1042-2587

Delineating the Domain of Development Entrepreneurship: A Market-Based Approach to Facilitating Inclusive Economic Growth

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Development economists and management scholars have called for a more market-based approach to address the extreme poverty suffered by the billion people residing primarily in least developed countries. This article proposes a theory of development entrepreneurship that blends business entrepreneurship, social entrepreneurship, and institutional entrepreneurship to accelerate the institutional change necessary to make economic growth more inclusive. After examining various explanations of market failure in the base of the pyramid and social entrepreneurship literatures, I explain why entrepreneurial transformation of formal institutions is needed and what differentiates development entrepreneurship from related concepts such as social entrepreneurship, social business entrepreneurship, and socio-political activism.

I. Introduction

Development economics is facing a new challenge that entrepreneurship scholars may be best equipped to address: what to do about the billion people subsisting on less than \$1/day and living in the least developed countries (LDCs)? While four of the five billion people in poverty live in countries that are developing, approximately one billion remain trapped in nations that are falling behind and falling apart (Collier, 2007). For poverty to become history, there will have to be growth in these LDCs, but this is not to say that all types of economic growth are equally beneficial to the poor. Clearly, cases exist—e.g., Equatorial Guinea—where only a handful of people have benefitted from a nation's economic growth, but these are exceptional (Collier). Growth usually benefits ordinary people (Goklany, 2007; Rosenberg & Birdzell, 1986). Moreover, the problem of the bottom billion has not been that they have had "the wrong *type* of growth, it is that they have not experienced *any* growth" (Collier, p. 11). Thus, some have argued that failure of the growth process in these societies should be the core concern of development (e.g., Collier; Easterly, 2006; Powell, 2008).

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DOI: 10.1111/j.1540-6520.2010.00428.x

Although entrepreneurship has long been recognized as a fundamental institution of economic growth (Baumol, 1990; North, 1990; Schumpeter, 1934), it has only recently begun to receive attention by development economics, which has historically favored top-down, planning-oriented strategies to poverty alleviation (e.g., Sachs, 2005). To date, development efforts, through inertia, ignorance, and incompetence, have been paltry, standing by and watching as change agents in LDCs were defeated by "the powerful internal forces stacked against them" (Collier, 2007, p. 96). By contrast, advocates of the new thrust in development (e.g. Collier; Easterly, 2008; Powell, 2008) emphasize bottom-up, market-based strategies for the endogenous transformation of LDCs and argue that the societies of the bottom billion may best be rescued through the self-reliant efforts of poor people and poor societies themselves as they borrow ideas and institutions from the West when it suits them to do so (Easterly, 2006).

This more market-based approach to development views various projects as experiments that are initiated by entrepreneurs and retained only when positive feedback is received from the poor. Easterly (2006, pp. 376–377), for example, describes GlobalGiving.com:

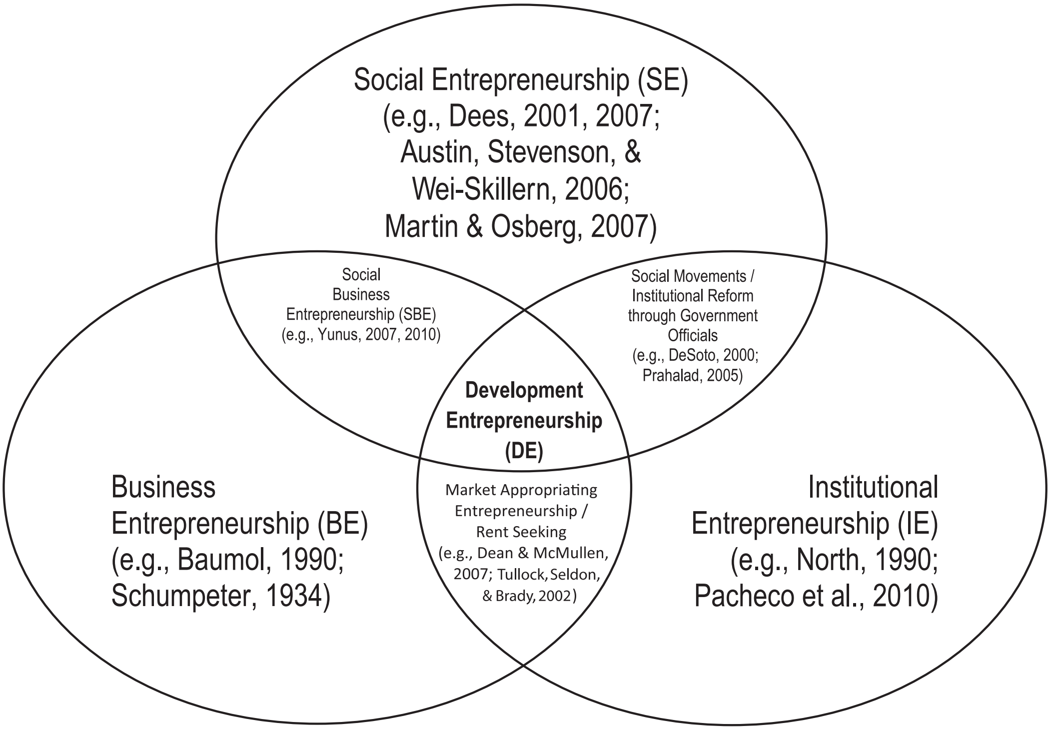
> They see three types of actors: (1) social entrepreneurs close to the poor who propose projects to meet their needs; (2) individuals and institutions with technical and practical knowledge; and (3) donors who have funds they want to give away. The current system has huge bureaucracies under (3) doing central planning of (1) and (2). [The founders] envision instead a decentralized market in which each category has many players who seek out players in the other categories and spontaneously form matches. . . . Projects would compete for funds, technical specialists would compete to be hired, and donors would compete to get results, and thus attract even more funds.

Easterly's example and advocacy of a more market-based approach to development is complemented by a growing number of scholars and practitioners who have described efforts by social entrepreneurs (Bornstein, 2004), social business entrepreneurs (Yunus, 2007, 2010), and business entrepreneurs (Prahalad, 2005) to alleviate poverty in LDCs at the so-called "Base of the Pyramid" (BOP). Despite growing attention, however, the BOP, the bottom billion, and poverty in general have not generated much academic research among management scholars. Bruton (2010, pp. 7–8) points out, "As management scholars we study business. But business involving the poor, whether selling to the poor or businesses among the poor, is a relevant topic for management scholars that should be examined directly."

In response to Bruton's call and in the spirit of the new thrust in development economics, this article proposes a market-based approach to facilitating inclusive economic growth through institutional change. The proposed theory is consistent with the logic of self-interest and trade that is common to economic theory (e.g., Powell, 2008; Smith, 1991). But it is not restricted solely or even predominantly to the pursuit of economic returns and is therefore capable of being reconciled with the social entrepreneurship literature's assumption that entrepreneurship can be motivated by charity as well as profit (Baron, 2007). Consequently, I offer an economic theory of social entrepreneurship that focuses on entrepreneurial activity occurring at the nexus of the three scholarly domains shown in Figure 1: business entrepreneurship (BE), social entrepreneurship (SE), and institutional entrepreneurship (IE). This development entrepreneurship (DE) seeks to change directly the formal institutions of economic growth by engaging in IE—the endogenous transformation of institutional environments (Pacheco, York, Dean, & Sarasvathy, 2010)—with the explicit purpose of making further BE easier. The result of this path creation is an institutional environment that makes productive entrepreneurship—i.e.,

Figure 1

Development Entrepreneurship as Nexus of Social Entrepreneurship, Business Entrepreneurship, and Institutional Entrepreneurship



BE that seeks profit through product innovation as opposed to rent-seeking or crime (Baumol, 1990)—a more efficient and path dependent choice for economic actors seeking to do business in LDCs.

Before delineating DE from related phenomena, however, I articulate the need for a new theory of development by (1) identifying the institutions of economic growth, (2) examining how current development efforts address conditions caused by the absence or impairment of these institutions, and (3) critiquing current explanations of market failure that argue that profit opportunities exist at the BOP that do not require charity or direct reform of formal institutions. To this end, Section II draws from the new institutional economics and economic growth literatures to explain why formal institutions are necessary for rapid economic growth. Section III examines the shift in development away from top-down, planning-oriented attempts to encourage political reforms and towards bottom-up, market-based strategies that seek to support entrepreneurs in their endogenous change efforts. It then describes some of the most visible efforts at endogenous reform in LDCs, noting that they tend to focus on alleviating the symptoms—i.e., lack of credit—of impaired or missing formal institutions rather than the direct reform of the formal institutions responsible for causing these symptoms. As a result, these efforts, while commendable for easing the suffering of those at the BOP, are unlikely to contribute directly to economic growth and the rise in real incomes necessary to improve standards of living over the long run. Section IV suggests that the focus of development efforts on symptoms rather than the root causes of poverty may be due to a conceptual misunderstanding of market failure. Critiquing the three most commonly offered explanations for the existence of unexploited profit at the BOP, this section concludes that government failure in LDCs, as opposed to some inherent flaw in the institution of the market itself, is a more likely cause of market failure.

