

# FINANCING SOCIAL ENTERPRISE—REALIZING POLITICAL EQUALITY: HOW THE CONSUMER- BENEFICIARY MODEL OF SOCIAL ENTERPRISE SECURES BENEFICIARY PARTICIPATION AND WHY WE SHOULD CARE

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## I.

### INTRODUCTION

*[T]he supreme touchstone of development is whether people who were previously treated as mere objects, known and acted upon, can now actively know and act upon, thereby becoming subjects of their own social destiny. When people are oppressed or reduced to the culture of silence, they do not participate in their own humanization. Conversely, when they participate, thereby becoming active subjects of knowledge and action, they begin to construct their properly human history and engage in processes of authentic development.<sup>1</sup>*

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1. Denis Goulet, *Participation in Development: New Avenues*, 17 WORLD DEV. 165, 165 (1989) (citing PAULO FREIRE, *CULTURAL ACTION FOR FREEDOM* (1970); PAULO FREIRE, *PEDAGOGY OF THE OPPRESSED* (1970); PAULO FREIRE, *EDUCATION FOR CRITICAL CONSCIOUSNESS* (1973)). Muhammad Yunus, founder of Grameen Bank, echoes Freire's sentiment when he writes: "Even if [a] policymaker identifies and works only for pro-poor growth, he is still missing the real issue. . . . [I]n this conceptualization, the poor people are looked at as objects. In this frame of mind, policymakers miss the tremen-

Explosive growth of the donative nonprofit sector over the last century has greatly expanded popular participation in projects designed to have a positive social impact ("social impact work").<sup>2</sup> Participation in such social impact work is not universal, of course, but today a credit card and access to the Internet are all one needs to participate in social impact work in almost any corner of the world.<sup>3</sup> This expansion in participation has been a kind of democratic revolution because an

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dous potential of the poor, particularly poor women and the children of poor families. They cannot see the poor as independent actors. . . . Another problem arises from the channel that donors use for the selection and implementation of projects. Both bilateral and multilateral donors work almost exclusively through the government machine. To make a real impact, they should be open to all segments of society and be prepared to utilize the creative capacity that is lying outside the government." MUHAMMAD YUNUS, *CREATING A WORLD WITHOUT POVERTY* 12 (2006).

2. See Lester M. Salamon, *The Rise of the Nonprofit Sector*, FOREIGN AFF. July/Aug. 1994, at 109, available at <http://www.foreignaffairs.com/articles/50105/lester-m-salamon/the-rise-of-the-nonprofit-sector> ("A striking upsurge is under way around the globe in organized voluntary activity and the creation of private, nonprofit or nongovernmental organizations."). In the United States from 1975 to 1995, for example, "the real assets and revenues of tax-exempt organizations filing information returns with the IRS more than tripled, compared to real growth in gross domestic product of 74 percent during the same period." STAFF OF JOINT COMM. ON TAXATION, 104TH CONG., *DESCRIPTION OF PRESENT LAW RELATING TO CHARITABLE AND OTHER EXEMPT ORGANIZATIONS AND STATISTICAL INFORMATION REGARDING GROWTH AND OVERSIGHT OF THE TAX-EXEMPT SECTOR* 42 (2004), available at <https://www.jct.gov/publications.html?func=startdown&id=1643> (citing study by the I.R.S.). Social impact work, here, includes all work done by organizations that has as a purpose the improvement of society.

3. Consider that almost one million Kiva users have funded a Kiva loan to support entrepreneurs in poor communities around the world. *Statistics*, <http://www.kiva.org/about/stats> (last visited Sept. 29, 2012); see also Robert Wexler, *Effective Social Enterprise—A Menu of Legal Structures*, 63 EXEMPT ORG. TAX REV. 565, 573 (2009) (describing Kiva's operations). Notice that one can participate in social impact work in any number of ways. One can participate by providing financial support to an organization conducting a social impact project. See, e.g., PARTNERS IN HEALTH, <http://www.pih.org/> (last visited Sept. 29, 2012). One can provide financial support directly to individuals in need—through Kiva, for example. Even consumption is now a way directly and consciously to support vulnerable populations. See, e.g., BE A BIOGRAPHER, <http://www.beabiographer.com/> (last visited Sept. 29, 2012); see also Alex Nicholls, *Fair Trade: Towards an Economics of Virtue*, 92 J. BUS. ETHICS 241, 245-46 (2010) (defending "ethical consumption," which he defines as "an economic space where consumers buy products that have added social or environmental value above other competing purchase options.").

increasing number of people have greater opportunities to affect the development of the larger social units of which they are members—neighborhoods, cities, countries and the globe.<sup>4</sup> The expansion in participation has also been *antidemocratic*, however, to the extent that it has left out one very important group: the intended beneficiaries of social impact work. Social impact organizations often exercise great power in the communities they aim to benefit while beneficiaries (or their governments) sometimes play virtually no role in directing the exercise of that power.<sup>5</sup>

Beneficiary participation has been a concern of both scholars and practitioners of social impact work, who generally understand beneficiary participation as a mechanism of “downward accountability” (i.e., accountability to beneficiaries

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4. Cf. LESTER M. SALAMON, *AMERICA'S NONPROFIT SECTOR: A PRIMER* 13 (2d ed. 1999) (claiming that the nonprofit sector supplies collective goods—including helping certain needy groups—that the market and the state fail to provide). This perspective assumes a thoroughgoing cosmopolitanism according to which all social impact a person helps create is social impact in her own community. An American who supports social impact in Sri Lanka is still affecting the course of development in *her* community insofar as she and the beneficiaries of the social impact work are all members of a global community.

5. See Diana Hortsch, *The Paradox of Partnership: Amnesty International, Responsible Advocacy, and NGO Accountability*, 42 COLUM. HUM. RTS. L. REV. 119, 129 (2010) (describing the growth of power wielded by international social impact projects in the 1990s and the scrutiny it drew); ACTIONAID USA ET AL., *HAITIAN LED RECONSTRUCTION & DEVELOPMENT: A COMPILATION OF RECOMMENDATION DOCUMENTS FROM SEVERAL HAITIAN CIVIL SOCIETY AND DIASPORA CONFERENCES, ORGANIZATIONS AND COALITIONS* 11 (March 29, 2010) [hereinafter *HAITIAN LED RECONSTRUCTION*], available at [http://ajws.org/assets/uploaded\\_documents/haitian\\_led\\_reconstruction\\_and\\_development.pdf](http://ajws.org/assets/uploaded_documents/haitian_led_reconstruction_and_development.pdf) (“More than 26 organizations and social movements in Haiti reported that the process established for formulating the ‘Plan for Reconstruction of Haiti’ at the donors’ conference that concluded yesterday in Santo Domingo has been characterized by an almost total exclusion of Haitian social actors and civil society, and very limited participation by uncoordinated representatives of the Haitian State.”); LINKLATERS, *CAMFED GOVERNANCE: ACCOUNTING TO THE GIRL* 44 (2010) [hereinafter *CAMFED GOVERNANCE*] (“Some [social impact] organisations want to protect their power and only relate with the constituency in which they are involved. They choose not to deal with the government because they do not want to moderate the power they have.” (quoting Dr. John Phiri, then Director of Planning and Information in the Zambian Ministry of Education)).

and their communities).<sup>6</sup> Concern with beneficiary participation, however, is often subordinated to concern with other standards by which we judge social impact work: other mechanisms of downward accountability (like disclosure, social auditing and accountability to beneficiaries' communities),<sup>7</sup> other forms of accountability (like "upward accountability" to do-

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6. See Alnoor Ebrahim, *Accountability in Practice: Mechanisms for NGOs*, 31 WORLD DEV. 813, 813-15, 818-19, 825 (2003) (defining downward accountability and describing beneficiary participation as a process of downward accountability); Devesh Kapur & Dennis Whittle, *Can the Privatization of Foreign Aid Enhance Accountability?*, 42 N.Y.U. J. INT'L L. & POL. 1143, 1153-56, 1168-79 (2010) (discussing the use of community feedback mechanisms (both ex post and ex ante) to achieve greater accountability to beneficiaries); David A. Crocker, *Participation in Local Development: Goulet and Deliberative Democracy*, in NEW DIRECTIONS IN DEVELOPMENT ETHICS 309-311 (Charles K. Wilbur & Amitava K. Dutt eds., 2010); Jay Drydyk, *Participation, Empowerment, and Democracy*, in NEW DIRECTIONS IN DEVELOPMENT ETHICS 333-35 (Charles K. Wilbur & Amitava K. Dutt eds., 2010). Practitioner charters addressing accountability include the International Non-Governmental Organisations Accountability Charter, Dec. 20, 2005, [http://www.ingoaccountabilitycharter.org/wp-content/uploads/INGO-Accountability-Charter\\_logo1.pdf](http://www.ingoaccountabilitycharter.org/wp-content/uploads/INGO-Accountability-Charter_logo1.pdf) [hereinafter INGO Charter] ("We will listen to stakeholders' [including beneficiaries'] suggestions on how we can improve our work and will encourage inputs by people whose interests may be directly affected.") and the Code of Conduct for NGOs in Disaster Relief, 1994, International Federation of Red Cross and Red Crescent Societies, <http://www.ifrc.org/Global/Publications/disasters/code-of-conduct/code-english.pdf> [hereinafter NGO Code] (attempting to address, among other things, ways of involving beneficiaries in management of relief aid, donor and beneficiary accountability and recognizing beneficiaries as dignified humans; mentioning accountability in sections seven and nine).

7. See Ebrahim, *supra* note 6, at 816, 822-24; Kapur & Whittle, *supra* note 6, at 1164-68 (2010). The Campaign for Female Education ("Camfed") is a social impact organization that strives "to ensure that accountability for its aid is not limited to accountability to its donor, or to a government, but that Camfed itself is accountable, first and foremost, to the girls its programs are intended to serve. In other words, Camfed is accountable to its 'intended beneficiaries' or 'clients'." CAMFED GOVERNANCE, *supra* note 5, at 1. While Camfed is committed to accountability to its beneficiaries and their communities, it lacks formal mechanisms of beneficiary participation in its programming; instead, and perhaps appropriately given the age of the primary beneficiaries, Camfed often relies on program alumnae to direct its programs. *Id.* at 23-26. This *former* beneficiary participation is a good example of downward accountability that is not the sort of (current) beneficiary participation that is the focus of this note.

nors),<sup>8</sup> and of course a broad range of non-accountability standards like efficiency, scalability and so on. Without taking a stand on the relative importance of these different standards, this note attempts to contribute to the broader conversation on evaluating social impact work first by further elaborating the theoretical basis for concern with strong forms of beneficiary participation and then by putting forward a particular model of social enterprise whose structure promotes a strong form of beneficiary participation.

There are several reasons we should be concerned with beneficiary participation. Many social impact organizations recognize one of these reasons: beneficiary participation can make social impact work more effective.<sup>9</sup> This note focuses on another reason: mechanisms of beneficiary participation in social impact work are respectful of beneficiaries.<sup>10</sup> The latter

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8. See Hortsch, *supra* note 5, at 128 (“[A]ccountability is generally based on a framework including loyalty to a mission statement, transparency, good governance, monitoring, reporting, evaluation, and the existence of a mechanism to receive complaints and issue sanctions if an organization is found to be behaving improperly.”); NGO Code, *supra* note 6 (mentioning accountability in sections seven and nine, but focusing on accountability to donors); Ebrahim, *supra* note 6, at 824-26 (concluding that “downward accountability mechanisms remain comparatively underdeveloped.”); Kapur & Whittle, *supra* note 6, at 1153 (“Many studies have commented that accountability measures in NGOs prioritize the needs of the donor over those of the other stakeholders.”). The nonprofit sector is often thought of as solving a particular instance of contract failure: supporters of social impact work generally do not rely on for-profit entities to effect social impact because they cannot ensure such entities will act as the supporters wish. Henry Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 504 (1981) (“Like for-profit organizations, virtually all nonprofit organizations are, in a sense, engaged in the sale of services. . . . [I]t is the donors who are the purchasers. . . . [The donors’] contributions are essentially efforts to ‘buy’ disaster relief . . . , and this is what the organizations in question exist to provide and ‘sell.’”).

9. Camfed, for example, sees beneficiary participation as a response to “[o]ne of the major challenges in international development . . . : how does a non-governmental organisation promote and support service provision in impoverished communities in a *lasting and effective* way?” CAMFED GOVERNANCE, *supra* note 5, at 1 (emphasis added). Camfed believes that it “encourages systemic change by giving communities themselves the responsibility for running the Camfed programs and making critical decisions.” *Id.* at 23.

10. Working through the cost/benefit analysis of introducing beneficiary participation into social impact work is an important but very difficult project. Establishing the ways in which mechanisms of beneficiary participation respect beneficiaries is a more manageable project and (I hope) is still a

reason is closely related to the reason governments ought to be elected—namely, equal participation in political systems by their members, or *political equality*, is one of our core democratic values.<sup>11</sup> Much more will be said about political equality below, but the core conviction driving our commitment to political equality is that, as the old Roman maxim had it, what touches all should be decided by all.<sup>12</sup> This conviction should generate concern with political equality not just at the governmental level but also in social impact work, where it can take the form of beneficiary participation.

After motivating the search for mechanisms of beneficiary participation in social impact work, the note will turn to its principal objective: to show that a particular kind of social enterprise, defined by its distinctive financing structure, is normally characterized by political equality and is, in that way, normatively superior to some alternative models of social impact work. This *consumer-beneficiary model* of social enterprise is normally characterized by political equality because it finances its activities in significant part through revenue from the sale

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helpful contribution to any all-things-considered evaluation of beneficiary participation in social impact work.

