HOW MUCH DOES CHANGE COST?

A THEORETICAL ANALYSIS ON THE MEASUREMENT OF SOCIAL VALUE IN THE CONTEXT OF THE SOCIAL ENTERPRISE

By

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ABSTRACT

This manuscript defines a social enterprise and the need for valuation approaches, as well as analyzes the most popular valuation techniques for social value. In doing so, this study works to create a new theory for the valuation of social value, as it pertains to the social enterprise.
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Introduction

The driving concept behind the for-profit business model and current capitalist beliefs is Milton Friedman’s widely known view that the main purpose of a business is to create profits for shareholders. However, this idea is radically shifting with the emergence of the social enterprise (Wilson & Post, 2010). “A social enterprise is a business whose primary purpose is the common good” ("What is Social Enterprise?", n.d.).

In contrast to the typical capitalist ideology, the main responsibility of the social enterprise is to use market dynamics to address its chosen social agenda. The complex nature and multidimensional foundation of the social enterprise makes it difficult for management and investors to accurately value and compare the social value each organization creates.

In order to solve this gap in the research this manuscript will work to explain an approach to the measurement of social value. This measurement technique can be used in a multitude of ways. The main uses of this information include the analysis of current activities and ways to increase their social return, as well as to create of competition within the social sector. Currently, there are various theories on how to measure social value. However, none of these theories take the multidimensional aspect of the social enterprise into account in a cost and time efficient manner. This manuscript defines a social enterprise and
the need for valuation approaches, as well as analyzes the most popular valuation techniques for social value. In doing so, this study works to create a new theory for the valuation of social value, as it pertains to the social enterprise.

What is a Social Enterprise?

The social enterprise structure is a modification of the current non-profit business model in response to the overwhelming pressures from competition and funding reductions (Polonsky & Grau, 2008). The model focuses on giving a “hand-up,” through the support of sustainable growth, rather than the traditional mentality of giving a “hand-out,” through subsidies (Wilson & Post, 2010). “The revenue generated by these profitable or self-sustaining enterprises to promote social change” is known as community wealth (“Our Work | Community Wealth Partners”, n.d.). Social enterprises use community wealth, which includes leveraging existing assets and generating sustainable new resources, as opposed to traditional fundraising, grants, or donations to support the organizations mission. The social enterprise is considered to be a hybrid model that synthesizes the social purpose of not-for-profits, and the economic motives of traditional for-profits (“Highlights from the National Field Study of Social Enterprise 2008”, 2009). This business model allows organizations to use the power of the market to proactively solve social problems, as well as provide for self-sufficiency (Sakarya, Bodur, Yildirim-Öktem & Selekler-Göksen, 2012). Moreover, this practice enables organizations to harness the power of the market
to build capital and increase awareness (Wilson & Post, 2010). The three key characteristics that distinguish a social enterprise from other businesses and non-profits are (“What is Social Enterprise?”, n.d.):

1. It directly addresses a social need and serves the common good through its goods or services

2. Its commercial activity is a strong revenue driver

3. The common good is its primary purpose

The Need for Valuation

Although shareholders of for-profit firms have demanded accountability and transparency for decades, the stakeholders of social enterprises have only recently started pressuring their organizations to study, and accept, a method for a higher standard of reporting (Antonaras, Iacovidou & Memtsa, 2011). Social enterprises are able to respond to this request, and demonstrate accountability, through the valuation of social impact. For the purpose of this study social impact and social value will be used synonymously. Social impact is the total impact that a social enterprise has on all of its stakeholders. (Polonsky & Grau, 2011) This impact is created through the use of resources, inputs, and processes to change the lives of individuals or society as a whole (Antonaras, Iacovidou & Memtsa, 2011).
There are two key groups that drive the demand for a standard valuation framework. First, the management of these companies need this information to raise and spend organizational funds to create the most change per dollar. On the other hand, investors and customers want to clearly see the results of their contributions and the returns on their investment (Mulgan, 2010). Although demand for this information is increasing, there is currently no generally accepted mechanism to evaluate the social impact of a social enterprise (Polonsky & Grau, 2011).

The analysis of social value helps the management team of these organizations to better understand how their organization can maximize the social return on investment and plan long-term focused strategies. Specifically, management can identify if and how much extra value arises from their actions. This will allow management to direct the organization’s efforts towards activities that create the most effective and efficient impacts (Great Britain. Social Enterprise Unit. Great Britain. Cabinet Office, 2010).