To explain how entrepreneurship can help to remove the institutional barriers of government failure so that the poor may benefit from economic growth, Section V returns to Figure 1 and delineates DE from (1) SE, BE, and market-appropriating entrepreneurship according to the motive for entrepreneurial action, (2) social business entrepreneurship (SBE) according to the nature and source of the opportunity to fulfill this motive, and (3) socio-political activism according to the means employed to recognize and exploit this opportunity. After acknowledging possible scope limitations of the theory in Section VI, the article concludes in Section VII by discussing how the proposed theoretical framework contributes to both the SE and economic development literatures.

II. Institutional Antecedents of Economic Growth

People from developed nations who are used to the creature comforts it provides may view the extreme poverty seen in LDCs as an anomaly to the norm of wealth, but history tells a different story. For much of the planet's history, poverty has been the norm, inspiring Thomas Hobbes in *Leviathan* to observe that the life of man is "solitary, poor, nasty, brutish, and short." After millennia of slow economic growth in which the natural resource endowments of geography provided the surplus necessary for the seeds of specialization and the division of labor to grow and give birth to increasingly sophisticated technologies, a breakthrough occurred that enabled a small sub-set of nations to experience an accelerated version of this growth process, and thus, enjoy wealth like never before (Diamond, 1997). This industrial revolution set the stage for early scientific inquiry into the wealth of nations (e.g., Smith, 1991) and the formal institutionalization of the growth process that produced it (e.g., Baumol, 2002).

Whether the focus of inquiry is the formal economies of developed nations or the informal economies of LDCs, gains from trade are essential for the creation of wealth (Smith, 1991). But because of imperfect information and dishonesty, these exchanges bear transaction costs (Coase, 1960; North, 1990; Williamson, 2000). Through much of history, small relatively closed communities have minimized these transaction costs by relying on personal exchange between parties who engage in repeat transactions and who possess considerable information about each other. The extent of the market defined by personal exchange, however, contributed both to high production costs by limiting specialization and the division of labor and to high opportunity costs by preventing gains from trade with strangers (North, 1987). Consequently, personal exchange often curtailed economic growth that could otherwise have been possible under an economic system that allowed for impersonal exchange.

By contrast, large relatively open communities, such as developed nations, have enjoyed lower production costs and opportunity costs from larger markets, but only after addressing the high transaction costs of heightened exposure to cheating, shirking, opportunism, etc. that arise from nonrepeat, impersonal exchanges (North, 1987). To constrain individuals from taking advantage of imperfect information, developed nations have constructed a number of well-specified and well-enforced property rights (Barzel, 1997; Bromley, 1989). Property rights define the privileges, obligations, and duties of individuals with respect to an asset (Libecap, 1989) and include formal contracts, bonding of participants, guarantees, brand names, elaborate monitoring systems, and effective enforcement agreements (North, 1987). Indeed, North (1990, p. 27) observes, "The costliness of information is the key to the costs of transacting, which consists of the costs of measuring the valuable attributes of what is being exchanged and the costs of protecting rights and policing and enforcing agreements. These measurement and enforcement costs are the sources of social, political, and economic institutions." Institutions—"the humanly devised constraints that shape human interaction" (North, 1990, p. 3)—emerge to reduce uncertainties and allow increasingly complex social frameworks to evolve by providing confidence in outcomes that become increasingly remote as the growth of specialization widens. Thus, modern economic growth results from the development of institutions that "permit an economy to realize the gains from specialization and division of labor associated with the sophisticated technology that has developed in the Western world in the last several centuries" (North, 1987, p. 422).

The price of impersonal exchange and the perpetually increasing technological sophistication it enables is the creation of a third party to exchanges—i.e., government—that is capable of specifying property rights and enforcing contracts within the market (Williamson, 1985). Indeed, impersonal exchange with third party enforcement is "the essential ingredient for sustained economic growth" (North, 1987, p. 425). With this rise of the state, however, comes an unequal distribution of coercive power. If individuals with superior coercive power have the opportunity to devise and enforce rules that serve the interests of the politically advantaged, there can be no guarantee of decreased transaction costs (North; Rodrik, 2000). A high degree of enforcement of property rights must exist. This requires that substantial resources be devoted both to enforcement and to mitigation of the principal-agent problem, such that "agents who enforce the law are, to a substantial degree, impartial in their judgments" (North, p. 426). That is, markets and property rights are not enough for economic growth; the rule of law is also required (Weingast, 1995, 1997).

Unlike anarchy or the arbitrary rule of men, the rule of law gives the state a monopoly on justice and sets objective standards by which all citizens including political leaders must abide (Rodrik, 2007; Smith, 1991). To achieve the productive benefits of great specialization, a society must develop an elaborate structure of law and its enforcement (Baumol, 2002). No cases of complex high income societies exist that do not have an elaborate structure of government (North, 1987). History suggests that the development of successful political economic systems, such as those found in the Netherlands and England during their rise (see Muller, 2002), requires market-induced pressures that "embed rules and their enforcement in an impartial body of law as far removed as possible from arbitrary changes" (North, p. 426). Representative government, for example, is consistent with this development because it implies a body of law that is impersonal and immune to arbitrary confiscation or alteration by rulers (North).

Thus, markets, property rights, and the rule of law are necessary for impersonal exchange, increasing technological sophistication, and economic growth, but they are insufficient without transaction governance capacity (TGC). "TGC is the capacity of a society to guarantee transparency in the process of economic transactions and the ability to enforce commercial contracts. . . . Clearly developed laws, transparent micro-regulations, social norms, and timely and uniform enforcement are all part of TGC" (Prahalad, 2005, p. 81). In other words, it is not enough to establish property rights and the rule of law, enforcement must also be consistent, impartial, and somewhat internalized by the parties interacting (North, 1990). Institutions that achieve consistency, impartiality, and reliability in their enforcement allow entrepreneurs to form expectations about the future, such as whether to invest in innovation, by removing some of the uncertainty about whether they will be able to capture the value they create (Baumol, 2002). Such institutions are also likely to facilitate the disciplinary presence of competition by protecting economic freedoms—e.g., elimination of statutory barriers to market entry and exit (Lawson, 2008; Scully, 1988). This encourages profit seeking to take a productive form in which value is created through product innovation, as opposed to unproductive or destructive forms in which value is created for customers at the expense of competitors (e.g., rent-seeking through market power or political power) or society (e.g., drug dealing) (Baumol, 1990). Thus, institutions that establish and objectively enforce property rights and the rule of law are characterized by higher levels of economic growth because they ensure that the free market is also a competitive market in which value creation requires product innovation.

In summary, both the new institutional economics (e.g., North, 2005) and economic growth literatures (e.g., Baumol, Litan, & Schramm, 2007) assume that markets are the most efficient means by which self-interested actors reallocate resources to their highest valued uses, but they recognize that the market is embedded in a matrix of political and socio-cultural institutions (Granovetter, 1985). Because economic growth is partly determined by the extent of the market, which in turn is highly dependent on entrepreneurs being able to engage in impersonal as well as personal exchanges, property rights must be established and enforced by a third party to reduce transaction costs, but it is also essential that this enforcement is grounded in a rule of law that is impartially administered. When transparency is achieved, entrepreneurship is likely to manifest in productive forms such as product innovation that contribute to rapid economic growth.

III. Market-Based Approaches to Development

Because formal institutions, such as regulatory structures, laws, and courts, are an obligation of the state, early development attempts at intervention in LDCs sought with mixed results to work through government officials to develop the institutions that allow these societies to realize the gains from specialization and division of labor that are associated with sophisticated technology (Kling & Schulz, 2009). In many cases, it is simply not in the self-interests of political elites and lower government officials to participate in reform efforts (Rodrik, 2007). Though long-term social interests may be facilitated by such reforms, there is a short-term cost in the amount of foregone bribes and other benefits for the lower level officials who are best positioned to implement such efforts (Prahalad, 2005). Likewise, it is difficult to encourage political elites to replace anarchy or the rule of men, in which their power may be unlimited, with the rule of law, in which their power is limited to the consent of the governed (Rodrik). As a result, legal reform through political channels has proven difficult.

Frustrated with government failure and insufficient foreign aid, a number of entrepreneurs have taken matters into their own hands, seeking micro-solutions to macro-social problems caused by inefficient legal institutions (Moyo, 2009). Three of the most prominent proponents of market-friendly reforms in LDCs are Hernando DeSoto (2000), C.K. Prahalad (2005), and Muhammad Yunus (2007). DeSoto is most closely associated with the property rights movement, which seeks to unlock the value of "dead capital" by making it easier for the poor to obtain legal title to their possessions and transition from the extralegal sector to the formal economy. He argues that the key to empowering the poor lies in providing them the ability to prove they own their possessions so that they may use them as collateral for loans that could generate additional income. Prahalad is known for championing the market potential of the BOP—the 2.7 billion individuals that live off less than $2/day. He argues that false assumptions about the poor have precluded multinational corporations (MNCs) and large domestic firms from recognizing that higher volume could offset and overcome lower margins. The key to empowering the poor, according to Prahalad, begins by viewing them as consumers and seeking to design product solutions for which they are willing and able to pay. Lastly, Yunus has become the face of micro-finance. He too argues that false assumptions about the poor have prevented bankers from providing them the opportunity to climb out of poverty. His remedy: collateral-free micro-loans.