11. See Jeremy Waldron, *Constitutionalism—A Skeptical View* 24 (NYU Sch. of Law Pub. Law Research Paper No. 10-87, 2012); see also CHARLES BEITZ, POLITICAL EQUALITY xi (1989) (“[A]ny philosophical theory of democracy that failed to take up the grounds and content of political equality would be seriously deficient.”). For a fascinating discussion of the need and potential for experimentation with participation in government (as distinguished from mere transparency in government), see Clay Shirky, Address at TEDGlobal 2012: How the Internet will (one day) transform government (June 2012), available at [http://www.ted.com/talks/clay\\_shirky\\_how\\_the\\_internet\\_will\\_one\\_day\\_transform\\_government.html](http://www.ted.com/talks/clay_shirky_how_the_internet_will_one_day_transform_government.html) (“The people experimenting with participation [e.g., members of GitHub finding new uses for a participatory software version control system] don’t have legislative power, and the people who have legislative power are not experimenting with participation. They are experimenting with openness. There’s no democracy worth the name that doesn’t have a transparency move, but transparency is openness in only one direction, and being given a dashboard without a steering wheel has never been the core promise a democracy makes to its citizens.”).

12. King Edward I of England used the Roman phrase (*quod omnes tangit ab omnibus approbetur*) in the late 13th Century. MICHAEL PRESTWICH, EDWARD I 465-66 (Yale Univ. Press 1997) (1988). The phrase is also mentioned in STEPHEN MACEDO, DELIBERATIVE POLITICS: ESSAYS ON DEMOCRACY AND DISAGREEMENT 215 (1999) (citing MICHAEL WALZER, SPHERES OF JUSTICE (1983)) and in JEREMY WALDRON, LAW AND DISAGREEMENT 114 (1999)).

of goods or services to its beneficiaries. Because of the social enterprise's financial dependence on its beneficiaries' collective choice to patronize the social enterprise,<sup>13</sup> the beneficiaries are able to participate in the social enterprise's social impact work by exercising their collective power as consumers of the social enterprise's goods and services. As demonstrated by the recent microfinance tragedy in India, however,<sup>14</sup> participation-by-consumption is likely to be a meaningful kind of participation, from the perspective of political equality, only when exercised within the right consumer protection regulatory framework. The note will conclude by considering a contractual innovation—introducing a nonprofit representative into the social enterprise–beneficiary relationship—that may also help to ensure that beneficiaries of the consumer-beneficiary model of social enterprise are able to enjoy real political equality in the context of the social enterprise's social impact work.

The reader will notice that this note's argument is driven by theoretical work done in a variety of fields, especially democratic theory, development ethics, nonprofit law, corporations law and contract law. An interdisciplinary approach of this kind is essential when the question presented is itself interdisciplinary: whether a particular financial model for a social impact project helps realize a democratic value such as political equality. If it accomplishes nothing else, this note should show

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13. In this way, beneficiaries in the consumer-beneficiary model fit Hansmann's definition of "patron", whose relationships with various kinds of entities are the focus on Hansmann's seminal analysis of ownership and control rights in relationships between individuals and various kinds of organization. Cf. HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* 12-16 (1996). It may also be that mechanisms of "upward" accountability, in the case of the consumer-beneficiary model, are also mechanisms of "downward" accountability, because the beneficiaries are also the social enterprise's financial supporters. These themes are not explored in this note but may bear further investigation. Another fruitful line of inquiry might be to analyze kinds of "voice" accountability in the consumer-beneficiary model, paying special attention to the distinctions between speaking *for*, speaking *as* and speaking *with* beneficiaries. See Horsch, *supra* note 5, at 145-48 (citing Hugo Slim, *By What Authority?: The Legitimacy and Accountability of Non-governmental Organisations*, Address at the International Council on Human Rights Policy International Meeting on Global Trends and Human Rights—Before and After September 11 (Jan. 12, 2002), <http://www.gdrc.org/ngo/accountability/by-what-authority.html> (last visited Mar. 23, 2013)).

14. See discussion *infra* Part II.C.



that social enterprise law scholarship could be advanced in important and interesting ways by entering into a dialogue with sophisticated normative theories developed in philosophy and elsewhere.

The following is a summary roadmap of the note. Part I of the note defines the concept of social enterprise and the consumer-beneficiary model. It also introduces the idea of normative superiority based in intrinsic features, defines political equality and defends the value of political equality generally and in social impact work, where it takes the form of beneficiary participation. Also introduced is an analytical framework that can be used to measure political equality in a political system like a social impact organization by measuring the quality of beneficiary participation in that organization. Part II applies the analytical framework to the consumer-beneficiary model to demonstrate that the model is normally characterized by political equality (because it enables high-quality beneficiary participation) and is, in that way, normatively superior to alternative models of social impact work. Part II also illustrates some of the weaknesses in participation-by-consumption, however, pointing to the 2010 microfinance tragedy in India. Part III identifies two mechanisms that would be helpful in realizing the political equality potential of the consumer-beneficiary model: a consumer protection regime and a contractual arrangement that would bring a nonprofit intermediary into the relationship between the social enterprise and its beneficiaries.

## II.

### FUNDAMENTAL CONCEPTS

#### A. *Social Enterprise and the Consumer-Beneficiary Model*

A social enterprise is a type of social impact organization (an organization for which achieving social impact is a primary objective). A social enterprise is distinguishable from other kinds of social impact organizations by the fact that it seeks to achieve social impact through the use of earned-income strategies generally associated with traditional for-profit businesses.<sup>15</sup> A good example of a social enterprise is Digital Di-

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15. For the most part, this definition tracks the definition provided by Keren Raz: "a social enterprise . . . is (1) an organization that serves first and

vide Data (“DDD”), a data-entry business that is staffed entirely by people with disabilities and victims of sex trafficking and that uses its profits to provide scholarships for its employees.<sup>16</sup> Other models of social enterprise exist.<sup>17</sup> For example, some social enterprises seek to achieve social impact by selling services to other social impact organizations that help those orga-

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foremost a social mission, (2) through the use of sophisticated business models typically associated with traditional corporate activity, (3) pursuing multiple financing options, and (4) facing novel governance challenges when balancing the interests of donors and investors.” Keren G. Raz, *Toward an Improved Legal Form for Social Enterprise*, 36 N.Y.U. REV. L. & SOC. CHANGE 283, 287-88 (2012). The only substantive difference between the definition used in this note and Raz’s is that Raz’s definition specifies that serving a social mission is first and foremost for a social enterprise while the definition used here leaves open the possibility that a social enterprise could have primary objectives in addition to serving a social mission. As Raz points out: “[t]he definitions of social enterprise and social entrepreneurship are controversial. The field lacks consensus . . . .” *Id.* at 285 n. 3. One of the broadest definitions of social enterprise comes from a major facilitator of social enterprise, Ashoka: “Social entrepreneurs are individuals with innovative solutions to society’s most pressing social problems.” *What is a Social Entrepreneur?*, ASHOKA, [http://www.ashoka.org/social\\_entrepreneur](http://www.ashoka.org/social_entrepreneur) (last visited Mar. 20, 2013).

16. Raz, *supra* note 15, at 288 (citing *Work at DDD: Education and Employment*, DIGITAL DIVIDE DATA, <http://www.digitaldividedata.org/impact/employment>).

17. A few helpful methods of categorizing social enterprises include: Sutia Kim Alter’s three-part typology (mission-centric, mission-related and unrelated-to-mission forms of social entrepreneurship), Sutia Kim Alter, *Social Enterprise Models and Their Mission and Money Relationships*, in *SOCIAL ENTREPRENEURSHIP: NEW MODELS OF SUSTAINABLE SOCIAL CHANGE* 205 (Alex Nicholls ed., 2006); a division of social entrepreneurship into Type 1 (social enterprise) and Type 2 (social innovation), Nicholls, *supra* note 3, at 242 (citing Alex Nicholls, *The Functions of Measurement in Social Entrepreneurship*, in *HANDBOOK OF SOCIAL ENTREPRENEURSHIP RESEARCH* (K. Hockerts, J. Robinson & J. Mair eds., 2009)); a two-dimensional categorization of social entrepreneurs developed by Columbia Business School’s Research Initiative on Social Entrepreneurship, CATHERINE H. CLARK & SELEN UCAK, *RISE FOR-PROFIT SOCIAL ENTREPRENEUR REPORT: BALANCING MARKETS AND VALUES*, 8 (Mar. 2006), <http://www.riseproject.org/rise-sep-report.pdf>; social enterprise business model archetypes by source of revenue (contributions, sales, service offerings, etc.), Jennifer L. Woolley, Albert V. Bruno & Eric D. Carlson, *Social Venture Business Model Archetypes: The Balance Between Economic and Social Value Creation* (unpublished manuscript) (on file with author); and Robert Wexler’s division of social enterprises along lines of legal authority based on the organizations’ specific activities, Wexler, *supra* note 3, at 570. DDD would likely fall under Wexler’s “job training” category. *See id.*

nizations to achieve their goals.<sup>18</sup> IDinsight is such a social enterprise: its mission is “to partner with [social impact organizations] to generate and use rigorous evidence to improve social impact.”<sup>19</sup> IDinsight designs randomized trials for particular social impact organizations through which it tests the strengths and weaknesses of current and alternative methods of implementing the organization’s social impact projects.<sup>20</sup> This note focuses on a model that is distinct from both the DDD model and the IDinsight model: the “consumer-beneficiary” model is one in which the social enterprise finances its activities in significant part through revenue from the sale of goods or services directly to its ultimate beneficiaries.<sup>21</sup> One of the defining features of this model is that its end consumers are also its intended beneficiaries. Notice that DDD’s beneficiaries are its employees, not its consumers, and that IDinsight’s consumers are the social impact organizations that serve the people IDinsight hopes will ultimately benefit from its efforts.<sup>22</sup>

KickStart is one example of a social enterprise on the consumer-beneficiary model.<sup>23</sup> KickStart develops and sells technologies to underprivileged individuals in Kenya, Tanzania and Mali that these individuals use to start new businesses or increase the profitability of existing businesses.<sup>24</sup> Irrigation

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18. These social enterprises fall into Wexler’s “provision of technical assistance” category. *See* Wexler, *supra* note 3, at 570.

19. IDINSIGHT, <http://idinsight.org>.

20. *Id.*

21. This model is slightly broader than Wexler’s “producing products for a charitable class” category, merely because the model explored here also provides services. *Cf.* Wexler, *supra* note 3, at 571. Yet another model, which serves as an interesting comparison, is used by Indego Africa, which connects artisans in Rwanda with markets in the U.S. while turning large portions of profits generated to educational programs for the artisans. *What is Indego Africa?*, INDEGO AFRICA, <http://www.indegoafrica.org/what-is-indego-africa>. Indego helps beneficiaries by helping them sell their products; whereas a social enterprise on the consumer-beneficiary model helps its beneficiaries by selling its products to them.

22. To the extent that IDinsight considers its social impact organization clients its ultimate beneficiaries, IDinsight also fits the beneficiary-consumer model.

23. *Cf. id.* (describing KickStart).

24. *About KickStart*, KICKSTART, <http://www.kickstart.org/about-us>. Four other examples of the consumer-beneficiary model include the INSTITUTE FOR ONEWORLD HEALTH, <http://www.oneworldhealth.org>; DESIGN THAT

pumps are KickStart's best-selling technology.<sup>25</sup> The pumps enable farmers to grow their crops year-round and get better yields. The pumps were designed to be easy to transport, install and repair.<sup>26</sup> As of February 1, 2012, KickStart has sold over 200,000 pumps,<sup>27</sup> retailing between \$35 to \$95.<sup>28</sup> The people who purchase KickStart's pumps are the very people KickStart aims to help out of poverty.<sup>29</sup> Approximately 28% of KickStart's income came from the sale of its products in 2010 and 24% in 2011.<sup>30</sup>

Microfinance institutions—like Grameen Bank and Compartamos Bancos—also follow the consumer-beneficiary model of social enterprise; but, unlike Kickstart, they sell services, rather than products, to their beneficiaries.<sup>31</sup> Both service-selling and product-selling social enterprises following the consumer-beneficiary model are normally characterized by political equality. As will become clear, however, consumer-beneficiary social enterprises that sell financial services (like Grameen and Compartamos) run into special problems: without regulatory or contractual solutions in place, they fail to achieve political equality, and such solutions have various effi-

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MATTERS, <http://www.designthatmatters.org>; ENTERPRISEWORKS VITA, <http://www.enterpriseworks.org>; and DESIGN REVOLUTION, <http://www.d-rev.org>. See Wexler, *supra* note 3, at 571.

25. See *About KickStart*, KICKSTART, <http://www.kickstart.org/about-us>.

26. See *id.*; *Establish a Supply Chain*, KICKSTART, <http://www.kickstart.org/what-we-do/process/step-03.php>; *Why We Sell Our Tools*, KICKSTART, <http://www.kickstart.org/what-we-do/why-we-sell>.

27. *Our Impact*, KICKSTART, <http://www.kickstart.org/what-we-do/impact> (last visited Feb. 17, 2013).

28. *About KickStart*, KICKSTART, <http://www.kickstart.org/about-us>.

29. *Id.*

30. *Financials*, KICKSTART, <http://annualreport.kickstart.org/financials.html> (last visited Feb. 18, 2013).

31. See GRAMEEN BANK, <http://www.grameen-info.org>; COMPARTAMOS BANCO, <http://www.compartamos.com/wps/portal/Compartamos>. Wexler places microfinance in its own category—separate from producing products for a charitable class—because microfinance is subject to its own, distinct line of legal authority. See Wexler, *supra* note 3, at 573. For the purposes of the argument developed in this note, it is helpful to focus on the larger category that contains both social enterprises that sell products to their end beneficiaries and social enterprises that sell services to their end beneficiaries. Both kinds of social enterprise share the feature that this note argues is relevant from the perspective of political equality—namely, their consumers are also their end beneficiaries.

ciency costs that must be accounted for, along with any political equality achieved.

