activity: the training and integration into employment of persons excluded from the labour market, and the delivery of personal and welfare services.

Solidarity economy (économie solidaire)

The idea of the solidarity economy is mainly used in France and Canada (Quebec), and is also widespread in Latin America. It has different meanings according to the geographical context in which it is used: in the South American context, it mainly refers to fair trade and the popular economy, in Quebec it is linked to cooperatives, non-profit enterprises as well as to community economic development (*mouvement économique communautaire*) and in Europe to solidarity initiatives, mainly, but not exclusively, in the proximity services. Sometimes the term is used in association with the term social economy (as in Quebec) and sometimes in opposition to it, notably where the social economy is seen as composed of established organisations, while the solidarity economy mainly refers to non-established citizens' initiatives aimed at experimenting with new paths of economic development. In the European context, examples such as the fair trade movement are developing inside the sector, together with innovative forms of financial/non monetary-exchanges based on reciprocity.

Third sector

The concept of "third sector" is often used as a synonym to the non-profit sector and, more recently, also to "social economy", particularly in European literature. The term was chosen to reflect the idea that the sector assembles these otherwise disjointed entities, and that it sits between the public and private sectors and follows unique social goals and internal organisational rules. Its mode of financing is mixed, as it can seek both private and public funding. The idea of establishing a distinct "third sector" has given rise to many hefty debates, which have centred upon the danger of using the third sector as a residual sphere or “dumping ground” for those individuals excluded from the private and public sectors. To avoid the danger of social polarisation, the third sector should not merely be seen as an alternative route or juxtaposition to the public and private sectors, but as an interactive and reflexive component of economy and society. Others have argued that the boundaries of the third sector cannot be established with certainty, and for this controversial reason the European Commission preferred the use of the term “Third System”.

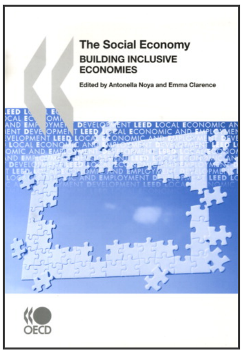
Third system

The term “Third System” was first utilised by the European Commission in 1997 and refers to the economic and social fields represented by co-operatives, mutual companies, associations and foundations, as well as all local job creation initiatives intended to respond, through the provision of goods and services, to needs for which neither the market nor the public sector appear able to make adequate provision. On the initiative of the European Parliament, in 1997 the European Commission introduced a new pilot action entitled “Third System and Employment”. The aim of the action was to explore and enhance the employment potential of the “Third System” with an emphasis on the areas of social and neighbourhood services, the environment and the arts (http://ec.europa.eu/employment_social/publications/2002/ke4502555_en.html).

Table of Contents

Tables

Figures



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