I focus on the work of these three thought leaders in micro-development for several reasons. Each speaks to a different audience—DeSoto to policy makers, Prahalad to executives of large firms, and Yunus to individuals and the general public. In addition, each emphasizes a different manifestation of the same problem only to arrive at the same proximal cause—lack of access to credit—responsible for preventing the poor from escaping poverty.

For DeSoto, credit is elusive because the poor do not have collateral to offer. This lack of collateral is due to a lack of legal title, which in turn can be attributed to the prohibitive costs of navigating excessive bureaucracy and corruption in order to join the formal economy. For Prahalad, credit is elusive because large companies have not viewed the poor as potential customers and therefore have not sought to identify the obstacles that have prevented them from consuming. Among these obstacles is the inability to pay, which Prahalad suggests is a problem that has already been solved through installment sales of big ticket items in developed nations. He then points to numerous companies that have sought to transform the poor into customers by developing ways to make installment sales to the poor. Again the solution revolves around how to extend collateral-free credit while minimizing exposure to default. Finally, Yunus focuses on overcoming a lack of access to capital by devising ways in which to ensure that collateral-free loans are repaid. Unlike DeSoto and Prahalad, however, he generally ignores interactions with the formal legal system.

In each case, a swim up the causal stream led to the identification of an institutional barrier that was responsible for perpetuating poverty. Each author began with an understanding of poverty as an inability to consume, which he in turn conceived of as a lack of purchasing power. Rather than examining this lack of purchasing power in terms of income—why it was low and how it might be increased, each author took low income as a given and focused instead on how to increase the purchasing power of this fixed income. This led each to conceive of the poor's weak purchasing power in terms of their inability to borrow, which was traced to the inability to guarantee repayment. This inability to prove one's creditworthiness prevented lenders from being able to minimize their exposure to loss, thereby perpetuating the cycle of poverty by preventing the extension of credit and the poor's attainment of lower priced goods and services (Prahalad, 2005).[1]

Ultimately, however, the true inability to minimize exposure to losses from lending can be attributed to a lack of formal institutions that can ensure that strangers will keep their promises. DeSoto and Prahalad recognize that this problem is partly a structural legal issue concerning formal regulative institutions—i.e., lack of property rights grounded in the rule of law. Focusing more on agency, Yunus (and to a lesser extent Prahalad) recognizes that this legal issue can also be addressed through normative institutions, such as peer pressure and other informal socio-cultural institutions (London, 2009; London &

1. Critics (e.g., Dichter, 2007) have argued that, historically, savings, not credit, has been the key to prosperity and that micro-loans tend to be used for consumption more than production. I return to this point below.

Hart, 2004). By lending to villages, communities, or groups rather than individuals, firms and micro-finance agencies seek to transform uncertainty into risk by having borrowers pool their resources for repayment and by having peer pressure by members of those groups serve as a "proto-institution" or substitute to courts as a mechanism of contract enforcement (Webb, Kistruck, Ireland, & Ketchen, 2010). That is, future access to credit by members of the group is diminished if they do not demand accountability from each other. This is likely to involve monitoring, internal sanctions, and occasional acts of charity to smooth over income volatility of individual members (Yunus, 2007). Whether this is good for the individuals partaking in the group has been questioned (Tucker, 1995, 2006), but it is clearly beneficial to lenders because the risk of default diminishes as responsibility for enforcing repayment becomes a matter of concertive control (Barker, 1993) rather than legally enforced external control.

Innovative arrangements that allow for installment sales or micro-lending are creative and commendable solutions to problems that have been created by missing or impaired formal institutions and may even result in institutional change over time. By defining lack of access to credit as the problem, however, these initiatives take the focus off the root cause of extreme poverty—inefficient legal institutions that encumber TGC and prevent equal access to the formal economy—and focus instead on treating a symptom of poverty that is likely to continue to affect other marginalized or disenfranchised citizens until the deeper structural problem is resolved. Enhancing the efficiency of legal institutions is likely not only to treat the symptom of poverty—the inability to borrow—but also to diminish the need for such treatment—low income—by making the institutional environment of the LDC more attractive to MNCs, thereby encouraging foreign direct investment and opportunities for the poor to increase income through wage labor. Thus, lack of access to credit is a proximate cause but not a root cause of extreme poverty. The root cause is government failure to establish and enforce property rights through a court system that is grounded in the transparent application of the rule of law. This root cause manifests as either (1) an inability by the borrower to ensure the lender of loan repayment, or (2) lack of employment opportunities that allow for savings and wages, making debt unnecessary.

IV. Market Failure and the Need for Institutional Change

If circumventing institutional obstacles is all that stands between entrepreneurs and realizing a profit by serving the BOP, then business entrepreneurs, according to the efficient market hypothesis (Passour, 1989), should exploit the opportunity without any additional encouragement by advocates (such as Prahalad, Yunus, or DeSoto), charity, or aid agencies. In other words, economic returns, if high enough, should provide enough incentive not only to encourage entrepreneurs (be they MNCs, large domestic firms, or indigenous entrepreneurs) to exploit opportunities but also to initiate the IE required to do so.

A case in point is MCI's efforts in the early 1980s to lobby the U.S. government for the right to compete in the telecommunications industry (Dean & McMullen, 2007). Dissolution of AT&T's statutory monopoly was one of many steps necessary not only to exploit the deadweight loss in that industry, but also to appropriate some of the rents being enjoyed by AT&T and to create new markets through product innovation. Years later, Strive Masiyiwa engaged in a similar journey within the LDC of Zimbabwe. Born in Southern Rhodesia in 1961, Masiyiwa went to high school in Scotland and college in Wales where he studied electrical engineering. He returned to the newly independent Zimbabwe in 1984 to take a job with the state-owned telephone company. Because sub-Saharan Africa had only two fixed-line telephones for every hundred people in the 1990s, Masiyiwa recognized the great potential for wireless phones to lead to quicker and less expensive development than land-based networks and created a cell phone network of his own after having his entrepreneurial ideas rebuffed by his employer Zimbabwe Posts and Telecommunications Corporation (ZPTC). Facing fierce opposition by ZPTC, which told him it held a monopoly in telecommunications, and the Zimbabwean government, which swamped him with red tape and demands for bribes, Masiyiwa pursued his case through a four-year legal battle culminating in the nation's Supreme Court. Econet's first cell phone subscriber was connected to the new network in 1998 after the court declared that the government monopoly on telecommunications had violated the constitution's guarantee of free speech.

In both the MCI and Econet cases, the promise of economic returns was enough to encourage entrepreneurs to initiate IE. Despite the uncertainty and difficulty of such efforts, institutional barriers were simply considered one of the many obstacles that had to be overcome to exploit the entrepreneurial opportunity. Therefore, government failure—in the form of statutory monopoly—caused market failure—the deadweight loss of unmet demand, but it did not prevent entrepreneurs, even in LDCs, from still finding ways to capture this profit—even if it meant having to create the market needed to meet the demand. Thus, business entrepreneurs will engage in IE in LDCs without exogenous influence (i.e., encouragement by aid agencies) when they believe it is in their financial interests to do so and investors believe likewise.

What happens, though, when expected financial returns do not justify initiating IE? Is the profit potential of eliminating deadweight loss simply lost until government officials find it in their financial interests to provide entrepreneurs with the freedom to compete? What about other forms of so-called "market failure"? If there are transaction costs that could be eliminated by enhancements in TGC, then they may be conceptually equivalent to deadweight loss in that their reduction is likely to create value for society and profits for those who can capture some of it (Dean & McMullen, 2007). Why has the market not exploited this profit potential, especially in LDCs where formal institutions are highly inefficient?

To date micro-development advocates championing both social and business enterprise solutions to extreme poverty have argued that significant profit potential exists in creating markets that serve the poor and that these efforts can be implemented through the current institutional structure, despite the challenges it poses. By definition demand requires consumers that are willing and able to purchase a product at the offering price (Dean & McMullen, 2007). Similarly, entrepreneurial action requires that someone be willing and able, based on expected returns, to make this product offering (McMullen & Shepherd, 2006). If expected returns are high enough, entrepreneurs are not only likely to be motivated to pursue them but also to be able to motivate others to provide the financial and human capital needed to act. To argue, as Prahalad, Yunus, and numerous others (e.g., Elkington & Hartigan, 2008) have, that there is significant profit potential in creating markets for the poor therefore requires an explanation of why this opportunity has gone unexploited by the market. In offering such an explanation, these authors typically propose that one or more of the elements necessary for entrepreneurial action—expectations, motivation, or ability—has been systemically impaired such that entrepreneurs, if enlightened, could profit by serving the poor without necessarily having to engage in direct reform of formal institutions. In the remainder of this section, I present micro-development's most common explanations of "market failure"—why markets in LDCs have failed to address the needs of the poor—and offer a critique of each explanation to demonstrate why market failure is more likely to be the product of government failure to establish and maintain efficient politico-economic institutions than some inherent flaw in the market itself.

Expectations-Based Explanations of Market Failure

Many of the market-based approaches to development discussed so far emphasize expectations in the form of false assumptions about the poor. Both Prahalad and Yunus, for example, claim that entrepreneurs can profit by serving the poor but have failed to do so because they erroneously assumed that the poor would not or could not either repay loans (Yunus, 2007) or pay for brand names and sophisticated technology (Prahalad, 2005). These assumptions about the poor are, in effect, expectations regarding consumer demand. These expectations assess the poor's willingness and ability to purchase proposed product solutions at a price point that the entrepreneur is willing and able to offer. If entrepreneurs consistently underestimate the returns associated with serving the poor, these expectations are likely to undermine their willingness and ability to offer product solutions by creating doubt about whether they can cover operating costs, much less the costs of capital.