### B. *Reasons: Intrinsic Features and Consequences*

As indicated above, this note aims to show that the consumer-beneficiary model is normally characterized by political equality and is, in that way, normatively superior to some alternative models of social impact work. The consumer-beneficiary model is normatively superior to alternatives in the sense that we have reasons to choose the model over alternatives when we make decisions about whether and how to support social impact work. These decisions may determine, for example, which social impact work model we as founders should use, which social impact projects we as investors and philanthropists should fund and which social impact projects we as policymakers or citizens should promote through changes in policy.

While the aim of the note is to show that we have reasons to choose the consumer-beneficiary model over alternatives, the aim is not to show that those reasons are always decisive. The note does not pretend to discuss all reasons or even all *kinds* of reasons relevant to choosing between the consumer-beneficiary model and alternatives. The aim is much more modest: only to show that at least a few of the reasons that should enter our deliberations when choosing between alternative social impact projects militate in favor of the consumer-beneficiary model. Thus, the argument here is not at all inconsistent with the position that alternative models of social impact work (like direct aid) are most appropriate in some circumstances (like disaster recovery).

The remainder of the note, after this section, will be devoted to elaborating on the reasons that militate in favor of the consumer-beneficiary model—the model is normally characterized by political equality, the value of which is grounded in respect for beneficiaries. It will be helpful at the outset, however, to describe the kind of reason that will be the focus of the ensuing analysis, because that kind of reason may be unfamiliar to some readers. The analysis focuses on reasons generated by the *intrinsic features* of implementing the consumer-beneficiary model and not on reasons generated by the *conse-*

quences of that implementation.<sup>32</sup> Both kinds of reason are commonly cited in academic literature, policy debates and everyday deliberation, and they ought to be distinguished.<sup>33</sup>

### 1. *The Distinction in Theories of Punishment*

To grasp the distinction between reasons based in consequences and reasons based in intrinsic features, recall the familiar debate between utilitarian and retributive theories of punishment.<sup>34</sup> Utilitarian theories of punishment were first

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32. The reader might skip this subpart if the distinction is familiar. One advantage flowing from a focus on intrinsic features is that it may help connect the question of beneficiary participation in all social impact work to literature on human rights organizations respecting human dignity. See Final Draft Report 2009, *Human Rights Organisations: Rights and Responsibilities*, INT'L COUNCIL ON HUM. RTS. ¶¶ 106-08 (2009), [http://www.ichrp.org/files/reports/67/119\\_report.pdf](http://www.ichrp.org/files/reports/67/119_report.pdf) ("Organisations are likely to stay true to their mission if they work in an appropriate way with the people they aim to protect or represent. The quality of this central relationship is likely to measure an organisation's respect for human dignity."); see also INGO Charter, *supra* note 6; NGO Code, *supra* note 6.

33. See Jean Hampton, *Correcting Harms Versus Righting Wrongs: The Goal of Retribution*, 39 UCLA L. REV. 1659, 1668 (describing the pervasiveness of reasoning relying on intrinsic features as follows: "Thus, Kant's second way of defining human worth is egalitarian, and critical to the concept of moral respect. All of us must be valued as equals insofar as we all have the same value as 'ends in ourselves.' This 'democratic' conception of value has been popular, albeit not universally accepted, in the modern world."); AMY GUTMANN & DENNIS THOMPSON, *DEMOCRACY AND DISAGREEMENT* 165 (1996) (stating that consequentialist reasoning is pervasive).

34. See generally JOHN KAPLAN, ROBERT WEISBERG & GUYORA BINDER, *CRIMINAL LAW* 29-102 (6th ed. 2008). Other examples might be used to illustrate the difference. Much discussion of human rights turns on the importance of intrinsic features relative to consequences. Many of us agree, for instance, that it is morally impermissible for a state to torture a person, even if torturing that person would have net positive effects. At bottom, the intuition generally is that torture, by its nature, simply treats the tortured person with inadequate respect. Torture has the intrinsic feature, that is, of treating the tortured person with inadequate respect. Consider the interesting list of different kinds of reasons ("reasons of principle" and "consequentialist reasons") provided by the BBC Ethics Guide. BBC, *Why is Torture Wrong?*, ETHICS GUIDE, [http://www.bbc.co.uk/ethics/torture/ethics/wrong\\_1.shtml](http://www.bbc.co.uk/ethics/torture/ethics/wrong_1.shtml) (last accessed Feb. 17, 2013). Notice that all the consequentialist reasons tend simply to reject the premise in the hypothetical that torture would result in a net benefit to society. This note relies on a slightly different view of reasons based on intrinsic features than that of most retributivists, but the difference will be easy to describe when the retributivist theory of punishment is in view.

put forward in Europe in the late 18th Century by Cesare Beccaria in Italy and Jeremy Bentham in England.<sup>35</sup> According to utilitarian theories, we ought to prefer an institution of punishment that prevents crime, because such an institution is conducive to achieving the greatest happiness and least pain for the greatest number.<sup>36</sup>

Utilitarian theories of punishment apply to institutions the normative standard that utilitarianism, a branch of ethics, applies to all acts.<sup>37</sup> Utilitarianism is a species of consequentialism, which holds that “the *only* thing relevant to determining whether or not an action is right are the *consequences* produced by that action . . . .”<sup>38</sup> All versions of consequentialism say that right actions are those that maximize the good, and different species of consequentialism specify the good in different ways. Utilitarianism says the good is utility and the absence of pain.<sup>39</sup> In shorthand, we can say that according to any species of consequentialism the good is prior to the right—that is, what action is right depends on what good or ill that action will produce. Consequentialists generally, like those who apply utilitarian standards to institutions of punishment, should agree that

35. KAPLAN, *supra* note 34, at 31-32.

36. *Id.*; see, e.g., JEREMY BENTHAM, THE THEORY OF LEGISLATION 322-25 (C.K. Ogden ed., Harcourt 1931) (“[P]unishment ought not to be inflicted . . . [where it has] no power to produce an effect upon the will, and . . . , in consequence, [has] no tendency towards the prevention of like acts. . . . The evil of the punishment [for the offender] must be made to exceed the advantage of the offence [for the offender].”), *quoted in* KAPLAN ET AL., *supra* note 27, at 35; see also John Rawls, *Two Concepts of Rules*, 44 PHIL. REV. 3, 5 (1955) ([T]he utilitarian view holds that . . . [i]f punishment can be shown to promote effectively the interest of society it is justifiable, otherwise it is not.”), *quoted in* KAPLAN ET AL., *supra* note 36, at 31.

37. The view that a utilitarian theory of punishment necessarily rests on a broad utilitarian theory of ethics has its detractors. Guyora Binder and Nicholas Smith hold the view that “utilitarian penology does not . . . entail an ethical obligation on the part of individuals to act so as to maximize utility.” Guyora Binder & Nicholas Smith, *Framed: Utilitarianism and Punishment of the Innocent*, 32 RUTGERS L.J. 115, 212 (2001), *cited in* KAPLAN ET AL., *supra* note 34, at 60. As indicated in the preceding footnote, however, Bentham certainly seemed to think his utilitarian penology rested on his broader utilitarian ethical theory. The distinction between “act utilitarianism” and “rule utilitarianism” is ignored in this note.

38. JULIA DRIVER, ETHICS: THE FUNDAMENTALS 40 (2007) (second emphasis added).

39. For an accessible overview of contemporary consequentialist theories and problems with them, see *id.* at 61-79.

our choice between alternative institutions of punishment ought to depend on the good or ill produced by erecting those different institutions.

Immanuel Kant developed a retributive theory of punishment in opposition to the utilitarian theories of his time.<sup>40</sup> Kant is the progenitor of most retributive theories of punishment,<sup>41</sup> but there is great variety among contemporary Kantian retributive theories of punishment, all of which are Kantian in slightly different ways.<sup>42</sup> The most important element of Kant's theory that appears in contemporary theories is the idea that our choice between alternative institutions of punishment ought to depend on their *intrinsic features* and, in particular, on whether the institutions treat persons in the right way.<sup>43</sup> Kant evaluated institutions of punishment only by reference to their treatment of *offenders*, but some contemporary Kantian theorists also require punishment to treat *victims* in the right way.<sup>44</sup> A number of points of clarification are now overdue. We will begin with the idea that choosing between institutions should depend on the intrinsic features of those institutions.

According to the Kantian view, whether an institution treats offenders and victims in the right way is determined completely independently of the consequences that actually result from that treatment.<sup>45</sup> Moreover, treating offenders and

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40. See IMMANUEL KANT, *THE METAPHYSICS OF MORALS* 195 (W. Hastie trans., 1887) ("[W]oe to him who creeps through the serpent-windings of utilitarianism to discover some advantage that may discharge him from the justice of punishment, or even from the due measure of it."), cited in KAPLAN ET AL., *supra* note 34, at 33.

41. KAPLAN ET AL., *supra* note 34, at 32.

42. See also DRIVER, *supra* note 38, at 100 ("There are many philosophers writing today who agree with the basics of Kant's [general ethical] theory, but who think him mistaken about its implications in some cases.").

43. See *infra* note 48 and accompanying text.

44. See, e.g., HAMPTON, *supra* note 33, at 1692 ("[O]n the Kantian view, which undergirds my retributive theory, it is not strength, power, intelligence, or skill that creates worth; it is our bare humanity, something possessed equally by the weakest and the strongest among us. To restore this value, the wrongdoer must be defeated in a way that makes the relative value of victim and wrongdoer apparent.").

45. KANT, *supra* note 40 ("Juridical punishment can never be administered merely as a means to promoting another good either with regard to the criminal himself or to civil society, but must in all cases be imposed only because the individual on whom it is inflicted has committed a crime."). See



victims in the right way is a necessary condition for one institution of punishment to be preferable to another; on their own, that is, good consequences brought about by an institution that fails to treat offenders and victims in the right way cannot make that institution preferable to an alternative that does treat offenders and victims in the right way.<sup>46</sup> This is what it means when Kantians say our choice between alternatives ought to *depend* on treating offenders and victims in the right way. In other words, where consequentialists understand the good to be prior to the right, Kantians understand the right to be prior to the good.<sup>47</sup>

Even supposing it is true that our evaluation of alternative institutions of punishment ought to depend on whether they treat offenders and victims in the right way, this tells us nothing about the *content* of that treatment. What makes one treatment the right way to treat offenders and victims and another the wrong way? The consequentialist, for whom the good is prior to the right, would simply ask what treatment would maximize the good. If the right is prior to the good, however, we can no longer look to the good in order to determine the content of the right. The right way to treat a person, according to

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also, DRIVER, *supra* note 38, at 80 (stating that Kantian ethics “defines right independently of the good”).

46. KANT, *supra* note 40. Note, of course, that this simple statement does not tell us how to choose between institutions that all fail or all meet the necessary condition. How such a choice should be made depends on the Kantian notion of the “categorical imperative,” which cannot be described in full, here. The “penal law,” as Kant puts it, is one example of such a categorical imperative. *Id.* For an admirably accessible explanation of what it means for something to be a categorical imperative in Kant’s moral theory, see JOHN DEIGH, AN INTRODUCTION TO ETHICS 140-46 (2010). For somewhat more technical discussions, see DRIVER, *supra* note 38, at 80-93 and Robert Johnson, *Kant’s Moral Philosophy*, STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Apr. 6, 2008), <http://plato.stanford.edu/entries/kant-moral> (last visited Feb. 17, 2013). For two of many sophisticated treatments of Kant’s moral philosophy, see CHRISTINE KORSGAARD, CREATING THE KINGDOM OF ENDS (1996) and JOHN RAWLS, LECTURES ON THE HISTORY OF MORAL PHILOSOPHY 143-232 (Barbara Herman ed., 2000).

47. See, e.g., JOHN RAWLS, A THEORY OF JUSTICE 38 n. 23 (1975) (citing “the priority of right as found in Kant”); John Rawls, *Two Concepts of Rules*, 44 PHIL. REV. 3, 5 (1955) (“The state of affairs where a wrongdoer suffers punishment [in proportion to his wrongdoing] is morally better than the state of affairs where he does not; and it is better irrespective of any of the consequences of punishing him.”).

the Kantian, is the way that *respects* the person as an autonomous, rational being of the same worth as all other persons.<sup>48</sup>

A brief look at one particular Kantian theory will show what it might mean to treat a person in a way that respects that person and, in turn, how a Kantian theory ultimately serves as a foundation for a theory of punishment. Some philosophers say that to know whether a particular act respects a person one ought to look to the *expressive function* of the act. So, Elizabeth Anderson and Richard Pildes write, for instance, that "what makes an action morally right depends on whether it expresses the appropriate valuations of (that is, attitudes toward) persons."<sup>49</sup> Expressing appropriate valuations of persons falls neatly into the idea of respect attributed to Kant, above.