Management can also use this information to better solicit customers and donors by clearly portraying the effectiveness of the organization through the measurement and demonstration of the impact of its actions (Barraket, n.d.). This enhanced marketing technique equips social enterprises to differentiate themselves from other organizations, consequently leading to increases in contributions and/or sales due to higher investor confidence (Polonsky & Grau, 2008).
Currently, philanthropists donate billions of dollars without fully understanding the impact of their donations and without assessing the effectiveness of the receiving organizations. The valuation of social impact creates an investment oriented mentality focused on outcomes, rather than feelings. A standard valuation technique could be used to inform investors of the organizations ability to create change. This information allows investors to make more educated decisions regarding their investment, giving them the opportunity to shift their money and support to the more efficient organizations. Ultimately, a framework for measuring social impact will facilitate competition in the social sector by giving customers the ability to compare each organization against each other (Polonsky & Grau, 2008).

**Difficulties in Measuring Social Impact**

The process for analyzing the social impact created by a social enterprise has proven to be a difficult task for various reasons. The most prominent obstacle involves the large set of stakeholders of a social enterprise. These organizations are responsible to the stakeholders of both for-profit and non-profit firms. On the for-profit side, social enterprises are accountable to its employees and shareholders because of its focus on economic value creation and profit maximization. On the other hand, these companies are similar to non-profits, as they are both accountable to the customers and community due to its focus on the creation of social value. More specifically, the stakeholder’s of a social enterprise include the consumers, employees, owners, investors, suppliers, and
the larger community. The actions of such organizations may have a much broader, long term social impact which must be incorporated when evaluating its social value due to this large array of stakeholders; the direct result of the organizations actions, as well as the indirect results of the actions must be accounted for when measuring social impact (Wilson & Post, 2010).

An example of this is the generation of a micro loan to a small business man in the Dominican Republic. The individual receiving the loan directly benefits from the loan because it provides the capital for him to grow his business. Additionally, the individual’s family will indirectly benefit from the loan because it is used to grow his family, consequently bringing in more income to provide for food and shelter. Lastly, this may be advantageous for the community because this loan puts more capital into the local markets and spurs additional business.

**Current Theories**

Currently, there are many theories that attempt to measure the social value. Although these methods have various advantages, none encompass the quantitative and qualitative factors of a social enterprise in a cost and time efficient manner.

**Financial Metric Approach to Measurement**

Measurements of social value based on financial metrics are similar to that of for-profit firms. In this approach, valuation of a social enterprise encompasses
traditional financial efficiency measures based on the financial statements. These measurements may include EBITA multiples or return on investment. For example, a social enterprise can measure the organization’s investment of today’s profits to build future growth in the organization (Polonsky & Grau, 2011).

There are four main benefits of this approach. First, it aligns the organizations performance and financial management systems because it forces organizations to reach their social mission efficiently in order to reach their financial goals. Additionally, the measurement of operational efficiency creates transparency and helps identify the critical sources of value for the organization by directly showing the cost, benefits, and returns for each social activity, as well as the organization as a whole (Antonaras, Iacovidou & Memtsa, 2011). Lastly, this model is simple, cost effective, and easily comparable between organizations because it is derived from current valuation models (Polonsky & Grau, 2011).

Although there are many benefits related to this theory because it clearly represents the financial and operational health of the organization, it does not adequately value the non-monetary benefits and outcomes of the organization (Polonsky & Grau, 2011). This is a large factor when analyzing the hybrid model of a social enterprise and is crucial in the measurement of social impact.

**Qualitative Approach to Measurement**

In contrast to the measurement through financial metrics, the qualitative approach strictly analyzes qualitative factors. In this model, management uses a self-assessment to examine the longevity of the organization. This approach is
extremely easy to conduct and relatively cost efficient because it takes little expertise. Although many organizations may prefer this method because it is relatively simple, it may not be truly beneficial because it completely neglects the monetization of the activities of the organization. Again, a valuation metric for social impact must represent the essence of the social enterprise business model which incorporates both the financial and social goals of the organization. Additionally, the lack in financial metrics makes it difficult for investors/ customers to directly compare organizations due to lack of inconsistency (Polonsky & Grau, 2011).

**Monetization of Social Impacts Approach to Measurement**

The model to monetize social impacts incorporates the ideas from the quantitative approach while integrating the use of finance metric in the analysis of social impact. The two main approaches included in this category are the Social Return on Investment and Social Accounting (Polonsky & Grau, 2011).