Both Yunus and Prahalad imply that these false assumptions about the poor are the result of inertia or ignorance. Because profits were achieved in the past through high margins on fewer transactions, firms may suffer from cognitive inertia in which they continue to seek only opportunities of this nature while overlooking the profit potential of the high volume, low margin business of the BOP (Prahalad, 2005). Higher volume may allow for lower prices that the poor would be willing and able to pay. In this scenario, expectations lead to market failure because they are adaptive and backward-looking, evolving from past conditions in developed nations, as opposed to forward-looking products of the imagination informed by facts about the current situation in LDCs (Dacin, Dacin, & Matear, 2010). Similarly, lack of exposure to the poor may contribute to the entrepreneur's ignorance about their needs, desires, capabilities, or customs, thus preventing the entrepreneur from knowing that the poor are brand conscious or that potential exists for relatively simple innovations (such as the extension of credit to groups rather than individuals or the demand for single-serving-sized goods) that could enable them to pay for products (Prahalad, 2005). Ignorance of either the desires of the poor or the obstacles they face may cause entrepreneurs to underestimate the demand for product solutions that these entrepreneurs would otherwise be willing and able to provide. Thus,

> **Explanation 1:** Inertia or ignorance prevents entrepreneurial action (thereby contributing to market failure) by causing entrepreneurs to underestimate the expected returns of serving BOP markets.

Critique. Although an expectations-based explanation of market failure has some merit on a case-by-case basis, it is less compelling at a systemic level of analysis. If ignorance of the poor's willingness and ability to pay were truly responsible for preventing the market from satisfying the needs of the poor, then it seems that anyone who was familiar with the plight of the poor and able to escape these conditions could educate investors and other stakeholders, and then return with the resources needed to profit wildly by remedying the situation. Both Masiyiwa and Yunus loosely fit this description. Somewhat aware of extreme poverty, both men left relatively poor nations for developed nations where they acquired the tools and skills that enabled them, when they returned home, to serve the poor in LDCs. Thus, if erroneous expectations are the primary cause of market failure, then market failure in LDCs is equivalent to a dispersed knowledge problem that is common to every society and arguably best remedied by the market (Hayek, 1948). Moreover, extreme poverty in LDCs would be a fleeting problem as people who possessed local knowledge about the poor's willingness and ability to consume acquired new knowledge from economic growth in developed nations, which enabled them to profit by serving BOP markets.

Despite increasing awareness about extreme poverty and the rapid dissemination of information made possible by the internet (Zahra, Rawhouser, Bhawe, Neubaum, & Hayton, 2008), the extreme poverty problem persists. Moreover, the reductions that have occurred in the last quarter century have resulted more from institutional reform in nations such as China and India than entrepreneurial enlightenment about the plight of the poor (Ahlstrom, 2010; Bruton, 2010; Khanna, 2007; The Economist, 2009). Thus, examination of motivation- and ability-based explanations of market failure may be not only beneficial but necessary to reach a better understanding of whether it is reasonable to expect entrepreneurship to be an effective tool in the fight against extreme poverty.

Motivation-Based Explanations of Market Failure

If entrepreneurs choose not to exploit the profit potential of BOP markets despite their ability to do so, then market failure must be the result of an unwillingness to act entrepreneurially. This argument tends to employ socio-cultural explanations that suggest that prejudice from racism or religious intolerance is responsible for precluding a particular group from participation in the market—i.e., India's untouchables (Bornstein, 2004). Thus, the market fails to serve the poor because nonfinancial disincentives in the form of social norms discourage entrepreneurs from acknowledging members of the excluded group as potential customers, regardless of their demand for products (Alvord, Brown, & Letts, 2004; Leadbeater, 1997). Thus,

Explanation 2: Prejudice prevents entrepreneurial action (thereby contributing to market failure) by diminishing entrepreneurs' willingness to serve BOP markets.

Critique. As globalization spreads and national economies are liberalized, impersonal exchange with unprejudiced parties is enabled. As a result, informal institutions become less effective in their attempts to exclude the marginalized (Muller, 2002). Profit-seeking entrepreneurs facilitate the socioeconomic empowerment of members of marginalized groups by viewing the poor as customers or as an inexpensive source of strategic factors (Moran & Ghoshal, 1999). Therefore, the argument that profit potential remains unexploited because of prejudice requires some explanation for why MNCs or other unprejudiced entrepreneurs do not find the profit potential of serving the BOP motivating enough to enter the market. Indeed, if market failure can be attributed to nothing more than prejudice, then ironically, the market may again be best suited for remedying the malady. That is, expansion of the market to include unprejudiced trade partners from outside the LDC would appear to be one of the most effective ways to make prejudice against the BOP less economically relevant. But instead of focusing on how to reduce prejudice in LDCs to encourage inclusive growth, it may be more productive to examine why MNCs have not been motivated to exploit the profit potential of the BOP and how and why entrepreneurial agents might profit by enabling the BOP to engage in greater liberalization of trade.

Ability-Based Explanations of Market Failure

If expected returns are enough to motivate entrepreneurial action, but entrepreneurial action still fails to occur, then the culprit must be an inability to act. This inability can be attributed to a lack of different types of capital (financial, human, social, political, etc.), but discussion to date has primarily emphasized financial capital (Austin, Stevenson, & Wei-Skillern, 2006). For example, Muhammad Yunus (2007) frequently tells the story of women making bamboo stools in Bangladesh, who, for the want of $27, were trapped in a cycle of poverty because of exploitation by a middle man. Thus,

> **Explanation 3:** Lack of financial capital prevents entrepreneurial action (thereby contributing to market failure) by diminishing entrepreneurs' ability to serve BOP markets.

Critique. Stories like Yunus's have prompted critics to argue that micro-finance is no silver bullet for poverty reduction (Karnani, 2007; Siemon, 2009). If financial capital were the primary cause of extreme poverty, then development could be largely facilitated by throwing money directly at the problem. Easterly (2006) notes that, somewhat surprisingly, this strategy has not been tried, despite decades of foreign aid to governments and recent calls for more (e.g., Sachs, 2005). Lack of financial capital is not unique to LDCs; it is a hurdle encountered by entrepreneurs regardless of institutional context and a key determinant of the supply of entrepreneurship (Schumpeter, 1934). Stories told by Yunus and others to advocate micro-finance, however, often communicate a fairly static economic view of the poor as agents who confront no uncertainty about demand or supply, who possess the technical knowledge and business skills necessary to run a business, and who operate in an institutional context in which entrepreneurship is not impossible (i.e., peace, infrastructure, and freedom exist at least to the degree that action can be taken, etc.); all that is preventing entrepreneurial action is a nominal amount of financial capital (Bradley, McMullen, Artz, & Simiyu, 2010).

Not only are the efficiency of institutions and the pervasiveness of technical knowledge likely to vary between developed nations and LDCs, such that, compared with financial capital, institutional and human capital would appear to be equally (if not more) important obstacles to entrepreneurial action (Mair & Marti, 2009), but also there is little reason to expect that demand and supply uncertainty and the need for business skills to navigate a dynamic economy are irrelevant concerns at the BOP. Indeed, it is difficult to imagine why entrepreneurs at the BOP would be immune to the need for innovation and the need to navigate the demand and supply uncertainty it creates in an LDC where resources are even more scarce and thus subject to even greater competition from alternative uses (Bradley et al., 2010).

Like any form of lending, micro-finance may have examples of entrepreneurs who have indeed recognized opportunities that they have been unable to exploit simply because of a lack of financial capital, but to suggest that this is the case for most of the poor would ignore statistics that suggest that, on average, only about 8% of a nation's population is typically engaged in early-stage entrepreneurial activity (Minniti, 2006). Worse yet, if micro-finance is seen as a silver bullet and charitable donations continue to increase based on this belief, funds could start chasing ideas (rather than the other way around) and yield an investment bubble similar to the dot.com fiasco of the late 1990s. Recent research suggesting that micro-finance funds are increasingly being used for consumption smoothing rather than production indicates that this concern may already be materializing (Amin, Rai, & Topa, 2003). Thus, inability to act entrepreneurially appears to be much more than a lack of financial capital.

If profit potential existed such that a simple capital infusion was all that was needed to unleash the entrepreneurial potential of the poor, development would already be taking place, albeit at a slower than desired pace. Like venture capital, micro-finance would simply contribute to development by accelerating economic growth. Consequently, market failure would be a relative term meaning only that the market was failing to grow as fast as people would like. For a capital infusion to produce economic growth, however, institutional incentives must be aligned with individual incentives (Dutz, Ordover, & Willig, 2000). Otherwise, profit-seeking is unlikely to manifest in a productive form such as product innovation and is more likely to take shape as imitative rent-seeking or crime (Baumol, 1990, 2002). Thus, financial capital is more likely to facilitate than enable economic growth, suggesting once again that market failure may be a misnomer and that the true culprit responsible for stymieing economic growth may be the inefficient formal institutions in which the market is embedded.