Importantly, the Anderson/Pildes expressive theory understands the expressive function of an act as an intrinsic feature of the act, not as a consequence of the act.<sup>50</sup> The theory does not look to the psychological results of a given expression, for instance, but instead "hold[s] people accountable for the *public meanings* of their actions"<sup>51</sup> which are "set by objective criteria for determining the meanings of action."<sup>52</sup> The public meaning of an act is not a consequence of the act but rather part of what the act is itself—that is, an intrinsic feature of the act. The meaning of the act is intrinsic in the way that, when musicians play music that expresses sadness, there is sad-

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48. This interpretation of Kantian ethics focuses on the second formulation of the categorical imperative, which runs as follows: "Act in such a way that you treat humanity, whether in your own person or in the person of another, always at the same time as an end and never simply as a means." IMMANUEL KANT, *GROUNDING FOR THE METAPHYSICS OF MORALS* 36 (James W. Ellington trans., Hackett Publishing 1981), *quoted in* DRIVER, *supra* note 38, at 90. *See also* Hampton, *supra* note 33, at 1668 ("[On Kant's view,] we are obliged to respect our fellow human beings *equally*, no matter what the state of their moral character, insofar as each human being is an autonomous, rational being . . . . All of us must be valued as equals insofar as we all have the same value as 'ends in ourselves.'"); Elizabeth Anderson & Richard Pildes, *Expressive Theories of Law: A General Restatement*, 148 U. PA. L. REV. 1503, 1509 (2000).

49. Anderson & Pildes, *supra* note 48, at 1504.

50. *Id.* at 1508 (distinguishing the concept of expression from both causation and communication).

51. *Id.* at 1513 (emphasis added).

52. *Id.* at 1512.

ness in the music itself, whatever sadness might also have been created in the psyches of the listeners.<sup>53</sup>

An example might clarify the point. Suppose teenagers blare a car horn late at night in a quiet residential neighborhood, intending to signal their arrival to a friend.<sup>54</sup> The teenagers' behavior fails "to consider or to take the neighbors' interests in peace and quiet as a reason for action, [and therefore] expresses inconsiderateness toward their neighbors."<sup>55</sup> Notice that the behavior expresses inconsiderateness even if no one in the neighborhood actually hears the horn. The expressive function that makes the act wrong is not fundamentally connected to the consequences of the act—possible negative psychological impact—but is instead an intrinsic feature of the act.

Consequences can and do come into play in an expressive theory, according to Anderson and Pildes, but only to the extent that they are objects of attitudes.<sup>56</sup> "Expressive theories," they write, "tell us [we ought] to pursue consequences that are good for people, provided that pursuing those consequences by the means selected is compatible with caring about people in the right way."<sup>57</sup> Thus, it is relevant to an expressive evaluation of an act that an actor *pursues* the right consequences—for to do otherwise could express disrespect for other persons—but it is not relevant to the evaluation what consequences are actually brought about. For such an expressive theory, as for other Kantian theories, the right is still prior to the good.<sup>58</sup>

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53. *Id.* at 1508 (using the example to make a related but slightly different point—namely, that what is expressed is not necessarily caused by the state of mind of the actor).

54. *See id.* at 1512.

55. *Id.* at 1512-13.

56. *Id.* at 1513 ("To disregard the consequences of one's actions is one way to fail to care about people in the ways we ought to care about them.").

57. *Id.* at 1513-14.

58. Note that the theory does not imply that we ought to maximize the intrinsic feature of correct expression. *Id.* at 1512 ("In this respect, expressive theories are like the rules of grammar or logic. Those rules do not tell us to maximize the amount of correct grammatical or logical statements in the world . . . . Instead, those rules tell us that when we are speaking or reasoning, we should do so subject to certain regulative constraints."). Any act that might increase expression of respect in the world is itself to be evaluated according to its intrinsic features, whether it expresses respect for persons.

Now, an expressive theory can be applied to the evaluation of institutions of punishment in the following way.<sup>59</sup> First, one can say that at least part of the wrong committed by the offender and suffered by the victim of a crime is an expressive wrong. That is, the offense expresses disrespect for the victim. Second, one can say that the right way for an institution of punishment to respond to this expressive wrong is with its own expressive act, one that "rights" the wrong.

Jean Hampton develops such an expressive theory. She writes that certain wrongs have the expressive function of "represent[ing] [the victim] as worth far less than his actual value [and] represent[ing] [the offender] as elevated with respect to [the victim], thereby accord[ing] [the offender] a value that she does not have."<sup>60</sup> Hampton points out that our response to such a wrong, whatever that response is, has an expressive function.<sup>61</sup> An institution of punishment has the right expressive function (i.e., treats an offender and a victim in the right way) when it treats the offender in a way that "vindicate[s] the value of the victim denied by the wrongdoer's action" by constructing "an event that not only repudiates the action's message of superiority over the victim but does so in a way that confirms them as equal by virtue of their humanity."<sup>62</sup> Hampton recognizes that constructing such an event can be an extremely difficult task.<sup>63</sup> It is also worth stating explicitly that

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59. Anderson and Pildes argue that their conclusion that "we are all morally required to express the right attitudes toward people" applies equally to the actions of individuals and to "the actions of collective agents, including the actions of States." *Id.* at 1514; see generally *id.* at 1514-27. Evaluating the actions of collectives/institutions may not be exactly the same as evaluating those collectives/institutions directly, but the Anderson and Pildes argument, as well as the Hampton argument, seem to apply to either kind of evaluation. This note continues to focus on the evaluation of institutions directly.

60. Hampton, *supra* note 33, at 1677.

61. *Id.* at 1684 ("[A] decision not to punish wrongdoers such as the rapist is also expressive: it communicates to the victim and to the wider society the idea that such treatment, and the status it attributes the victim, are appropriate, and thus, in the case of the rape victim, reinforces the idea that women are objects to be possessed and are 'there for the taking.'").

62. *Id.* at 1686.

63. *Id.* at 1685. One important point is that, for Kantians, treating the offender and victim in the right way does not only mean refraining from treating the offender too harshly. *Id.* at 1691. An institution could also fail to treat an offender in the right way if it treated the offender too leniently. *Id.*;

neither Hampton nor this author means to endorse, through this analysis, any particular regime of punishment.<sup>64</sup> The end result is that Hampton believes we ought to prefer one institution of punishment to an alternative not because its implementation has better consequences, but because its treatment of offenders and victims is respectful.

## 2. *The Distinction in Social Impact Work*

The reasoning used in these evaluations of institutions of punishment applies relatively straightforwardly to the evaluation of social impact projects. On a consequentialist view, roughly, one would have reason to choose one social impact project over an alternative where implementation of the one has better consequences than implementation of the other. This is a familiar approach to evaluating social impact work. For example, Linklaters begins its report on the governance model developed by the nonprofit Camfed by stating that “[o]ne of the major challenges in international development is to deliver aid effectively: how does a non-governmental organisation promote and support service provision in impoverished communities in a lasting and effective way?”<sup>65</sup>

On an intrinsic features view, roughly, one would have reason to choose one social impact project over an alternative where implementation of the one has certain intrinsic features

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see also KAPLAN ET AL., *supra* note 34, at 32 (“[Kantian] retributivism involves both a limiting principle (there must be no undeserved punishment) and an affirmative justification for punishment (desert justifies punishment).”); John Rawls, *Two Concepts of Rules*, 44 PHIL. REV. 3, 5 (1955) (“[A] person who does wrong should suffer in proportion to his wrongdoing.”).

64. As Jeffrie Murphy observes (echoing the sentiments of many), it is sobering that “of the . . . offenders handled each day by some agency of the United States correctional system, the vast majority (80 percent on some estimates) are members of the lowest 15-percent income level . . . [and unless] one wants to embrace the belief that all these people are poor because they are bad, it might be well to . . . [consider the] suggestion that many of them are ‘bad’ because they are poor.” Jeffrie Murphy, *Marxism and Retribution* 2 PHILOSOPHY & PUBLIC AFFAIRS 217, 237 (1973), *quoted in* KAPLAN ET AL., *supra* note 34, at 68. If Hampton is right that punishment is also about vindicating victims, this softens the sting of Murphy’s criticism, but the point remains that identifying exactly the right way to respond to wrongdoing is an extremely difficult matter. All the more reason to think carefully about what justifies various responses.

65. CAMFED GOVERNANCE, *supra* note 5, at 1.

the other lacks. Someone seeking to provide financial support to a church-sponsored charitable project might, for instance, choose one church's project over another because that church permits women to hold leadership positions while the other does not. In such an instance, the consequences of implementing the two projects might be quite similar, and the decision might instead turn primarily on intrinsic features of the projects—namely, their implementation under churches with particular sets of rules governing leadership structure. In this note, the intrinsic feature being sought out is political equality, the value of which is grounded in respect for beneficiaries.

One last crucial point must be made regarding the nature of the argument in this note.<sup>66</sup> This note eschews both the consequentialist view that consequences are the *only* thing that matters to an evaluation of alternative social impact projects *and* the Kantian view described above that *only* intrinsic features matter to such an evaluation. The premise on which the rest of this note builds is the idea that intrinsic features of social impact projects—and, in particular, whether they respect beneficiaries—give us reasons to choose one project over another. The note assumes that consequences *also* matter, but the note only analyzes potential consequences of implementing the consumer-beneficiary model in a particular context in Part III. A judgment taking into account all relevant reasons (whatever their source) is referred to a few times, below, as an all-things-considered judgment. This note does not propose to make this judgment.<sup>67</sup>

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66. The point was made earlier, *supra* notes 9-10 and accompanying text, but it needs to be emphasized.

67. Derek Parfit recently published a much-anticipated book in which he challenges the distinction between these two modes of thinking (and a third I have not mentioned). 1 DEREK PARFIT, *ON WHAT MATTERS* 419 (2011) ("It has been widely believed that there are such deep disagreements between Kantians, Contractualists, and Consequentialists. That, I have argued, is not true. These people are climbing the mountain on different sides."). Parfit's claim is that the best versions of Kantianism, rule consequentialism and contractualism (as developed by Tim Scanlon) all actually agree which actions are wrong. Mark Schroeder, Book Review, *NOTRE DAME PHIL. REV.* (Aug. 1, 2011), <http://ndpr.nd.edu/news/25393-on-what-matters-volumes-1-and-2/>. For a few accessible criticisms, see Constantine Sandis, *On What Matters, Volumes I & II: Not Quite the Top of the Mountain*, *THE TIMES HIGHER EDUCATION* (June 9, 2011) (book review), <http://www.timeshighereducation.co.uk/story.asp?storycode=416411>.

The goal of this section has been to demonstrate two things. First, a focus on intrinsic features is not alien to legal analysis. Second, for some (perhaps including some readers), focusing on intrinsic features is intuitive, at least some of the time. Notice that the goal has not been to offer a defense of a focus on intrinsic features. Defending this focus in any rigorous way would take many more pages than are available in one section of a larger argument. The focus on intrinsic features is simply the starting point of the following analysis. Just as every paper that references human rights need not begin with a complete treatise on the coherence and value of the concept, so this note will start with the idea that intrinsic features matter. The following analysis is also not meant to rest on the exposition given above. In other words, what follows is not an argument by analogy to retributive theories of punishment. The preceding exposition was offered merely to introduce the distinction between reasons based on intrinsic features and reasons based on consequences.

### C. *Political Equality and Social Impact Work*

#### 1. *Political Equality in General*

Before arguing that political equality is an important feature in social impact work, a general introduction to the concept is necessary. Political equality is a core value in contemporary theories of democracy.<sup>68</sup> Political equality is understood to hold political systems' decision-making to some kind of egalitarian ideal. On a utilitarian view, political systems must be characterized by political equality in order to maximize social welfare.<sup>69</sup> In contrast to utilitarian theories of political equality, *procedural* theories tend to ask whether political systems have a particular intrinsic feature: namely, that their members have equal opportunities to influence political decisions.<sup>70</sup> As stated above, this note seeks to identify reasons for

68. See Waldron, *supra* note 11; see also BEITZ, *supra* note 11.

69. BEITZ, *supra* note 11, at 31. See generally *id.* at 31-48 (discussing John S. Mill, *Considerations on Representative Government* (1861), reprinted in COLLECTED WORKS, VOL. 1 (J.M. Robson & J. Stillinger eds., 1981) and John S. Mill, *On Liberty* (1859), reprinted in COLLECTED WORKS, VOL. 1 (J.M. Robson & J. Stillinger eds., 1981)).

70. *Id.* at 75; see also *id.* at 117; see generally *id.* at 75-119 (discussing principally BRIAN BARRY, *POLITICAL ARGUMENT* (1965), PETER SINGER, *DEMOCRACY*

preferring the consumer-beneficiary model that are rooted in intrinsic features. In what follows, therefore, this note assumes a procedural view of political equality. After briefly describing what procedural political equality is and attempting to defend the significance of political equality in both traditional political institutions and in social impact work, the note will lay out a framework we can use to measure political equality and then apply the framework to the consumer-beneficiary model of social enterprise.

The democratic ideal of political equality is a response to the inevitability of reasonable disagreement in political systems. We know that people in a free society will disagree with each other in good faith about important questions. Political equality is achieved by establishing procedures that give every member's (expressed) opinion the same weight in determining the political system's decisions. The reason that political systems *ought to be* characterized by political equality is that such institutions treat their members with adequate respect.<sup>71</sup>

There are two reasons to think political systems characterized by political equality treat members with adequate respect.<sup>72</sup> First, such political systems recognize the moral significance of the fact of good faith disagreement by registering the disagreement.<sup>73</sup> Registering the disagreement signals at a societal level the individual recognition that

whatever the state of my confidence about the correctness of my own view, I must understand . . . that mine is not the only mind working on the problem in front of us, that there are a number of distinct intelligences, and that it is not unexpected, not unnatural,

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AND DISOBEDIENCE (1973), DAVID GAUTHIER, *MORALS BY AGREEMENT* (1986), JOHN RAWLS, *A THEORY OF JUSTICE* (1971) and T.M. Scanlon, *Contractualism and Utilitarianism*, in *UTILITARIANISM AND BEYOND* (Amartya Sen & Bernard Williams eds., 1982)).

71. Waldron describes legislation generated by a process characterized by political equality as "a *respectful* achievement—because it is achieved in a way that is respectful of the persons whose action-in-concert it represents." WALDRON, *supra* note 12, at 109.