Social accounting is a, “systematic analysis on the effects of an organization on its communities of interest or stakeholders, with the stakeholder input as part of the data that are analyzed for the accounting statement (Richmond, Mook & Jack, 2003).” This approach monetizes all inputs and outputs, such as the value of volunteer’s contributions, to create a complete perspective of the organization. Although much research has been done on the social accounting method, there is still no way to standardize the monetization of all aspects of an organization (Polonsky & Grau, 2011).
Compared to social accounting, the social return on investment (SROI) approach gives a deeper analysis and is currently one of the most popular and most studied methodologies. SROI is an analysis of the inputs, outputs, and various outcomes created by a social enterprise (Antonaras, Iacovidou & Memtsa, 2011). This method involves a six step process to assess the return on investment which includes the calculation of enterprise value, social purpose value, blended value, enterprise index of return, social purpose index of return and blended index of return. SROI helps to identify and understand how a particular service increases or decreases social impact through the identification of groups affected by the organizations activity (Polonsky & Grau, 2011).

This method is preferred over social accounting and other methods because it makes a broader attempt to quantify inputs and outputs, as well as incorporate various stakeholder objectives. Additionally, it takes a long term perspective when valuing the organization by looking at the cash flows over time. Moreover, this allows for more effective decision making by analyzing the impacts of these changes in the organization (Antonaras, Iacovidou & Memtsa, 2011).

In contrast, SROI is completely dependent on the ability to quantify costs and revenues based on cost savings and revenue contributions which, in many circumstances, is difficult to do. Additionally this approach does not take into account the broader social impacts to a community which, again, are not easily monetized. (Polonsky & Grau, 2011).
**COMBINED APPROACHES TO MEASUREMENT**

The combined approaches to measurement goes one step further than simply monetizing social impacts; it employs both quantitative and qualitative measures, as well as financial and non-financial criteria. The two key methods included in this approach are the Kaplan and Norton’s Balance Score Card and Public Value Score Card (Polonsky & Grau, 2011).

Kaplan and Norton’s Balance Score Card examines the customer, financial and internal business issues, as well as the innovation of the organization. This model is forward focused and links performance and organizational objectives together (Polonsky & Grau, 2011).

The second approach, Public Value Score Card is a “strategic Triangle.” The three points are: Social Mission, Legitimacy and Support, and Organizational Capabilities’ (Polonsky & Grau, 2011).

The social mission focuses on the social outcome, which is the ultimate value the organization is attempting to create, rather than value created for shareholders. This measurement is based on values, goals, and objectives to assess if and how well the social enterprise is fulfilling their social mission. The second piece, legitimacy and support, emphasizes the measurement of the social value that stakeholders receive, rather than the financial returns of the organization. This can be measured by examining the variety of customers and constituents. Lastly, the organizational capabilities are based on the ability of the firm to achieve its overall goals (Polonsky & Grau, 2011).
Although these approaches encompass various aspects of a social enterprise, they are difficult to conduct, complex, and timely.

The Need for a Multidimensional Method to Evaluate Social Impact

Although some of these models have slightly overlapping ideas, there is a large variance between the different social value measuring techniques. As one can see, each major category of valuation methodologies has a different emphasis, but none of these methods address the various layers and aspects of social value, leaving us without an appropriate valuation of social performance. Furthermore, since each approach concentrates on one aspect of social value, while ignoring others, it may be concluded that multiple methods may be required to give an adequate perspective (Polonsky & Grau, 2011).

Financial return and social impact are not mutually exclusive for a social enterprise due to its large set of stakeholders (Lingane & Olsen, 2004). Therefore, financial metrics and ratios will not give the whole picture of the impact created by these organizations while solely quantitative metrics are not easily comparable. This highlights the need for a multidimensional method for evaluating social impact (Smit, n.d.). In order to take the social enterprise’s broad range of stakeholder’s interests into account, quantitative metrics, as well as the more difficult to measure and identify, qualitative outcomes, must be taken into account (Wilson & Post, 2010).
Not only is a multidimensional method required to satisfy the needs of the various stakeholders, it is rudimentary to satisfy a social enterprises mission. The main purpose of the business is not to simply make a profit, but to also serve society through its actions; therefore, social impact is not merely a byproduct of the business, it is the primary purpose. Furthermore, the social enterprises is focused on the net difference in the total value creation, social and economic, not just net profits. This reinforces the idea that financial metrics alone will not give a complete representation of the value of a social enterprise (Wilson & Post, 2010).