V. Delineating Development Entrepreneurship

If inertia, ignorance, prejudice, and financial capital are unlikely to explain the systematic failure by entrepreneurs to exploit the profit potential of BOP markets, then two possibilities require closer examination: (1) the profit potential associated with serving the BOP has been grossly overstated—see Karnani (2007) for an example of such criticism—and/or (2) the obstacle to development may be more structural than agency-oriented. For example, the institutions in which the market is embedded may encourage agents to seek profit that does not contribute to economic growth because of a misalignment in private and social incentives (Baumol, 2002; Dutz et al., 2000). Although both points may have merit, only the latter offers hope for the bottom billion and a possible remedy to their plight.

Recognition that the market is an institution that consists of exchanges that can be personal or impersonal, that significant economic growth requires impersonal exchange, and that impersonal exchange requires an effective government that establishes and enforces property rights through an impartial and objective rule of law, provides a much more compelling explanation of why BOP markets have not been served. But perhaps more important, this government failure may describe the root cause of the market's failure to serve the BOP. As previously mentioned, government officials often do not have the financial incentive to alter institutional arrangements. Likewise, business entrepreneurs are likely to alter institutional arrangements only if they expect high enough returns, but there is no guarantee that they will change these institutions in ways that enhance social welfare. Indeed, many scholars have warned that capitalism is susceptible to capture by incumbent firms who will seek to construct barriers to protect themselves from competition (Schumpeter, 1942; Tullock, Seldon, & Brady, 2002). Even in the MCI example provided earlier, MCI's attainment of the right to compete was driven by the profit-driven desire to capture some of the dead-weight loss caused by AT&T's statutory monopoly, not some charitable motive to provide less expensive telecommunications to the public. Thus, Dean and McMullen (2007) refer to this profit-motivated IE as market-appropriating entrepreneurship—see Figure 1. Similarly, the public choice literature describes such efforts as rent seeking—"legal and illegal activities to obtain special privilege such as seeking monopoly status, special zoning, quantitative restrictions on imports, protective tariffs, bribes, threats, and smuggling" (Tullock et al., p. 44). Consequently, recognition that institutional arrangements can be variables that entrepreneurs can influence does not mean that socially beneficial outcomes are likely. As Adam Smith

(1991, p. 137) acknowledged long ago, "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." Thus, for market-based approaches to produce development outcomes, there must be some degree of charity to supplement the profit motive. It is with this understanding that I propose the construct of development entrepreneurship shown in Figure 1 and delineate it from a number of overlapping constructs.

Development Entrepreneurship as Nexus of SE and BE: Delineation by Motive

If an opportunity does not promise the best financial return available but is still expected to be profitable and to produce socially beneficial outcomes, then people could be expected to experience nonfinancial incentives of a moral or social nature that could supplement the profit motive (Zahra et al., 2008). This supplemental charity motive encourages entrepreneurial action despite the opportunity's second-best financial status. Indeed, institutional change, by definition, requires innovation which in turn requires some sacrifice of known financial returns associated with past activities for uncertain financial returns associated with new activities (Battilana, Leca, & Boxenbaum, 2009). Reform of the politico-economic institutions needed to strengthen the economic incentives of productive entrepreneurship and weaken the incentives of nonproductive entrepreneurship requires that some of this financial sacrifice be made in the hope of producing social benefit (Dacin et al., 2010).

This exchange of financial, private return for nonfinancial, social return, however, should not be viewed as an all or nothing proposition. It is entirely possible that significant financial reward will accrue to those implementing reform efforts, despite pursuit of a second-best opportunity. Given the uncertainty in which such opportunities are shrouded, financial rewards could wildly exceed expectations such that the financial return on the investment outperforms investment opportunities promising more financial return but little-to-no direct social benefit. This, however, is not known a *priori*. Therefore, some sacrifice of *expected* economic return in exchange for higher social or moral return is needed to encourage DE, which is expected to capture some of the value it creates, but not enough to make it the most profitable investment opportunity available to the agent.

If examined solely in terms of financial return, DE appears unlikely. Although MNCs may have the capital needed to bear the uncertainty associated with IE, they also have less uncertain investment opportunities available to them in developed nations. This yields opportunity costs that result from conducting business under various institutional regimes (McMullen, Bagby, & Palich, 2008; Zacharakis, McMullen, & Shepherd, 2007). Indigenous entrepreneurs often do not bear these inter-institutional opportunity costs, but they tend to lack the capital needed to bear any uncertainty that is not deemed absolutely necessary to achieve a profit. Thus, second-best opportunities carry significant financial opportunity costs of an intra-institutional nature. This too discourages IE. Therefore, despite profit potential, financial incentives alone appear to be inadequate to encourage socially beneficial institutional change via BE. Consequently, SE may be necessary.

If DE requires the entrepreneur to expect some degree of financial return, but not enough to entice action based on the profit motive alone, then DE must be a subset of SE. SE is regularly offered as a hybrid solution existing between the extremes of purely market-based commercial enterprise and charity- or government-funded social programs (Austin et al., 2006; Certo & Miller, 2008). It is often recognized that social enterprises do not promise the economic return on investment that is offered by commercial ventures.

Instead, they offer blended value comprised of social and economic return on investment (Brooks, 2009; Emerson, 2003). Often this social value is difficult to measure and/or specific to a segment of the general population (Zahra, Gedajlovic, Neubaum, & Shulman, 2009), making it hard to justify the use of government funds to resolve the problem it addresses (Sud, VanSandt, & Baugous, 2009). Moreover, SE is often needed most in LDCs where there is not enough formal business activity to generate an adequate tax base to fund social welfare programs (Leadbeater, 1997). Consequently, many nongovernmental organizations (NGOs) seek to fill the void by providing social services with funds received through charitable giving and/or foreign aid from developed nations (Fowler, 2000).

Although SE researchers (e.g., Martin & Osberg, 2007) commonly equate SE with social innovation by referring to the conception of entrepreneurship put forth by Schumpeter (1934), they ignore evolution in entrepreneurship theory since Schumpeter, such as that conducted by Baumol (1990, 2002), who equates entrepreneurship with profit-seeking. Baumol (1993) recognizes that profit-seeking always occurs within an institutional context and therefore is subject to the payoff structures in which it is embedded. This does not imply that the entrepreneur must comply fully with existing institutional arrangements, otherwise novelty would rarely be introduced to the price system and productive entrepreneurship could not occur, but it does force the theorist to recognize that value created and value captured are distinct concepts. Moreover, value captured does not necessarily have to be created by the party capturing it, as unproductive and destructive forms of entrepreneurship demonstrate (Baumol, 1990, 1993, 2002). Similarly, the creation of value often does not accrue to its creator, as witnessed in the acts of catalyst firms who unsuccessfully apply technical knowledge, but whose efforts enable others to capture value that they themselves could not (Davidsson & Wiklund, 2001).

Can SE be considered entrepreneurship if the social enterprise responsible for its creation cannot capture enough value to sustain itself (Boschee, 2001; Mizik & Jacobson, 2003)? This is similar to asking whether innovation can be considered entrepreneurship if the new venture responsible for its creation cannot capture enough value to sustain itself (Davidsson & Wiklund, 2001). Although the *post hoc* answer is a resounding yes, the *a priori* answer is an equally resounding no. In its economic form, entrepreneurship occurs because of expected economic return—the profit motive. While the institutional contingency of this profit was mostly an implicit assumption in the work of Schumpeter (1934), it is explicitly recognized by Baumol (1990). Either way, however, the innovation of entrepreneurship is considered unlikely to occur without the promise of financial profit (Baumol, 2002). Moreover, both Mises (1935) and Hayek (1948) demonstrated that profit is more than a motive, it also communicates the wants and needs of the market, thereby informing entrepreneurial decision making about what and how much to produce. Without this feedback, it becomes difficult to determine how to allocate scarce resources efficiently to meet others' needs. Thus, the value creation of BE appears to be contingent on the promise of private value capture whereas the value creation of SE is free of this contingency; but as a result, SE cannot rely on profits to communicate what the market wants or to verify that value has been created by its activities. If these properties are essential for a market system to function effectively, then SE may not constitute entrepreneurship in a way that is meaningful to economic theory.

The concept of entrepreneurship, however, is not exclusively defined in terms of innovation, value creation, or profit-seeking, it has also been conceived as organizational creation (Gartner, 1988). Although this may rescue the use of the term from the *a priori* financial profit litmus test advocated above, it fails to explain why the concept of SE is needed over and above the notion of charitably funded organizations, such as nonprofits, NGOs, associations, and the like. Often the conception of entrepreneurship as the creation of an organization is comingled with Schumpeter's (1934) understanding of entrepreneurship as innovation, except that this innovation is said to produce a new social (as opposed to economic) equilibrium. SE is often distinguished from the creation of an organization that simply provides social services because the former is considered scalable whereas the latter is not (Martin & Osberg, 2007). Thus, SE is proposed to be the creation of an organization that results in a sustained social equilibrium. As such, the concept focuses exclusively on value creation, neglecting value capture at the organizational level, and is divorced entirely from any requirements of financial sustainability. I am not arguing that this conception is unhelpful or wrong, only that it is unsatisfactory for making an economic case for SE in which the construct is explicitly tied to notions of financial sustainability, economic growth, and/or development. Instead, it is a purely sociological argument occurring wholly in the social or moral domain and classifiable primarily as philanthropy and/or charity. Although such efforts can provide economic returns on capital, this capital is not "invested" for the purposes of economic return. Instead, it is provided purely for charitable motives, without the expectation of an economic return on investment.