72. These two reasons are taken from WALDRON, *supra* note 12, at 111-14.

73. See WALDRON, *supra* note 12, at 111.



not irrational to think that reasonable people would differ.<sup>74</sup>

An alternative approach to disagreement, rejected by political equality, blithely dismisses opposing views as “beneath notice in respectable deliberation” and “ignorant or prejudiced or self-interested or based on insufficient contemplation of moral reality.”<sup>75</sup> Registering disagreement allows a political system to start from an assumption that is more respectful of members: we disagree largely because the issues are difficult and because we bring different perspectives to the table.<sup>76</sup>

While the first reason had to do with simple recognition of disagreement, the second reason has to do with how the registered views affect the decision in question.<sup>77</sup> Political equality enables members positively to affect the political system’s decisions.<sup>78</sup> Resolving disagreement with a coin toss might treat that disagreement as morally significant, but it would not allow people to affect the outcome of a decision-making procedure the way a right to vote would.<sup>79</sup> Political equality

says that in the case of each individual, the fact that that individual favours option X is a reason for the group to pursue option X, even though there is disa-

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74. *Id.* at 111-12. Beitz considers understanding the notion of institutions’ “public recognition of each person’s status as an equal citizen” as “public recognition of the equal worth of persons, conceived as autonomous centers of deliberation and action,” avoiding interfering with and even contributing to members’ “respect for themselves and for one another as persons equally capable of making deliberate choices about their own situations and of carrying out these choices in action.” BEITZ, *supra* note 11, at 92-93 (citing ALEXANDER MEIKLEJOHN, *POLITICAL FREEDOM* 13 (1960)). Beitz finds this latter explication of the equal status of citizens insufficient to determine the question of institutional fairness, which for him is at the core of political equality, *id.* at 4, 16-19, 93-94, but I do think that Beitz believes the cited notions are important to understanding how some ways of recognizing disagreement are respectful. Consider, also, Rawls’ notion of the burdens of judgment. RAWLS, *supra* note 36, at 54-58, *discussed in* WALDRON, *supra* note 12, at 111-12.

75. WALDRON, *supra* note 12, at 111.

76. *Id.* at 112-13 (“The difficulty of the issues—and the multiplicity of intelligences and diversity of perspectives brought to bear on them—are sufficient to explain why reasonable people disagree.”).

77. *Id.* at 113.

78. *Id.* at 113-14.

79. *See id.*

greement. Because there *is* disagreement, it is not yet a conclusive reason; still, it counts in favour of the group's pursuing X.<sup>80</sup>

Treating a person's view that the group should do X as a reason to do X is a way of respecting that person, because it implies that the person's view is presumptively offered in good faith and potentially relevant to our own deliberations.<sup>81</sup> Treating a person's view that the group should do X as a reason for the group to do X could also be understood as an acknowledgment of the person's qualified moral right to direct her life as she chooses.<sup>82</sup>

## 2. *Political Equality Outside Electoral Systems*

The democratic ideal of political equality was characterized above as a response to the inevitability of reasonable disagreement in political systems, one that treats members with a minimally acceptable degree of respect. If this is a fair characterization, then political equality, or something very like it, may also have a place in political systems outside the national electoral systems for which political equality is typically thought to be an ideal. To argue that political equality itself has a place in industry or social impact work, for example, we might appeal to a distinction Beitz draws between two kinds of

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80. *Id.* at 113.

81. *See id.* at 113-14. I am not convinced that such a procedure implies that participants ought not, in their own independent judgments, dismiss the views of other members as ignorant, prejudiced, self-interested or based on insufficient contemplation of moral reality. In some religious communities, for example, it is expected that true believers will hold to fundamental tenants as absolute certainties and will view failure to hold to those tenants as the result of a spiritual failing. Members of these communities might still believe that political procedures ought to register a range of views including some that reject these fundamental tenants. For them, the procedures recognize, for political purposes, that views within the acceptable range ought to be considered; however, they need not imply that those participating in the procedure should not, in their own minds, reject some views as the result of a spiritual failing.

82. We find this idea in, for example, JOHN RAWLS, *POLITICAL LIBERALISM* 52 (1993) and ROBERT NOZICK, *ANARCHY, STATE, AND UTOPIA* 6, 12 (1974). Arguably, this idea was a driving force even in Hobbes' political philosophy, in which the sovereign's authority ultimately derives from the "Right of Nature" belonging to all persons to preserve themselves. *See* THOMAS HOBBS, *LEVIATHAN* 86 (A.R. Waller ed., Cambridge Univ. Press 1904) (1651).

democratic theories, the narrower of which seeks only to identify central features of the best government and the broader of which seeks to identify central features of the best society.<sup>83</sup> So a defense of political equality in industry and social impact work might be developed *within* democratic theory (of the broader kind). What follows is first such a defense and then an explanation of the way in which something *like* political equality could be defended in industry and social impact work by analogy to defenses in democratic theory.

According to Carole Pateman, political equality in a national electoral system is *not* the only political equality that matters for democracy.<sup>84</sup> This should not be too surprising, since it is fairly commonplace to assume that political equality is a democratic value in local electoral systems and even in nongovernmental contexts, as in neighborhood associations.<sup>85</sup> Pateman takes this notion one step further, however, and claims that other sectors, including industry, are also political systems that can be characterized by more or less political equality—according to the quality of participation permitted in the systems—and that political equality in these systems is, indeed, a democratic value.<sup>86</sup>

Pateman's defense of political equality in industry takes a consequentialist line not pursued in this note.<sup>87</sup> She asserts that high-quality participation in industry has the salutary educative effect of preparing the participant for participation in other political systems.<sup>88</sup> This preparation results not only in

83. BEITZ, *supra* note 11, at ix.

84. CAROLE PATEMAN, *PARTICIPATION AND DEMOCRATIC THEORY* 42 (1999) ("The existence of representative institutions at national level is not sufficient for democracy . . .").

85. See, e.g., HANSMANN, *supra* note 13, at 43 (discussing the value of participation in consumer cooperatives).

86. PATEMAN, *supra* note 84, at 43. "[S]pheres such as industry should be seen as political systems in their own right." See also Crocker, *supra* note 6, at 311 (endorsing Goulet's view that "[a]lthough the popular image of participation involves balloting in national elections, citizens' face-to-face involvement in local governments, or grassroots development projects, issues of participation of women arise in households, and citizen participation in addition to voting is possible in national and global governance structures.").

87. See discussion *supra* Part I.B.1.

88. PATEMAN, *supra* note 84, at 42-43 ("The existence of representative institutions at [the] national level is not sufficient for democracy; for maximum participation by all the people at that level socialisation, or 'social

familiarity with democratic procedures, but also in a sense that participation can have a real impact, in a "broadening of outlook and interests" and in an "appreciation of the connection between private and public interests . . . ."<sup>89</sup> This is all necessary, in Pateman's view, because "for a democratic polity to exist it is necessary for a participatory society to exist, i.e. a society where all political systems have been democratised and socialisation through participation can take place in all areas."<sup>90</sup> Pursuing Pateman's consequentialist line, we might argue that we ought also to look for political equality in social impact work.<sup>91</sup> Notice that the benefits of participation that Pateman says would accrue in the industry context would also accrue in social impact work.<sup>92</sup> Almost by definition, if people participate in social impact work designed to benefit them,

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training', for democracy must take place in other spheres in order that the necessary individual attitudes and psychological qualities can be developed. . . . [T]he justification for a democratic system in the participatory theory of democracy rests primarily on the human results that accrue from the participatory process. One might characterise the participatory model as one where maximum input (participation) is required and where output includes not just policies (decisions) but also the development of the social and political capacities of each individual, so that there is a 'feedback' from output to input."). Pateman considers industry to be the most important area in which these capacities can be developed, in part because "most individuals spend a great deal of their lifetime at work and the business of the workplace provides an education in the management of collective affairs that is difficult to parallel elsewhere." *Id.* at 43. In many poor communities around the world, social impact projects play a large role in shaping collective affairs—access to food, water, education, etc.—and thus provide a similar opportunity for education in the management of collective affairs.

89. *Id.* at 74.

90. *Id.* at 43.

91. Participation may be valuable for other consequentialist reasons as well: various activities that constitute participation may be enjoyable in themselves for beneficiaries. As Henry Hansmann puts it, participation may be a consumption good. HANSMANN, *supra* note 13, at 43. It may also be that beneficiaries are better off when they feel an extra degree of control over their financial rights and obligations—a very important aspect of their lives. *Id.*; see generally discussion *infra* Part III.B.2.a.

92. Most of those employed in industry, like intended beneficiaries of social impact work, tend to be relatively disempowered—they do not tend to have the ear of politicians the way wealthier individuals do. Learning how political participation works (in its various forms) is therefore especially important for these segments of the population.

they gain experience in making decisions about important social, economic, political issues that affect them.<sup>93</sup>

As explained in Part I, this note is concerned with evaluation of social impact projects based on their intrinsic features rather than their consequences. For this reason, Pateman's consequentialist argument for introducing political equality into various political systems is left to the side. Turning to the question of intrinsic features, we see that all of the virtues of political equality in some kind of national electoral system appear also to be virtues in social impact work.

Establishing a procedure that gives beneficiaries' opinions decisional weight is a way of respecting beneficiaries' capacity to reflect on the nature of the problems they face and come to conclusions that are different from the conclusions of those who manage the social impact work.<sup>94</sup> Such a procedure registers disagreement regarding how a beneficiary population should be helped, thereby recognizing the moral significance of the views of the beneficiary population on the questions at hand. Giving decisional weight to a beneficiary's view that the social impact organization should do X is a way of treating that view as a reason to do X, which is a way of respecting the beneficiary (treating the beneficiary's views as presumptively worthy of consideration). At bottom, the intuition is still that what touches all should be decided by all.<sup>95</sup>

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93. Crocker and Goulet agree that such participation can prepare the participant for participation in other, larger systems. Goulet argues that part of the value of participation in "micro venues" lies in the manner in which such participation opens the way for scaling up to participation in "macro venues." Crocker, *supra* note 6, at 315; *see also id.*, *supra* note 6, at 311 ("Throughout his career Goulet insisted that one of development's most important challenges is to find ways in which 'micro' participation can be extended to venues of 'macro' decision-making.").

94. Disagreement of this kind is especially unsurprising in the context of social impact work, particularly where it is international. *See, e.g.*, Julius Nyerere, *Education for Self-reliance*, in *FREEDOM AND SOCIALISM* 267 *et seq.* (1968) (arguing that the education system in post-independence Tanzania had a fundamentally different purpose from the education system established there by England, the former colonial power); HAITIAN LED RECONSTRUCTION, *supra* note 5, at 11.

95. It is possible that democratic theorists would prefer to limit the application of a concept like political equality to political systems like national electoral systems. Even if democratic theory does not apply directly to social impact work, though, it seems that many of the reasons (grounded in respect for persons) that democratic theory gives for political equality support

We should not ignore potentially relevant differences, though, between political systems like industry and social impact work and political systems like national electoral systems. There may be systems where we do not expect political equality (or anything like it). For example, students in primary and secondary schools have next to no say in the governance of their schools,<sup>96</sup> and, likewise, non-shareholder consumers of many larger companies have no say in the governance of the companies they patronize.<sup>97</sup> The question may be, then, why we should think industry and social impact work are the sort of system in which political equality matters rather than the sort of system in which political equality does not matter. Pateman, at least, would likely agree that political equality matters in social impact work: for a truly democratic polity to exist, she holds, all “political systems” (not just national government systems) must be characterized by political equality, where a political system is understood as “any persistent pattern of human relationships that involves to a significant extent power, rule or authority.”<sup>98</sup> But this view seems overinclusive because it includes in the concept of a political system primary schools and most company-consumer relationships.

The problem might be resolved by viewing it in a different light. It might be that political equality does matter in all the political systems caught by Pateman’s broad definition, but that other considerations weigh against or trump establishing participatory procedures in some of those systems. In other

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something very much like political equality in the context of social impact work. For the sake of simplicity, the argument proceeds as if the democratic theory analysis of political equality can apply directly to social impact work.

96. Of course, people like Alexander Neill, founder of the Summerhill School (England), would likely say that we *should* have political equality in schools. Neill would likely find support among the administrators, faculty and students of schools like the Harmony Education Center (Bloomington, IN) or the Manhattan Free School (New York, NY). See ALEXANDER NEILL, *SUMMERHILL: A RADICAL APPROACH TO CHILD REARING* (1960); *About, HARMONY SCHOOL*, <http://www.harmonyschool.org/home/about> (last visited Sept. 29, 2012); *FAQ, MANHATTAN FREE SCHOOL*, <http://www.manhattan-freeschool.org/faq> (last visited Sept. 29, 2012).

97. There are, of course, many companies that are, in fact, owned and controlled by their customers. See Hansmann, *supra* note 8, at 149-226 (discussing customer cooperatives).

98. PATEMAN, *supra* note 84, at 44 (quoting R.A. DAHL, *MODERN POLITICAL ANALYSIS* 6 (1963)).

words, political equality might demand equal participation in certain retail companies, but other considerations, such as prohibitive agency costs associated with implementing anything more than consumers' participation-by-consumption, might simply undo any notion of an all-things-considered requirement of equal participation in such companies.<sup>99</sup> Meanwhile, in the context of national government, any countervailing considerations do not defeat the importance of equal participation by citizens. Viewed in this way, the question is whether social impact work is like other companies, where other considerations defeat the importance of political equality, or like government, where other considerations do not defeat the importance of political equality.<sup>100</sup> Given the significance of the role played by many social impact projects in underprivileged communities, it does seem fair to expect those projects to respect beneficiaries in the same way governments respect their citizens and, thus, to require political equality in social impact work.