An Approach to the Measurement of Social Value

After further evaluation of the gaps in the current methods for the valuation of social value, it became clear that the analysis had to include six key components, in order to give the entire picture of the organization’s ability to create sustainable social value. These include the analysis of:

1. The mission and Purpose
2. Stakeholders
3. Income and Expenditures
4. Social Return: Outcomes & Impacts
5. Social Effectiveness: Inputs & Outputs

Mission and Purpose

This is the first stage of the analysis of the organizations ability to create social value. In this stage you must define the organizations values, vision, mission, objectives and activities (Olsen & Nicholls, 2005). Furthermore, the
study must include the extent to which the organization is addressing its mission and chosen social problem. Social enterprises formation is driven by a clear social purposes, making the social mission of the organization vital to the enterprise. The social mission of such organizations is typically multi-faceted and includes various social impact areas and stakeholders. Moreover, the analysis of the organizations social mission is an important aspect of this process because it affects how leaders perceives and assesses opportunities (Wilson & Post, 2010).

**Stakeholder Analysis**

In this stage of the valuation of social value the stakeholders affected by the organizations activities must be identified. Additionally, specific organizational objectives and activities should be defined for each stakeholder group through the use of internal information and the engagement of stakeholders. Social, environmental and economic values can affect all stakeholders. Thus, it is important to consider the impacts of all activities on stakeholders before decided the largest and most influential activities to include in the analysis of the overall social value created by the organization (Olsen & Nicholls, 2005).

**Income and Expenditures**

Typically, companies do not differentiate income and expenditures based on financial and non-financial value creation. However, in the case of the social enterprise, organizations should assign revenues and costs to specific activities, which are also known as areas of responsibility. This reclassification results in the ability to determine the gross margin for each responsibility center. Thus,
making it easier to evaluate each of the organizations main activities based on
segmented profitability and efficiency. Additionally, this process makes the
supporting costs of each activity evident, i.e. administration and helps to evaluate
the appropriate costs to realize each piece of revenue. Together, these results
not only help investors determine the efficiency of the organizations activities, but
they also allow management to understand which projects or activities create the
most social value in relation to their costs (Bagnoli & Megali, 2011).

**Social Return: Outcomes & Impacts**

The analysis of the social return of the organization focuses on
quantitative factors. The quantitative evaluations of a social enterprises overall
return should include: (Bagnoli & Megali, 2011)

1. Outcomes, the benefits to the direct and intended beneficiaries
2. Impact, the impact magnified to the wider community

The outcomes should be measured on a quantitative basis. The goal of
this step is to evaluate the benefits that flow to the intended beneficiary. These
outcomes can be measured in two ways; an internal basis such as the
achievement of a mission or other objective, or an external basis such as
customer satisfaction or employment outcomes. Moreover, this element of the
analysis is the direct impact of the performance in relation to its achievement of
the goals and mission in the organization (Bagnoli & Megali, 2011).
The expected return must be calculated to fully understand the return of the organizations outcomes, whether it be on an internal or external basis. “The expected return is the predicted benefit per dollar invested (Brest, Harvey & Low, 2009).” This calculation allows investors to compare organizations against each other, which ultimately gives them the ability to spend their dollar effectively. This equation is (Brest, Harvey & Low, 2009) (Tuan, 2008):

\[
Expected\ Return = \frac{Outcome \times Probability\ of\ the\ Outcome}{Cost}
\]

This equation describes the outcomes as the impact the organization makes if the organization were exclusively responsible for these outcome. In reality, many organizations or government activities may contribute to the outcome, however, this will be disregarded for simplicity. Additionally, no outcome is guaranteed to be fully reached. For this reason, the probability of the outcome must be included in this equation. The numerator may include social, as well as financial return as part of the intended outcome.

The financial metrics for the outcome can be derived from the area of responsibility revenues found in the previous step in this overall analysis. The social metrics associated with the benefits of outcomes are highly subjective and may be very difficult to calculate. An example of this calculation may include the present value of the future earnings of women who are employed by the organization, who otherwise would not have been employed. Not all women will
continue to work for the firm till the typical retirement age. Thus, the percentage of women estimated to stay with the firm will then be multiplied times the present value of the total future earnings of all employees. The numerator for the expected return equation is as follows:

\[
\text{Expected outcome} = \text{% of women estimated to stay with firm} \times \text{PV of total earnings}
\]

The denominator accounts for the total costs associated with the realization of an activity. Similar to metrics for outcomes, the total cost is equal to the total expenditures per area of responsibility. Examples of these costs include administrative expenses, materials, equipment and training (Bagnoli & Megali, 2011).