If the promise of profit is required for an act to qualify economically as entrepreneurship, then SE is likely to be a narrower concept than social innovation. Or, if one wishes to treat SE and social innovation as equivalent terms, then it may be necessary to introduce and distinguish the concept of SBE, which requires enough earned income to cover operating costs, from SE, which does not (Yunus, 2007, 2010). However, the expected return from this earned income cannot be too great, otherwise the act becomes the most attractive opportunity to economic agents such that economic incentives will be enough to entice IE, hence making the modifier, "social," meaningless. Thus, for SE to have economic meaning, it must address a space in which profit is deemed possible but insufficient to motivate entrepreneurial action unless supplemented by moral or social incentives in the form of charity. This results in the overlap of SE and BE in Figure 1 that includes both SBE and DE.

Development Entrepreneurship vs. Social Business Entrepreneurship: Delineation by Opportunity

All SBE is not DE. DE is SBE that seeks directly to change formal institutions in ways that will enhance social welfare. This distinction is more than a matter of difference in objective (Zahra et al., 2009). The institutional obstacle that the entrepreneur seeks to overcome and change also serves as the source of the opportunity for DE. Inefficient institutions create high transaction costs, the reduction of which can constitute an opportunity for enhanced market efficiency or the creation of entirely new markets (Dean & McMullen, 2002, 2007; Elkington & Hartigan, 2008; McMullen et al., 2008). Exchange-prohibiting transaction costs, however, are not in and of themselves an entrepreneurial opportunity. A change in supply, demand, or both is necessary for the emergence of entrepreneurial opportunities (Companys & McMullen, 2007; Sarasvathy, Dew, Velamuri, & Venkataraman, 2003). This change in circumstances, however, must be significant enough to suggest that the emerging opportunity promises a higher net present value (factoring in switching costs) than alternative opportunities, which may be less uncertain. Thus, two questions emerge: (1) what has changed to reduce the transaction costs associated with inefficient institutions such that entrepreneurial action is feasible and/or desirable where previously it was not, and (2) if this profit opportunity does not promise a higher private return than alternative investment opportunities (once discounted for institutional uncertainty and switching costs), is society left with the unappealing alternatives of inaction grounded in the efficient markets hypothesis or coercive redistribution schemes such as welfare and government subsidies? The charity motive of SE addresses the second question, enabling entrepreneurs to exploit second-best opportunities, but the source of these opportunities, to which the first question refers, is the existence of sophisticated technologies and innovations that have been created by economic growth in developed nations, but which government failure in LDCs has prevented from diffusing (Bruton, Ahlstrom, & Li, 2010).

For example, denial of the right to compete in the telecommunications industry in Zimbabwe did far more than prevent customers from enjoying lower prices and better phone coverage, it precluded the dissemination of information that would subsequently reduce transaction costs in various dimensions of economic and political life. Similarly, the democratization of technology in India has not only enabled farmers to cut out the middle man and enjoy higher prices for their crops (Prahalad, 2005), it has also allowed citizens of Kenya to circumvent politicians' attempts to intimidate them at the polls by communicating venues at which they could safely cast their votes ("Kenya: Avoiding trouble during referendum voting," 2010). Thus, institutional reforms such as those initiated by Masiyiwa often reduce transaction costs by enhancing both economic and political freedom such that a greater proportion of resources can be invested in productive rather than protective activities. As a result innovative entrepreneurship that contributes to economic growth becomes more efficient and a more appealing choice while nonproductive forms of entrepreneurship such as imitative rent-seeking or crime become relatively less efficient and less appealing options for profit seeking.

SBE that does not directly seek to change formal institutional arrangements—e.g., see Yunus (2007, 2010)—is extremely helpful in reducing human misery, as are the efforts of many NGOs (Fowler, 2000), but these organizations treat the symptoms rather than the root cause of extreme poverty. In contrast, DE tackles the institutional barriers that prevent economic growth, the development of the tax-paying formal business sector, and consequently the incomes and tax revenues that could render some of these NGOs unnecessary. By targeting the institutional cause of disenfranchisement, DE can empower the marginalized by increasing economic and political freedom.

Eradication of extreme poverty requires more than superficial legal reform. Not only has land titling in Africa been far more challenging than anticipated (Easterly, 2008), the very premise that proof of collateral will enable consumers to spend an economy into prosperity appears dubious upon closer examination. As critics of DeSoto have noted, legal title to an asset is fairly meaningless unless there is a market for that asset (Gilbert, 2002)—e.g., providing title to a home in a declining urban neighborhood is no road to prosperity if there is no one who wants to purchase that property. Like markets for property, markets for property rights require a buyer as well as a seller. Thus, possessions must have an exchange value if they are to produce income in the form of rent or interest.[2] It is for this reason that SE needs global markets. Without the markets of developed nations, it is unlikely that LDCs can enjoy enough economic growth to catch up with the living standards of developed nations (Collier, 2007). Exclusion from the global economy denies access to the advances in knowledge that membership provides (Friedman, 2008). Direct application of this knowledge in the form of knowledge spillovers (Audretsch, 1995) or indirect application of this knowledge in the form of new product possibilities

2. Worse yet, Gilbert (2002) suggests that rights to property in the slums could lead to downward raiding as wealthier agents from the formal sector purchase the possessions of the poor.

made possible by newly available goods and services (Romer, 1994) are inputs enjoyed by nations participating in the global economy but denied to members of nations whose political institutions leave them segregated (Warsh, 2006). Thus, the institutional barriers that have precluded the diffusion of innovations from developed nations to LDCs are also responsible for creating knowledge arbitrage opportunities for agents capable of traversing the divide that keeps suppliers of various forms of capital—located in developed nations—ignorant of demand for various goods and services—located in BOP markets in LDCs—and vice versa.

Frequently, advocates of SE have denounced globalization for engaging in free as opposed to fair trade and for providing a path out of poverty through employment in factories or cubicles for subsistence rather than "living" wages (Esty, 2001). Though noble in intent, these positions frequently overlook the intergenerational benefits of the dynamism of capitalism by comparing the living conditions of workers in LDCs today to those of workers in developed nations without considering the sacrifices made by the generations of workers who contributed to the development of developed nations (Hayek, 1978). The cause of low wages in LDCs is not exploitation by MNCs, it is institutional conditions that prevent numerous MNCs from entering a nation and having to compete for the labor of those employees (Friedman, 2005; Prahalad, 2005). The lack of such competition is what is responsible for the reduced bargaining power of would-be employees in these nations, low wages, and lower standards of living. With institutional reform comes security, entrants, jobs, competition for labor, rising wages, increased tax revenues, increased standards of living, and disposable income to be invested in the next generation's education and training, thereby reducing discrepancies in access to opportunities in the global economy across the focal developing nation and developed nations (Bhagwati, 2004). Though it may be tempting to prefer the autonomy and control of isolationism, it is likely not only to perpetuate poverty, but also to amplify the discrepancy over time, as advances in knowledge in developed nations continue to grow at an exponential pace (Friedman, 2008; North, 2005).

Development Entrepreneurship vs. Socio-Political Activism: Delineation by Means

A focus on institutional change delineates DE from SBE, but this focus on institutional change makes DE similar to social movements that tend to be indirect attempts to initiate institutional change by applying pressure on government officials. Because it is often not in the self-interest of political elites in LDCs to initiate institutional reforms (Easterly, 2001, 2006), many reform efforts that have led to institutional change have begun as grassroots movements initiated by social entrepreneurs (Alvord et al., 2004) and socio-political activists (Martin & Osberg, 2007). Though an important source of institutional change, this socio-political activism does not seek earned income and therefore does not qualify as DE. That is, unlike socio-political activists, development entrepreneurs expect to capture some of the value they create to ensure the operational sustainability of their social enterprise.

Despite suggestions that social entrepreneurs are motivated only by social value creation, anecdotal evidence suggests that simply solving the problem is not enough for many social entrepreneurs. Social entrepreneurs often want their organizations to live on and/or to be recognized for their efforts (Below & Tripp, 2010). For example, Nicholas Negroponte, founder of One Laptop per Child, has clearly communicated frustration with for-profit competitors such as Intel who have sought to compete with his organization (Sherriff, 2007). If the mission were all that mattered, Negroponte would relish as "mission accomplished" the fact that these firms are now seeking to offer products that the poor can afford. Although it is difficult to say what drives any social entrepreneur, it is safe to say that the knowledge that he had enacted a positive change did not appear to provide much comfort to Negroponte. Can the desire to ensure financial sustainability (because of the social entrepreneur's need to leave a personal legacy) conflict with, rather than enable, fulfillment of the mission for which a social enterprise was ostensibly created? Questions such as this suggest that scholars may find justification for the conceptual existence of SE by explicitly acknowledging that entrepreneurial motives are mixed, but in doing so, they must also recognize that social entrepreneurs may be just as susceptible as business entrepreneurs to ego or greed (albeit of a social rather than economic nature).