Two remarks are warranted before proceeding. First, the all-things-considered judgment regarding whether political equality is required in social impact work is not necessarily a consequentialist judgment. It is rather a judgment that may have to reconcile diverse values. So one might decide that political equality in social impact work makes that work more respectful of its beneficiaries and that such respectfulness is important. Meanwhile, one might acknowledge that introducing mechanisms that ensure greater political equality has costs—reducing the number of beneficiaries reached by the social impact work, for instance. This note does not propose any particular way of reconciling the importance of respectful social impact work and the importance of reaching a larger number of beneficiaries.

Second, much of the following argument proceeds as if political equality is in fact important in social impact work because it renders that work more respectful of beneficiaries. On that basis, costs associated with achieving greater political equality in social impact work will be relevant to any all-things-

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99. Cf. HANSMANN, *supra* note 13, at 35-53.

100. Some of the countervailing considerations in the context of social impact work will be considered later in this note. See discussion *infra* Part III.B.2.

considered judgment about the desirability of pursuing greater political equality in social impact work. However, those costs will not be directly relevant to whether political equality in social impact work is in fact more respectful of beneficiaries. It is worth asking what it would take for a social impact project fully to satisfy the demands of political equality, because we have reasons to value political equality that are independent (at least to some extent) of the reasons we have to value increases in beneficiary welfare.

D. *Measuring Political Equality: Introducing  
the Analytical Framework*

Now that we have a general sense of what political equality is, why it makes systems respect members and why it might be relevant in social impact work in particular, we need a way to characterize or measure political equality in a social impact project. Almost by definition, political equality is a function of quality of member participation.<sup>101</sup> To determine the degree of political equality in a social impact project, then, we need to know how to evaluate the quality of beneficiary participation in that social impact project. Denis Goulet and David Crocker write on beneficiary participation in social impact work.<sup>102</sup> Their evaluations of beneficiary participation operate along the same three dimensions Pateman uses to evaluate participation in industry. What follows is an elaboration from Goulet's, Crocker's and Pateman's work of a three-dimensional analytical framework we can use to evaluate beneficiary participation in social impact work.<sup>103</sup>

Modes of beneficiary participation in social impact work can be ranked from "thick" to "thin":<sup>104</sup>

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101. That this idea would be acceptable to the three main theorists of participation under consideration here—Carole Pateman, Denis Goulet and David Crocker—will be substantiated below in Part I.C.

102. Crocker, *supra* note 6, at 308; Goulet, *supra* note 1.

103. A version of this analytical framework might be used to evaluate participation in other political systems. If I am right about the similarities between Pateman's, Goulet's and Crocker's classificatory schemata, participation in industry should be especially easy to evaluate with this framework.

104. The articulation that follows comes from Crocker, *supra* note 6, at 313-14 (drawing on and supplementing classificatory work in Jay Drydyk, *When Is Development More Democratic?* 6 J. HUM. DEV. 247 (2005) and elsewhere). One mode that Crocker lists (participatory participation, in which



- C1. *Deliberative participation*—the beneficiary, along with other beneficiaries or other decision-makers, has the power to make the decision;
- C2. *Bargaining*—the beneficiary has at least a small amount of leverage that she can use to push the decision-makers to make one decision rather than another;
- C3. *Petitionary participation*—the beneficiary has a right to force the decision-makers to listen to her opinions before the decision is made, but the decision-makers are not bound by the beneficiary's opinions;
- C4. *Consultative participation*—the decision-makers decide to ask the beneficiary for her opinions before a decision is made, but the decision-maker is not bound by the beneficiary's opinions;
- C5. *Passive participation*—the beneficiary attends meetings but only to hear what the decision-makers have decided and maybe to ask questions about those decisions; and
- C6. *Nominal participation*—the beneficiary is theoretically permitted to attend meetings but in practice does not or cannot attend.<sup>105</sup>

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beneficiaries have control over implementation of broad goals but no control over the setting of those goals) has been removed, because this mode has less to do with the degree of power held by the beneficiary—the question of mode—and more to do with what kinds of decisions the power can be used to decide—the question of entry point. The order in which the modes are listed is also the reverse of the order Crocker uses. This helps coordinate the list of modes of participation with the list of participation entry points.

105. Crocker's ranking of modes of participation is easily reconciled with Pateman's own distinctions between pseudo participation, partial participation and full participation. Nominal and passive participation (C6. and C5.) can be thought of as kinds of Patemanian *pseudo participation* (which occurs after the decision has been made and in which the actor participates only in the sense that she has an opportunity to discuss that decision with the decision-maker), since they occur before the decision has been made. PATEMAN, *supra* note 84, at 68-69. Consultative and petitionary participation (C4. and C3.) are kinds of Patemanian *partial participation*, which occurs before the decision has been made but in which the actor lacks ultimate authority to determine the outcome of the decision, having only an opportunity to try to influence the real decision-maker. PATEMAN, *supra* note 84, at 70. Deliberative participation (C1.) is Patemanian *full participation*, which occurs before the decision has been made and in which the actor possesses as much ulti-

Kinds of participation can also be distinguished based on a beneficiary's point of entry into the process of decision-making, moving from "upstream" to "downstream"<sup>106</sup>:

- G1. *Initial diagnosis of the problem*;
- G2. *Listing of possible solutions*;
- G3. *Selecting one course of action*;
- G4. *Preparing for implementation*;
- G5. *Evaluating and self-correcting during implementation*; and
- G6. *Considering the merits of further action*.<sup>107</sup>

A final classification schema to mention, recognized by both Crocker and Goulet and implicit in Pateman's work, is *inclusiveness*. For example, one might classify social impact projects according to the degree to which they include traditionally marginalized populations in decision-making processes.<sup>108</sup> Adding the inclusiveness dimension to the Crocker and Goulet schemata gives us a three-dimensional analytical framework, which enables us to classify types of participation. On one axis we have six modes of participation, from thick to thin; on a second axis we have six entry points (or kinds of decisions a participant might help make), from up-

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mate authority to determine the outcome of the decision as any other actor. See PATEMAN, *supra* note 80, at 71. Bargaining (C2.) is Patemanian *partial participation* or Patemanian *full participation*, depending on the amount of leverage the beneficiary has.

106. The articulation that follows comes from Goulet, *supra* note 1, at 322.

107. Goulet's entry-point classification concerns the nature of the decision the outcome of which a participant might or might not have power to determine. This is very close to Pateman's distinction between low-level and high-level management, *see* PATEMAN, *supra* note 48, at 70, only Goulet's classification schema is finer-grained. Pateman's high-level management decisions (decisions regarding the running of the whole enterprise, investment and marketing) are likely made at points G1., G2., G3. and G6. Low-level, day-to-day management decisions, on the other hand, are likely made at points G4., G5. and G6. It may be that Pateman's notion of low-level management decisions captures a residual element—day-to-day implementation without evaluation—that is less clearly identified in the Goulet schema.

108. Crocker, *supra* note 6, at 313 (citing Bina Agarwal, *Participatory Exclusions, Community Forestry, and Gender: An Analysis for South Asia and a Conceptual Framework*, 29 WORLD DEV. 1623 (2001)).

stream to downstream;<sup>109</sup> and on a third axis we have degrees of inclusiveness.<sup>110</sup>

This analytical framework helps us unpack the definition of political equality: relevant factors in determining whether political equality exists in a given social impact project include the *thickness* of the participation of the beneficiaries permitted by the structure of the project, the *entry point* of that participation and the *inclusiveness* of that participation. Determining the relative importance of each dimension is beyond the scope of this note, but the framework should still provide a way to identify some of the differences between models of social impact work that are relevant from the perspective of political equality. In particular, the framework should help us identify some of the advantages and disadvantages of the consumer-beneficiary model of social entrepreneurship.

Pateman, Crocker and Goulet would likely accept the proposition that political equality is a function of quality of participation and would understand it as follows. Pateman understands political equality in industry in terms of its tendency to foster political equality in other spheres and indicates that higher-level participation (“upstream” participation in the language of the framework developed above<sup>111</sup>) is more likely to have the educative effect in question.<sup>112</sup> It stands to reason that thicker participation (what Pateman would call “fuller participation”<sup>113</sup>) would also be more conducive to such education. While one might learn about democratic procedures

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109. This is a simplification, of course, since multiple entry points are possible. Note, also, that these axes are not completely independent since one of the differences between C4. and C5., for instance, is that the former occurs before the decision is made, and the latter occurs *ex post*.

110. The shape of the framework seems to cohere with the tenor of Pateman’s analysis. Our framework is simply more precise. Uses of the framework in the context of employee participation in industry or beneficiary participation in social impact work seem equally unproblematic.

111. G1., G2. and G3. are especially likely to count as higher-level participation in Pateman’s sense.

112. PATEMAN, *supra* note 84, at 74 (“For education in this sense higher level participation would seem to be required, for only participation at this level could give the individual experience in the management of collective affairs in industry and insight into the relationship between decisions taken in the enterprise and their impact on the wider social and political environment.”).

113. *See id.* at 69.

and the connection between public and private interests from observation, the lesson will likely be more profound if one is responsible for navigating the procedures to arrive at a decision about a substantive issue.<sup>114</sup>

Finally, it seems quite likely that Crocker and Goulet would agree that the framework developed above measures political equality by measuring the quality of participation, along different dimensions.<sup>115</sup> Thicker participation, according to Crocker, “more fully express[es] individual or collective agency”;<sup>116</sup> and although each kind of participation is valuable, Goulet writes that “upstream” participation enables beneficiaries more fully to “express their agency.”<sup>117</sup> Goulet reaffirms the views of Paulo Freire on participation in social impact work expressed in the passage at the outset:

[T]he supreme touchstone of development is whether people who were previously treated as mere objects, known and acted upon, can now actively know and act upon, thereby becoming subjects of

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114. Additional arguments from effects can be made. For example: democracy at the national level (electing representatives to government, etc.) is a necessary condition for economic development, *see, e.g.*, Adam Przeworski et al., *Economic Development and Political Regimes*, in THE DEMOCRACY SOURCEBOOK 108 (Robert Dahl, Ian Shapiro & José Antonio eds., 2003), is at least not detrimental to a society's economy, *see, e.g.*, Hristos Doucouliagos & Mehmet Ulubasoglu, *Democracy and Economic Growth: A Meta-Analysis*, 52 AM. J. POL. SCI. 61 (2008), or promotes the amelioration of oppression, *see, e.g.*, Milton Fisk, *Justifying Democracy*, 22 CAN. J. OF PHILOSOPHY 463 (1992). These arguments, if sound, would make Pateman's argument more significant, because if democratic participation at the national level is a good thing, understanding processes that improve such participation (here, participation in other sectors) is all the more important.

115. *See* Crocker, *supra* note 6, at 314 (“Popular participation is a way in which people manifest their inherent worth.”); Crocker, *supra* note 6, at 311 (“To respect and promote such participation is to respect the dignity of hitherto neglected or despised people . . . .”); Crocker, *supra* note 6, at 309-10 (“The basic idea is that persons and groups should make their own decisions, at least about the most fundamental matters, rather than having others—government officials, development planners, development ethicists, community leaders—make decisions for them or in their stead. Authentic development occurs when groups at whatever level become subjects who deliberate, decide, and act in the world rather than being either victims of circumstance or an object of someone else's decisions and the tool of someone else's designs.”).

116. *See* Crocker, *supra* note 6, at 314.

117. *See* Crocker, *supra* note 6, at 312 (discussing Goulet).

their own social destiny. When people are oppressed or reduced to the culture of silence, they do not participate in their own humanization. Conversely, when they participate, thereby becoming active subjects of knowledge and action, they begin to construct their properly human history and engage in processes of authentic development.<sup>118</sup>

A model of social impact work that permits thick, upstream and inclusive beneficiary participation does a better job of respecting beneficiaries than does a model of social impact work permitting only thin, downstream and non-inclusive (or no) beneficiary participation.

Reflecting on the definition of political equality, together with its potential value in social impact work and the analytical framework for measuring political equality in political systems, the next question is: what is the measure of political equality in the social impact work done by social enterprises on the consumer-beneficiary model? Does the consumer-beneficiary model permit thick, upstream and inclusive beneficiary participation? The conclusion will be that it does, with certain exceptions. Consumer-beneficiary social enterprises that provide financial services, for example, only permit meaningful participation under an appropriate regulatory regime. A contractual arrangement between the social enterprise, its beneficiaries and a third-party nonprofit may also help ensure meaningful participation, though perhaps at some cost.<sup>119</sup>

### III.

#### APPLYING THE ANALYTICAL FRAMEWORK TO THE CONSUMER-BENEFICIARY MODEL

##### A. *The Baseline*

Before applying the analytical framework to the consumer-beneficiary model, it is helpful to have a baseline for comparison. Consider how a traditional model of philan-

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118. Goulet, *supra* note 1, at 165 (citing Freire). Yunus seems to be on board as well when he echoes Freire's sentiment in *Creating a World Without Poverty* by chastising NGOs for treating poor people as objects instead of independent actors with creative ideas to contribute to solving their own problems. See YUNUS, *supra* note 1, at 12.

119. See discussion *infra* Part III.B.

thropic social impact work would fare in the framework.<sup>120</sup> Wealthy philanthropists in one part of the world decide that they would like to help a particular group of people in a village in another part of the world (the beneficiaries). The philanthropists research problems faced by the beneficiaries, seeing malnutrition, disease, failure of local educational institutions and lack of or insufficient access to drinking water as primary problems. They select access to drinking water as the problem to tackle and then begin to devise a way to solve that problem, eventually settling on drilling a well in the beneficiaries' village. These days,<sup>121</sup> such philanthropists usually identify a few people among the beneficiaries (or at least from that part of the world) who can help the philanthropists to identify problems and intervention strategies and then to implement those interventions. Once the intervention has been crafted, the philanthropists present their intervention to the beneficiaries and begin to implement it, hiring a team to drill the well. Sometime after the intervention has been implemented, the philanthropists make some attempt to determine whether the intervention has actually solved the original problem.