The last step in this process is to measure the impacts on the wider community. These are the secondary effects of the organizations activities and can be measured in a number of ways. The two most encompassing and simplistic measurements are “avoided expenditures” and the economic multiplier. "Avoided expenditures" are savings to the large community. These are expenditures that will not be incurred because of the lack of need for intervention by public authorities (Bagnoli & Megali, 2011). On the other hand, the economic multiplier is “the ratio of total economic impacts associated with a given project or policy to the direct expenditure ("Statistics Glossary - BC Stats", n.d.).” The multiplier depends on the percent that households are willing to spend, also
known as the marginal propensity to consume; the income only has the opportunity to grow the community if it is spent in the community. If 80% of new income is spent on products in the community, the marginal propensity to consume is .8. The formula to calculate the economic Multiplier is as follows:

\[
\frac{1}{1-MPC}
\]

Per the previous example, the multiplier would be \((1/1-.08)\) or 5.

Ultimately, for every $1 of new income into the community, $5 of new income is generated ("The multiplier effect", n.d.).

SOCIAL EFFECTIVENESS: INPUTS & OUTPUTS

The final step in evaluating an organizations overall contribution to social value is the evaluation of social effectiveness. Effectiveness is “the ability to achieve goals and implement strategies while using resources in a socially responsible way (Bagnoli & Megali, 2011).” For typical profit-driven companies, effectiveness can usually be assessed through the analysis of the income statement and industry benchmarks. Although these same financial metrics are important in evaluating a social enterprise, the analysis of the effectiveness of these organizations should be centered on the enterprises ability to meet the social needs stated in its mission. This analysis should measure the concrete results of the activities, the magnification of the results, and the sustainability of
the process. The qualitative evaluations of a social enterprises overall effectiveness should include (Bagnoli & Megali, 2011):

1. Inputs, the resources used to support activities or produce goods/services
2. Outputs, the realized results from activities and goods/services to achieve the organization’s mission

Inputs can be measured by the degree to which the organization is using resources in a socially responsible manner. Examples of this include the use of local or fair trade suppliers, the adoption of decent work conditions, or the employment of disadvantaged workers (Bagnoli & Megali, 2011).

The second step in evaluating the effectiveness of the organization is to examine the outputs of the activities. This involves evaluating the results and products of organizational activities. This information, combined with the revenue and cost analysis in the prior stage, can be used to determine the productivity and effectiveness of the activities in order to realize the mission. Additionally, the quality and quantity of the organizations products should be examined in this stage (Bagnoli & Megali, 2011).

Implications and Future Research

Once this analysis has been completed, the information can be used to assess the organizations current operations, as well as compare companies within the same domain against each other. This theory provides a holistic
method for measuring the social impact of social enterprises by incorporating the financial and non-financial aspects of the organization. Additionally, this analysis is relatively easy to complete and cost efficient.

It should be noted that there are limitations to this theory. Although some comparisons can be made between different industries and mission fields, the differing quantitative and qualitative benchmarks for each field make it difficult to make accurate judgments between organizations with different missions. Thus, this theory works best when comparing companies with similar missions and may be difficult to analyze companies with dissimilar fields.

In order to determine the true effectiveness of this valuation approach, I would like to complete a case study of Z’s Café. Z’s Café is a local restaurant in Fort Worth that hires individuals who would have otherwise not been employed; these individuals are namely from the homeless community in Fort Worth. This case study will allow me to analyze the cost and benefits for small and local firms, as well as large enterprises to complete this study of their ability to create social value. With this information, I hope to critique my current approach to make it more useful for these organizations.

Conclusion

The social enterprise is not only changing the way customers and investors think toward their everyday spending, but it is also changing the business world. Till the emergence of the social enterprise the capitalist business
model was mainly driven by Friedman’s widely known view that the main purpose of a business is to create profits for shareholders. However, the social enterprise is turning this idea upside-down with their idea that corporations are not only charged to create value for their shareholders, but they must also create a shared value for the larger community.

Although one of the main purposes for a social enterprise is to create social value, this is currently an extremely understudied subject. However, management and customers are starting to demand a common valuation technique in order to accurately value and compare the social value each organization creates.

In order to solve this gap in the research this manuscript focused on explaining an approach to the measurement of social value. As seen in this study, there are no current theories that take the multidimensional aspect of the social enterprise into account for the measurement of social value. This paper explains and defines the social enterprise and the necessity for a valuation approach, as well as investigates the most popular valuation techniques for social value. In doing so, this manuscript introduces a new theory for the valuation of social value, as it pertains to the social enterprise.
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