Like SBE, the potential for DE would appear to be greatest in LDCs for two reasons. First, the transaction costs are highest in these nations because of the institutional inefficiencies resulting from legal obstructions preventing the market from functioning as efficiently as it otherwise could (North, 1990; Olson, 2008). Second, these transaction costs have prevented knowledge that has been discovered and applied in the form of innovation in developed nations from being able to diffuse fully into LDCs (Bruton et al., 2010). The result is a knowledge arbitrage opportunity in which innovations that have emerged in global markets can, if introduced to LDCs in culturally appropriate forms, enable entrepreneurs and consumers in those nations to circumvent, reduce, or even eliminate institutional barriers that encumber gains to trade.

Because the knowledge needed to overcome institutional obstacles is dispersed across producers and consumers in developed and developing nations, distributed agency is needed to enable entrepreneurial action (Garud & Karnoe, 2003). On the supply side, awareness of available technology, technical experience, access to capital, and business expertise may be dispersed primarily in developed nations while the socio-cultural understanding of norms and socio-political network and savvy needed to do business locally may be dispersed primarily in LDCs (Easterly, 2006; Prahalad, 2005). On the demand side, a lack of awareness to consumer wants and needs and the obstacles that prevent their fulfillment is likely to prevent agents in developed nations from recognizing potential in LDCs (Webb et al., 2010). Conversely, entrepreneurial agents in developing nations may lack awareness or access to demand for their products from potential customers in developed nations.

Although dispersed knowledge may require distributed agency, it does not necessarily require multiple agents. In some instances, one party may possess the knowledge of supply and demand needed to initiate entrepreneurial actions intended to circumvent, reduce, or eliminate institutional obstacles to development. For instance, Muhammad Yunus was born and raised in what is now Bangladesh. He then received training in economics in the United States only to return to the newly formed state of Bangladesh as an academic. Only by juxtaposing actual conditions (as provided by familiarity with Bangladesh) with the institutional conditions that are needed for a market economy to function efficiently (as implicitly assumed by the economic training he received in the United States) was Yunus provided the conceptual framework of which he became so critical. One cannot be disappointed by expectations that one does not have. Ironically, this suggests that Yunus's actions were largely motivated by exposure to economic models (technical supply) acquired in the West, even though he perceived these models to be inadequate.

Like Yunus, Masiyiwa's entrepreneurial efforts produced significant institutional change, especially regarding political conditions. Also like Yunus, Masiyiwa served as a concentration in one man of otherwise dispersed knowledge and distributed agency owing to travel from the developing world to the developed world and back again. Unlike Yunus, however, Masiyiwa directly targeted politico-economic institutional reform such that political change enabled the economic freedom required for him to create a new cell phone market. Subsequent endeavors, involving the financially strapped newspaper, the *Daily News*, which opposed the Zimbabwe government, indicate however, that Masiyiwa was motivated by more than economic return. Masiyiwa mobilized various stakeholders through moral or social exchanges while concurrently believing that he could capture some of the value he created if he succeeded in his institutional reform efforts ("Strive Masiyiwa," 2010). Like Yunus, but even more directly, Masiyiwa's efforts had the by-product of encouraging economic development as business entrepreneurs subsequently entered the new cell phone market to compete with him.

Contrary to Yunus and Masiyiwa are collaborations that involve multiple parties, some of whom may be located in developed nations and some of whom may be located in LDCs. Whether the economic return on the attempt to reform legal institutions constitutes the highest possible return on investment available to the investors may or may not be distributed across agents. That is, return on IE might be the most attractive economic return on investment for an indigenous entrepreneur while simultaneously being primarily an act of charity for a donor in a developed nation. Or, it could be that sacrifices of financial returns in exchange for nonfinancial returns are spread across numerous parties, such that the expected economic return is only slightly less than alternative investment opportunities. Either way, some sacrifice of financial return in exchange for nonfinancial returns is required or else the act would constitute BE without overlapping the domain of SE.

Recognition that SE is most likely the product of distributed agency (owing to the fact that knowledge of supply and demand are likely to be dispersed) increases the complexity of coordination and the necessity for trust (Webb et al., 2010; Zacharakis et al., 2007). As investors from developed nations provide funds that are partly investment (to the extent that some economic return is expected from the social enterprise's activities) and partly charitable donation (to the extent that only a nonfinancial return is expected), increased scope for fraud exists (Anderson, 2000). Perhaps equally problematic is the provider of funds who views his charitable donation as an investment and, thus, seeks to exert control over the social enterprise beyond the influence to which his investment entitles him. In either case, future research is needed regarding problems arising from information asymmetry and how moral hazard may be more effectively mitigated in national contexts with weak legal institutions and political regimes.

Why Development Entrepreneurship May Be Preferable to Government Intervention

Government intervention and SE may be motivated on occasion by a shared misattribution of extreme poverty to market failure, but the fact that SE must compete against other solutions to social problems to receive funding from individuals subjects the persuasiveness of its case to the discipline of competition (e.g., Easterly, 2006). In contrast, government intervention's reliance on coercion allows for a disconnection between the decision maker—a political representative—and the investor—the tax payer, such that investors cannot immediately reallocate their funds from projects they perceive as ineffective without having to become part of a voting block large enough to replace their political representation. Thus, it would appear that SE must demonstrate its efficacy in addressing social problems more frequently and compellingly than government intervention.

If social entrepreneurs attribute social problems to symptoms (as opposed to root causes) or create ventures that target erroneous causes, then their efforts are likely to be less effective than efforts by social entrepreneurs who have properly defined the social problems they seek to tackle. As a result, misguided social entrepreneurial efforts are likely to be revealed as ineffective more quickly than a comparable government program. In addition, failure to understand the dynamic institutions of capitalism is likely to contribute to the generation of business models that are not economically sustainable. Without competitive markets and the rule of law to protect property rights, there is no incentive for entrepreneurs to innovate and no spillover of the technological advancements that produce economic growth (Baumol, 2002). And without economic growth, there is not only less wealth created, there is less wealth to be redistributed, whether coercively through taxes or voluntarily through charitable giving. As a form of entrepreneurship, DE relies on the competitive markets and property rights of capitalism to transform resource inputs into value-added goods and services. Without these institutions, the value created by a social enterprise is difficult if not impossible to capture by the organization and the various stakeholders it seeks to serve. This lack of operational and/or financial sustainability does not necessarily negate the value created by a social enterprise, but it does require the social entrepreneur to justify the value created enough to ensure the continuance of charitable donations.

Thus, regardless of whether an organization must be able to cover its operating costs to be considered an entrepreneurial venture, it is clear that SEs must be able to demonstrate that they are creating more value than competing opportunities, be they economic, social, or blended, if they are to survive. It is this competitive litmus test that explains why a social enterprise may not achieve profitability but still persist absent coercion—that is, it is the best known solution available for a problem and therefore deemed worthy of charitable giving.

VI. Possible Scope Limitations

Before concluding, it is important to note that significant differences may exist between the use of entrepreneurship as a way of making institutions more efficient and the use of entrepreneurship as a means of poverty reduction when no formal institutions are present whatsoever. Recently, Carl Schramm (2010) has advanced the notion of expeditionary economics, which speaks to the latter. While his focus on using entrepreneurship and economic growth as means of ensuring stability and reducing poverty are inspiring and compatible with arguments I have put forth in this article, I echo others' (e.g., Collier, 2007; Zahra et al., 2009) concerns about the challenges of development in countries regularly plagued by civil war or persistent power struggles and suggest that it may be more prudent to study and facilitate DE in LDCs where some semblance of social order already exists before experimenting with such intervening techniques in war-torn or disaster-stricken nations.

The arguments put forth in this article view SE as a critical component of DE because the charity motive that SE introduces to economic theory allows for path creation and thus a means for entrepreneurs to escape the path dependency of institutionalized incentives that may encourage nonproductive forms of entrepreneurship over productive forms of entrepreneurship that yield economic growth. This argument presumes some degree of institutional infrastructure, albeit incredibly inefficient owing to government failure to ensure the political and economic freedoms associated with entrepreneurial capitalism—i.e., rule of law, property rights, competitive markets, and incentives for innovation and entrepreneurship (Baumol et al., 2007). In contrast, the social chaos that is associated with the rule of force (anarchy) or even the arbitrary rule of men that are likely to characterize war-torn nations or disaster-stricken regions is also likely to require that greater attention and resources be allocated to security concerns. Thus, hopes of profitable and financially sustainable enterprises (social or commercial) may be premature or completely ridiculous without the proper institutional infrastructure. In contrast, I limit the scope of DE in this article to LDCs that, while spared from social chaos, are not yet experiencing the economic growth needed to reduce extreme poverty.