This example of a traditional philanthropic model is not very inclusive. Of the beneficiaries, only a few "experts" participate at any stage, unless, that is, the evaluation of the intervention after implementation includes other beneficiaries. The entry points of participation are few and downstream in Goulet's scheme.<sup>122</sup> The experts are probably consulted at the point of finding a specific way to implement an intervention already settled on by the philanthropists (G4. *Preparing for implementation*). The beneficiaries might be consulted at the point of evaluating the effectiveness of the intervention (G6. *Considering the merits of further action*). The modes of participa-

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120. The term "philanthropic social impact work" is used to exclude various forms of grassroots social impact work. Even narrowing the field in this way, there are obviously many "traditional" models of philanthropic social impact work. I describe a slightly exaggerated case. The description proceeds largely without citation but coheres with the general picture described by writers in development ethics. See, e.g., Crocker, *supra* note 6; Drydyk, *supra* note 6.

121. See Drydyk, *supra* note 6, at 333-34.

122. *Supra* Part II.D.

tion, furthermore, are quite thin in Crocker's scheme.<sup>123</sup> The experts likely consult the beneficiaries before implementing the project without binding themselves to change their course based on input the beneficiaries give (C4. *Consultative participation*). It is possible that all the beneficiaries are engaged in consultative participation at the evaluation stage, but only with respect to the question of what step should be taken next and not with respect to the initial intervention. In sum, in this example of the traditional model of a social impact project, beneficiary participation is downstream, thin and not inclusive.

The foregoing example is in no way an effort to dismiss the significance of contributions made by traditional philanthropy. Political equality is only one of many values. In some cases, especially severe emergencies, beneficiaries need immediate aid from experts and have no interest in significant participation in their own rescue (defined in a short timeframe). Nevertheless, it is instructive to see how little political equality there is in at least one picture of traditional philanthropy and how much there is, by contrast, in at least one model of social enterprise.

#### B. *The Political Equality Virtues of the Consumer-Beneficiary Model*

In the consumer-beneficiary model, the consumer-beneficiary engages in relatively high quality participation in the social enterprise by consuming the social enterprise's goods and services.<sup>124</sup> This is a form of participation-by-consumption. The following analysis evaluates beneficiary participation-by-consumption in the consumer-beneficiary model of social enterprise along the three dimensions of the analytical framework developed above.

123. *Supra* Part II.D.

124. It is perhaps worth anticipating the claim that one individual's purchase decision is not a significant form of participation because the individual has much less say in directing the enterprise than someone on the board of directors. This is simply the wrong comparison to make. Instead, as the analysis proceeds in this section, consider how an individual's purchase decision is like an individual's vote. Only collectively does either form of participation make a difference in how the relevant political system runs, but in both cases the political systems give their members enough opportunity for high-quality participation to be said to be characterized by political equality.

Through participation-by-consumption, the consumer-beneficiary of a social enterprise on the consumer-beneficiary model is arguably involved at all entry points identified by Goulet. If we understand demand for a good or service as the willingness and ability to purchase that good or service,<sup>125</sup> we can see the demand-formation stage as the problem-diagnosis stage (G1. *Initial diagnosis of the problem*). The consumer-beneficiary is a participant at this stage.<sup>126</sup> It is the borrowers who first decide that they need a loan from a microfinance social impact organization. Notice, in fact, that in the consumer-beneficiary model it may well be the company, rather than the beneficiary, that enters only at the second, solution-listing stage (G2. *Listing of possible solutions*). The company enters this stage when it offers its goods or services as candidate methods of satisfying the consumer-beneficiary's demands. Thus, Grameen or Compartamos offer a range of financial services to potential borrowers. To the extent that the company consults the consumer-beneficiary (during the market research stage, for example) the consumer-beneficiary also participates at this stage.

The company will participate in the third stage (G3. *Selecting one course of action*) by deciding to offer for sale only some of the goods or services it considered offering in the second stage (loans but not savings accounts, for example). The consumer-beneficiary must participate in this stage if intervention is to continue at all, by purchasing goods or services (usually only some of those on offer). In simple cases, such as where a consumer-beneficiary purchases a food item and consumes it, the implementation of the "solution" (including G4. *Preparing for implementation* and G5. *Evaluating and self-correcting during implementation*) could be understood to occur at the point of sale. The sixth step (G6. *Considering the merits of further action*) is taken by the consumer-beneficiary, as she considers her experience with the good or service (perhaps with some consultation with the company) and decides whether to approach the

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125. See *Demand*, ECONOMIST, <http://www.economist.com/economics-a-to-z/d#node-21529654> (last visited Mar. 24, 2013); 4 OED 430 (ed. 1989) ("*Polit. Econ.* The manifestation of a desire on the part of consumers to purchase some commodity or service, combined with the power to purchase . . .").

126. The notion that the consumer-beneficiary might not be the *only* participant at this stage is taken up below. See discussion *infra* Parts II.C, III.



company again in the future. It is also taken by the company, as it decides whether to continue offering the good or service.<sup>127</sup>

The contrast between the traditional model of philanthropy and participation-by-consumption in the consumer-beneficiary model of social enterprise is perhaps clearest when one looks to modes of participation. In basic terms, the mode of participation by the consumer-beneficiary can be classified as bargaining (C2. *Bargaining*). It is helpful to focus on purchases made by individuals for themselves or as representatives of some small unit, such as a family or a business partnership, and on classifying the participation of the individual actually executing the contract of sale. There is no particular reason to assume that such a focus will identify the “normal” case, if there is one, since the participation of persons who furnish funds but do not make purchase decisions, for instance—which we could classify somewhere between passive participation (C5. *Passive participation*) and bargaining (C2. *Bargaining*)—might account for a large percentage of the participation we want to count, depending on how we are counting. Focusing our attention in the way described above allows us to analyze the more straightforward cases, however, thereby demonstrating the difference between the consumer-beneficiary model and the traditional philanthropic model. On a widely accepted definition of bargaining—according to which each party must offer something the other wants in exchange for a good, service or promise<sup>128</sup>—it is easy to classify the individual

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127. One concern with the application of Goulet's hierarchy in this context is that Goulet's entry points might not always be ordered in the way he sequences them. So, the listing of solutions (i.e., the listing of things for which there is demand), for example, could be part of identifying the initial problem (i.e., the demand to be satisfied) and, thus, the first stage. Where this is the case, the process of deciding which goods or services are going to be made available becomes much more important relative to the choices made by the beneficiary consumers. This may reduce the quality of their participation. Put another way, Goulet's hierarchy may not be sufficiently sensitive to variations in the social enterprise's responses to the information and bargaining power asymmetries mentioned below. See discussion *infra* Part III.D.

128. “A performance or return promise is bargained for if it is sought by the promisor in exchange for his promise and is given by the promisee in exchange for that promise.” RESTATEMENT (SECOND) OF CONTRACTS § 71(2) (1981). A fruitful comparison might be made between the bargaining in the

purchase case as one of bargaining. Grameen, for example, wants to exchange cash now for cash later (with a higher net present value, which it then puts back into the company), and the Grameen borrower wants cash now that she believes she can use to generate more than what Grameen is willing to accept at repayment.<sup>129</sup>

The individual purchase case could even be classified as deliberative participation (C1. *Deliberative participation*). It is certainly fair to characterize some individual purchases as expressions of collective deliberation. Alex Nicholls writes about the growth of different kinds of ethical consumption, which he defines as “an economic space where consumers buy products that have added social or environmental value above other competing purchase options.”<sup>130</sup> Examples include boycotts of sugar produced on plantations that use slave labor<sup>131</sup> and pa-

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consumer-beneficiary model and the process of iteration used (especially in the tech industry) to develop products that satisfy consumer demands. See, e.g., Ian Spence & Kurt Bittner, *What Is Iterative Development? Part 2: The Customer Perspective*, DEVELOPERWORKS, <http://www.ibm.com/developerworks/rational/library/apr05/bittner-spence/index.html> (last visited Mar. 18, 2013).

129. The KickStart exchange with its beneficiaries can similarly be characterized as bargaining. KickStart, for example, wants money instead of the pumps it has, and the farmers want pumps instead of the money they have. The picture is more complicated than this, of course, because KickStart uses for-profit distributors. KickStart sells below-cost to the distributors, which then sell the pumps for a profit to the farmers. The end result is that the distributors make a profit, the farmers get pumps below cost and KickStart gets some money but less than what it cost to produce the pumps. Whether KickStart gets any of this money—thus, whether it is able to continue its operations without serious revision—depends ultimately on whether the farmers are willing to purchase the pumps. If the farmers are unwilling, the distributors will be unwilling and KickStart will have no purchasers. The KickStart–farmer relationship is mediated, but the farmer participation in the enterprise can still be characterized as bargaining in Crocker’s sense because the farmers can choose to exchange their money for the offered good or to keep it. Notice that by choosing one piece of equipment offered by KickStart over another, the farmers also leverage their buying power to affect KickStart’s future design/production choices.

130. Nicholls, *supra* note 3, at 246. His more technical definition is: “the product and purpose of markets that aggregate consumer-provider (demand-supply) exchange transactions for goods or services that have—as one of their defining product characteristics—a normalised notion of social and/or environmental benefit.” *Id.*

131. *Id.* (citing AMANDA BERLAN, *Child Labour, Education and Child Rights Among Cocoa Producers in Ghana*, in *THE POLITICAL ECONOMY OF SLAVERY* 158-

tronizing shops like Pret à Manger because of their treatment of their employees.<sup>132</sup> Ethical consumption is recognition that even (or maybe especially) the choices we make in economic life have an ethical dimension.<sup>133</sup> More than that, ethical consumption is recognition that our individual choices in our individual economic lives are part of a bigger picture in which *we* are responsible for consequences of our collective economic choices.<sup>134</sup>

In the consumer-beneficiary model of social enterprise, the consumer is the beneficiary of the social enterprise. At least in some circumstances, consumer-beneficiaries can exercise power over the social enterprise (Grameen or KickStart) in the same way that those engaging in ethical consumerism exercise power over companies by choosing to patronize or not to patronize, and this choice can be a collective choice. In this way, the beneficiaries in the consumer-beneficiary model can sometimes engage in deliberative participation (C1. *Deliberative participation*) in the social impact work. Basing purchase choices on decisions about the aggregate effects of our purchase choices is less possible when one lacks the means to choose any but the cheapest option, of course, and deliberative participation (through ethical consumption) may not always (or may only rarely) be possible in the consumer-beneficiary model for this reason.

Beneficiary participation-by-consumption in a consumer-beneficiary social enterprise's social impact work can be thick,

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78 (C. van den Anker ed., 2004); SIMON SCHAMA, *ROUGH CROSSINGS: BRITAIN, THE SLAVES, AND THE AMERICAN REVOLUTION* (2005)).

132. See PRET À MANGER, [http://www.pret.com/us/about\\_our\\_company/our\\_team.htm](http://www.pret.com/us/about_our_company/our_team.htm) (last visited Oct. 3, 2012).

133. Nicholls, *supra* note 130, at 250 (citing Amartya Sen for a challenge to the notion that economic behavior is self-interested behavior, AMARTYA SEN, *ON ETHICS AND ECONOMICS* (1987), and pointing out that the ethical dimension of economic life was recognized by John Stuart Mill, JOHN STUART MILL, *UTILITARIANISM* (G. Sher ed., 2001), and by Adam Smith, ADAM SMITH, *THE THEORY OF MORAL SENTIMENTS* (A. Macfie & D. Raphael eds., 1976)).

134. *Id.* (mentioning the contesting of a notion central to neo-liberal market economics that "an individual's choice is not constrained by recognition of the interdependence of his or her own actions with the choices of others . . ."). For a discussion of the concept of collective obligations, see CHRISTOPHER KUTZ, *COMPLICITY: ETHICS AND LAW FOR A COLLECTIVE AGE* (2007) and Christopher Kutz, *The Collective Work of Citizenship*, 8 *LEGAL THEORY* 471 (2002).

upstream and inclusive. Comparisons between the consumer-beneficiary model and other models could prove fruitful. In any event, though, the high quality of beneficiary participation in the consumer-beneficiary model shows that the consumer-beneficiary model of social enterprise is normally characterized by political equality, at least in theory.

### C. *The Importance of Financial Dependence*

One might reject the conclusion that the consumer-beneficiary model is distinguishable from the traditional model by pointing to social impact projects on the traditional model that offer their services for free. A health clinic might operate on this model. One might suggest that the evaluation of beneficiary participation in such a clinic using the framework developed above would yield the same results it yielded in the evaluation of the consumer-beneficiary model—that beneficiary participation is thick, upstream and inclusive because the beneficiaries participate at all entry points and in the modes of deliberative participation or, at least, bargaining. After all, the beneficiaries of a free health clinic choose whether to receive the services, and, presumably, the health clinic will lose its funding if the intended beneficiaries all reject the services.

The distinction between a social enterprise on the consumer-beneficiary model and a free health clinic is that the funds of the former come, in significant part, from the sale of its goods or services to its beneficiaries. The social enterprise on the consumer-beneficiary model is therefore at least somewhat *financially dependent* on its beneficiaries. KickStart, as noted above, received between a quarter and a third of its funds from the sale of its products in 2010 and 2011.<sup>135</sup> A social impact project that is financially dependent on its beneficiaries will be responsive to their purchase decisions in a way that a financially independent social impact project, like the clinic described above, would not need to be.