VII. Conclusion

> *Business has the potential to do far more to solve the issues of poverty than any number of government aid programs. But to help business in these domains we need to have an understanding of the relevant issues in such institutional settings.* (Bruton, 2010, p. 8)

Many undeveloped nations would like to participate in global markets and enjoy the increased standard of living that economic growth enables, but they are precluded from doing so by institutional barriers to entry (Easterly, 2001; Elkington & Hartigan, 2008). In some instances, top-down strategies in which policy makers introduce reforms have been successful at reducing levels of extreme poverty—e.g., the Asian tigers (Hong Kong, Singapore, South Korea, and Taiwan), China, or India (Powell, 2008)—but this has not been the norm, especially in sub-Saharan Africa where most nations have experienced an increase in the level of extreme poverty over the last 30 years (Collier, 2007). The question of this article was not whether SE is better than foreign aid or redistribution at alleviating extreme poverty in LDCs. Moreover, I did not claim that SE is sufficient or that globalization is contingent on the existence of SE. Indeed, if one is willing to wait long enough, SE may not be necessary to encourage removal of institutional barriers such as those that preclude people in extreme poverty from participating in global markets. After all, self-interest should presumably encourage investment in institutional change when the promise of inexpensive strategic factors or emerging markets justifies bearing (privately or through collective action) the risk associated with entry into a nation with weak property rights regimes (Luo, 2001; North & Thomas, 1970). If the goal, however, is to eradicate extreme poverty by accelerating access to global markets through the least interventionist and most efficient means available, then SE may be necessary (Gates, 2008).

My purpose has been to demonstrate how SE, in the form of DE, can expand trade by removing institutional barriers that exclude a population from participating as producers or consumers in global markets. Such participation unleashes resources from being geographically bound and allows them to be reallocated to their highest valued use (Bhagwati, 2004; Hayek, 1948). Political, legal, social, and cultural institutions that constrict economic and political freedom obstruct participation in global markets and prevent the division of labor and the benefits it can convey in terms not only of income potential but also the full development of human capabilities (Sen, 1999). In each instance, inefficient institutions contribute to high transaction costs that discourage or preclude productive transactions (McMullen et al., 2008). By identifying the institutional obstacles to development and the sources of the motive, opportunity, and means needed to address it through entrepreneurship, the resulting theory of DE offered a number of contributions to both the SE and economic development literatures.

First, the proposed theory focused on government failure rather than market failure as the primary obstacle to development. Proponents and researchers of SE often blame the perpetuation of poverty on market failure, which they explicitly attribute to profit maximization (e.g. Yunus, 2007) and laissez faire economics—even to the point of emphasizing that they are "certainly *not* Friedman disciples" (Sud et al., 2009, p. 202). In contrast, I did not presume that the profit motive causes markets to be inherently flawed or incapable of addressing social problems, nor did I invoke the theory of market failure (e.g., Pigou, 2002) to justify the need for SE in LDCs. Instead, I suggested that LDCs often lack the formal institutions needed to allow markets to emerge, much less allocate resources efficiently. Consequently, it may not make sense to condemn markets for failing to address social problems when government failure has prevented them the opportunity to try. Moreover, given that most LDCs cannot boast social safety nets owing to limited public funds, it may be more productive to begin with the laissez faire assumption that unfettered markets are capable of addressing social needs and to assess whether the institutions that the state *must* provide to enable economic growth of *any* kind are present and functioning properly before designing a cost-prohibitive welfare state that seeks to steer a currently nonexistent market to achieve a particular *type* of economic growth.

Second, the proposed theory offered an explanation of the source of entrepreneurial opportunities in LDCs. By denying access to the markets of the global economy, the failure by LDC governments to provide efficient formal institutions can prevent diffusion of innovations from developed nations to LDCs (Bruton et al., 2010). This prevents LDCs access to the knowledge advances made possible by global capitalism (Baumol, 2002; Bhide, 2008; Mueller, 2006). As a result, profit potential from knowledge arbitrage exists for those entrepreneurs willing and able to engage in IE to exploit the opportunity.

Third, the theory suggested that social entrepreneurs may be more willing than business entrepreneurs to initiate the change needed to reduce the institutional obstacles that give rise to knowledge arbitrage opportunities. Recognition and exploitation of knowledge arbitrage opportunities requires institutional change that tends to be complicated by several problems. First, many of the politicians best positioned to enact institutional change may not find it in their interests to do so (Rodrik, 2007). This can frustrate top-down reform efforts that rely on sanctions or other exogenous forms of influence that seek to encourage economic and political freedom (Gwartney & Lawson, 2007; Pape, 1997). In addition, the benefits of institutional change are likely to be dispersed whereas the costs of IE are likely to be concentrated (Pacheco et al., 2010). This makes IE a highly uncertain profit opportunity owing to the difficulty associated with capturing the value one creates. Finally, the dispersion of knowledge across developed nations and LDCs is likely to require distributed agency (Garud & Karnoe, 2003) in order to imagine and exploit opportunities—e.g., agents in developed nations may possess the financial and technical capital needed for entrepreneurial action while agents in LDCs may possess the human and social capital needed for entrepreneurial action. Though it is possible for this agency to be concentrated in a single entrepreneur, it may be more likely for it to take form as collaboration between agents from developed nations and LDCs (Zahra et al., 2008). Such collaboration, however, poses numerous coordination challenges (Webb et al., 2010).

The uncertainty associated with IE often prevents business entrepreneurs (be they individuals or MNCs) from being willing and/or able to forgo pursuit of less uncertain entrepreneurial opportunities in favor of socially beneficial institutional change (Zahra et al., 2008). Charity is needed therefore to compensate for the discouraging motivational effect of the uncertainty associated with these problems (McMullen & Shepherd, 2006). That is, moral or social incentives must compensate for economic incentives that may not otherwise be competitive with the expected returns of less uncertain, but also less socially beneficial entrepreneurial opportunities. At one extreme, motives may be purely philanthropic with no expected financial return whatsoever. At the other extreme, change may be deemed the second best financial opportunity available, requiring only a small sacrifice of financial return to overcome the additional costs of bearing uncertainty. Either way, some voluntary sacrifice of financial return in the hope of generating institutional change is required. Thus, the nonfinancial incentives that motivate social entrepreneurs may enable IE that is unlikely to occur when only financial incentives are considered.

Fourth, by delineating financial and nonfinancial incentives, the proposed theory allowed DE to be distinguished from similar concepts such as SE and BE. If the financial returns from IE were high enough, SE would be unnecessary because profit-driven BE could sufficiently ensure the IE needed to facilitate economic growth, thereby solving the development problem without the need for SE. Conversely, if resources were not scarce or people were more altruistic, then no promise of financial return would be needed to encourage IE; consequently, charity-driven SE would sufficiently ensure the IE necessary to facilitate economic growth. Because extreme poverty in LDCs persists, however, a form of SE appears to exist in which entrepreneurs seek to empower others because of complex motives involving both profit and charity.

Although the charity-motivated social aspects of SE have received considerable attention in the literature,[3] the profit-motivated entrepreneurship component has not (Austin et al., 2006). This is potentially problematic if the focus of inquiry is on SE's theoretical function within economic development. Profit is about more than motivation; it also conveys information (Hayek, 1948). When a venture cannot, at least partly, cover its operating costs with earned income, profit and loss cannot provide feedback about whether the entrepreneur is serving the market efficiently (Mises, 1935). Even Schumpeter (1934), whose conception of entrepreneurship SE researchers often use to justify their own extension of the concept beyond the confines of economic theory (e.g., Dees, 2001; Martin & Osberg, 2007), presumed that entrepreneurs were initiating institutional change through innovation in *pursuit of profits*. Thus, despite arguments to the contrary (e.g., Dees, 2007), it may be necessary when considering SE's role in economic growth to distinguish between social *innovation* that does not expect to realize earned income and social *entrepreneurship*, which expects to realize earned income but, unlike BE, not enough to cover the full costs of capital.

Finally, because SE is less constrained by the economic incentives determined by existing institutions, the theory proposed that SE will be capable of path creation. If positive, this path creation could enable even further institutional change by making productive forms of BE more efficient and nonproductive forms of BE less efficient for subsequent market entrants. Thus, this article proposed that SE can contribute to the inclusivity of economic growth by enabling institutional change that starts a virtuous circle of productive BE. In the process, SE not only expands the market to include members of marginalized or disenfranchised groups within a nation but also facilitates a nation's ability to participate in the global economy. Consequently, this article responded to Mair and Marti's (2006, 2009) calls to acknowledge the institutional context in which SE is embedded. In doing so, I hope not only to have provided a clearer understanding of SE's unique role in enabling the institutional change that facilitates inclusive economic growth but also to have demonstrated why a relative increase in SE that targets root

3. For recent comprehensive reviews of the social entrepreneurship literature, see Short, Moss, and Lumpkin (2009) and Dacin et al. (2010).

institutional causes as opposed to the symptoms of extreme poverty may be a more efficient, effective, and less invasive way to help alleviate poverty at the BOP.

Although institutional reform may diminish a nation's autonomy, it also allows indigenous entrepreneurs to access the knowledge that has been accumulated over centuries by the innovation machine known as global capitalism (Baumol, 2002). For agents in developed nations, however, the profit opportunity associated with investment in LDCs is undermined by the uncertainty of those nations' legal systems and political regimes. Consequently, SE is needed to enable the IE required to enable economic growth in LDCs. Although economic return may not be necessary to motivate such reform efforts—e.g., charitable motivations may be adequate—some expected financial return is necessary to make an economic case for SE and explain how its function is distinct from the value created through the charitable acts of social innovators or creators of NGOs. As reformers of institutions, development entrepreneurs have an economic role to play in preparing the soil of the market for the gardeners to come. Thus, I hope to have shown why, even though profit is possible, development from BE is unlikely to occur without the encouragement of SE. Consequently, DE would appear to be crucial to expediting the broadening of global markets, suggesting that there is indeed room for market advocates under the ever growing tent of SE.

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