A financially independent social impact project need only worry about a decrease in the total number of beneficiaries if that number drops below some threshold that discourages grant-makers and others from providing funds, whereas a fi-

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135. *Financials*, KICKSTART, <http://annualreport.kickstart.org/financials.html> (last visited Feb. 18, 2013).

nancially dependent social impact project will require a relatively high number of consumer-beneficiaries just to remain solvent. Thus, the general attitude toward providing widely-desired goods or services would likely be quite different. Moreover, a financially dependent social impact project is more likely to be sensitive to even slight preferences consumer-beneficiaries have among the offered goods and services. If one particular product sells especially well, the financially dependent social impact project has a financial incentive to try expanding its offering to include new, similar products. A financially independent social impact project, meanwhile, is more likely to remain content with its current offering because of its own views (and its funders' views) on what is needed by the beneficiaries.

Funders might well seek out beneficiary input, of course, when deciding how to direct the funded entity, but this would likely be a relatively thin mode of participation (probably C4. *Consultative participation*) for the beneficiaries. The decisions would be made about the beneficiaries; their input would be taken into account only to the extent that the funders care about their input. The financially dependent, consumer-beneficiary model, on the other hand, must be responsive to the beneficiaries themselves. Thus the consumer-beneficiary model of social enterprise, but not the traditional model of social impact work, is normally characterized by political equality, at least in theory.

#### D. *Concerns: SKS and the 2010 Microfinance Tragedy*

If an analysis of beneficiary participation-by-consumption in the consumer-beneficiary model of social enterprise shows that the model is normally characterized by political equality *in theory*, is it so *in fact*? It might well be so, in the context of social impact work done by an organization like KickStart, which sells products to its beneficiaries. Consumer-beneficiary social enterprises that sell financial services to their beneficiaries, however, like microfinance institutions ("MFIs"), sometimes are *not* characterized by political equality. The mere fact that beneficiaries can participate through consumption is not enough to secure political equality in the MFI context. Other

safeguards are required.<sup>136</sup> MFIs require other safeguards largely because information and bargaining power asymmetries in the microfinance context undermine the meaningfulness of participation-by-consumption.<sup>137</sup> One might add another dimension to the analytical framework to capture this variable, but setting aside the difficulties of visualizing any framework with more than three dimensions, here the concern has less to do with variations on participation and more to do with what counts as participation at all. Meaningful participation implies meaningful choice. Asymmetries of information and bargaining power interfere with choice. Hence, the asymmetries of information and bargaining power in microfinance undermine meaningful beneficiary participation in MFIs.

The story of the SKS tragedy in India demonstrates the seriousness of these information and bargaining power asymmetries. In 2010 Vikram Akula led SKS Microfinance, a for-profit microfinance company operating in India, to one of the first initial public offerings (IPOs) in microfinance.<sup>138</sup> However, even as SKS's offering became oversubscribed more than thirteen times,<sup>139</sup> Muhammad Yunus of Grameen Bank was writing in opposition to the IPO to express concerns shared by many in the microfinance community:<sup>140</sup> Yunus argued that *for-profit* microfinance institutions would inevitably begin engaging in predatory lending practices, one of the very things which microfinance ought to protect the poor against.<sup>141</sup> As

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136. Differences between different models of microfinance—especially the Grameen model, the SKS model and the beneficiary-control arrangement introduced below—should become clear as the analysis proceeds.

137. This might be expressed partly in relation to Goulet's hierarchy. See *supra* note 127.

138. The first was Compartamos Banco's IPO in 2007. *The Banco Compartamos Initial Public Offering*, ACCIÓN INSIGHT 1 (June 2007), [http://www.microcreditsummit.org/enews/2007-07\\_Accion%20Compartamos%20Article.pdf](http://www.microcreditsummit.org/enews/2007-07_Accion%20Compartamos%20Article.pdf).

139. Xavier Reille, *SKS IPO Success and Excess*, CGAP (Aug. 11, 2010), <http://www.cgap.org/blog/sks-ipo-success-and-excess> (last visited Sept. 29, 2012).

140. See Joe Ippolito, *The New Controversy Over Microfinance*, GOOD, <http://www.good.is/posts/the-new-controversy-over-microfinance> (last visited Feb. 23, 2012).

141. Muhammad Yunus, Op-Ed., *Sacrificing Microcredit for Megaprofits*, N.Y. TIMES, Jan. 15, 2011, at A23, [http://www.nytimes.com/2011/01/15/opinion/15yunus.html?\\_r=1&hp](http://www.nytimes.com/2011/01/15/opinion/15yunus.html?_r=1&hp).

the drama unfolded, Yunus's argument turned tragically prophetic. Around the time of SKS's late 2010 IPO, a wave of some 200 debt-related suicides hit the Indian state of Andhra Pradesh, the center of microfinance in India, where SKS had most of its operations.<sup>142</sup> The government of Andhra Pradesh concluded that the wave of suicides was largely caused by the microfinance industry, particularly for-profit MFIs like SKS.<sup>143</sup> The ensuing crackdown made government approval a prerequisite for operating an MFI in the state and imposed a margin cap of 12% on all industry players.<sup>144</sup> In the wake of opposition in the microfinance community, the suicides committed by customers and the response by the Andhra Pradesh government, the price of SKS stock plummeted to less than a quarter of its September 2010 high.<sup>145</sup> In November of 2011 Akula resigned from SKS.<sup>146</sup>

It has become clear that SKS was directly implicated in some of the suicides.<sup>147</sup> Several reports indicate that in the lead-up to the IPO, SKS made a major push to acquire new customers (so that it could demonstrate the company's growth potential to investors), which caused employees at various levels to relax the application of borrower selection criteria, to induce unwise borrowing and even to use aggressive collection techniques generally associated with loan sharks.<sup>148</sup> In late February of last year, Akula spoke publicly about his experience with SKS for the first time since his resignation: "In retrospect," he said, "Professor Muhammad Yunus was right."<sup>149</sup>

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142. Erika Kinetz, *Indian Lender SKS' Own Probe Links it to Borrower Suicides, Despite Company Denials*, ASSOCIATED PRESS (Feb. 24, 2012, 10:57 AM), <http://finance.yahoo.com/news/ap-impact-lenders-own-probe-080122405.html>.

143. *Id.*

144. Kyle Muther, *Consumer Protection and Financial Inclusion in India: An Analysis of the Draft 2011 Microfinance Bill*, 13 (Harv. L. & Int'l Dev. Soc'y., Working Papers 2011-2012), available at <http://www3.law.harvard.edu/orgs/lids/files/2011/11/LIDS-WP-1112-Muther.pdf>.

145. Arjun Kashyap, *SKS Microfinance Falls 18 Percent After JPMorgan Price Cut*, REUTERS (May 6, 2011, 4:15 PM), <http://in.reuters.com/article/2011/05/06/idINIndia-56816020110506>.

146. Kinetz, *supra* note 142.

147. *Id.*

148. *Id.*

149. Vikram Akula, Address at the 2012 Harvard University Social Enterprise Conference: The Indian MFI Crisis (Feb. 26, 2012) [hereinafter *Akula Address*]; Alex Gregor, *A Report from the Harvard Social Enterprise Conference*, ACUMEN FUND (Feb. 29, 2012), <http://blog.acumenfund.org/2012/02/29/>

Akula admitted that “[b]ringing private capital into social enterprise was much harder” than he anticipated and that he “had focused on scaling SKS’s model and had not fully anticipated the potential downside of accessing the public market for social enterprise.”<sup>150</sup>

The tragic number of debt-related suicides in India is a testament to the seriousness of the information and bargaining power asymmetries that characterize microfinance. Financial agreements can carry with them significant legal, moral, psychological and social consequences. The stakes are high in microfinance, which means that the soundness of a borrower’s choices is especially important. Behavioral economics teaches us that external forces affect our choices in profound ways.<sup>151</sup> Consumers do not operate in a vacuum. Financial institutions, moreover, often have both the motive and the capacity to undermine the soundness of their clients’ choices. This is what happened in India with microfinance institutions like SKS. In their rush to drive up lending levels, SKS’s top executives implemented policies that put pressure on the loan officers on the ground to encourage unqualified lenders to make the unsound choice to take SKS loans.<sup>152</sup> SKS took advantage of its borrowers’ relative lack of sophistication and provided loans to people who could not meaningfully have chosen those loans. Indian borrowers of microcredit are not the first to be harmed by the asymmetries in question, of course. Consider the loans banks lent to would-be homeowners in the U.S. leading up to

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a-report-from-the-harvard-social-enterprise-conference. See also Neha Thirani, ‘Yunus Was Right,’ *SKS Microfinance Founder Says*, N.Y. TIMES (Feb. 27, 2012, 11:08 PM), <http://india.blogs.nytimes.com/2012/02/27/yunus-was-right-sks-microfinance-founder-says>.

150. Thirani, *supra* note 149. It is important to note that it appears Akula fought the management decisions that caused SKS to over-lend and engage in rapacious collection practices. Kinetz, *supra* note 142. Akula acknowledges, however, that earlier decisions on his part made it possible for management to make those later decisions. *Id.*; Akula Address, *supra* note 149; Gregor, *supra* note 149.

151. Cf. Marianne Bertrand, Sendhil Mullainathan & Eldar Shafir, *Behavioral Economics and Marketing in Aid of Decision Making among the Poor*, J. PUB. POLICY & MKTG. (forthcoming), available at [http://scholar.harvard.edu/mullainathan/files/decision\\_making.pdf](http://scholar.harvard.edu/mullainathan/files/decision_making.pdf) (discussing the positive and negative impact (actual and potential) of marketing on the poor, who are susceptible to some of the same influences as others but for whom the stakes tend to be higher).

152. Kinetz, *supra* note 142.



the financial crisis,<sup>153</sup> or consider the continuing controversy surrounding borrowing for law school in the U.S., which many say is financially unwise.<sup>154</sup>

The consumer-beneficiary model of social enterprise has a lot of promise from the perspective of political equality. In the context of providing financial services, however, the model can be particularly exploitative of beneficiaries because of the very same feature that made the model attractive in the first place: the fact that its consumers are also its beneficiaries. We will now look at two ways in which microfinance on the consumer-beneficiary model can be salvaged so that its unique structural feature achieves, rather than destroys, political equality in social impact work. First, consumer protection has an important role in protecting political equality in microfinance on the consumer-beneficiary model. Second, a particular contractual arrangement has the potential to further empower the model's beneficiaries.<sup>155</sup>

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153. See generally Yuliya Demyanyk & Otto Van Hemert, *Understanding the Subprime Mortgage Crisis*, 24 REV. FIN. STUD. 1848, 1849-55, 1863-71 (2011) (discussing borrower characteristics in the subprime loan market); see also Michael Simkovic, *Competition and Crisis in Mortgage Securitization*, 88 IND. L. J. (forthcoming 2013), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1924831](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1924831) (last visited Feb. 17, 2013).

154. Lincoln Caplan, *An Existential Crisis for Law Schools*, N.Y. TIMES (July 14, 2012), <http://www.nytimes.com/2012/07/15/opinion/sunday/an-existential-crisis-for-law-schools.html>.

155. This note does not consider one important set of possible safeguards against the dangers just described—namely, prohibiting (through law or internal policies) the MFI from being or becoming for-profit and otherwise institutionalizing principles of commitment to social impact. These are the safeguards that Akula himself is exploring in his new book: 1) a culture of commitment to social impact; 2) codes of conduct rooted in core values; and 3) control of the enterprise by those with the original vision. *Akula Address*, *supra* note 149; Gregor, *supra* note 149. (Note, also, that SKS might in fact be excluded from some definitions of social enterprise. See Raz, *supra* note 15, at 287-88.) I wholeheartedly agree that these safeguards should be explored, but I suspect that these safeguards may be too drastic and too limiting. In this, I probably disagree not only with Akula but also with Yunus. See Yunus, *supra* note 141.

## IV.

SAVING THE CONSUMER-BENEFICIARY MODEL THROUGH  
REGULATION AND CONTRACTUAL INNOVATIONA. *Consumer Protection*

Consumer protection is one possible response to the information and bargaining power asymmetries that can harm the beneficiaries of social enterprises on the consumer-beneficiary model. Advocates of robust consumer protection regimes know well that, without regulation, companies could consistently sell goods and services to consumers who would reject those services if they had adequate information and bargaining power.<sup>156</sup> In the context of microfinance, in particular, analysts recognize that consumers are vulnerable—perhaps especially so because of the recent commercialization of microfinance.<sup>157</sup>

Thus, it should not be too controversial to say that, where an MFI's beneficiaries are also its consumers, political equality demands some level of consumer protection designed specifically for microfinance consumers.<sup>158</sup> It may be that political

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156. MARY DEE PRIDGEN, CONSUMER PROTECTION AND THE LAW § 1:1, at 1 (2011) ("In simpler times, when buyers and sellers were equally competent to judge the quality of goods, sales were for cash and merchants dealt face to face with their customers, the law took the approach that all parties to the transaction should watch out for their own interests. . . . As goods became more complicated, cash was replaced by credit, and sellers evolved into large corporate entities selling nationwide through impersonal marketing organizations, the old doctrines began to seem unjust. Buyers were not able to protect themselves from unscrupulous sellers and defective products.").

157. See, e.g., Brigit Helms & David Porteous, *Protecting Microfinance Borrowers*, Focus Note No. 27, CGAP, at 1 (2005) ("Increasing commercialization has heightened awareness of consumer issues. . . . [V]ulnerable borrowers are being more exposed to potentially abusive lenders. . . . Individuals who are functionally illiterate, first-time consumers, or different in language or ethnicity from the staff of financial institutions are particularly vulnerable. Even middle-income, relatively educated borrowers may be insufficiently informed about their rights and can be pressured into making poor borrowing decisions."), available at <http://www.cgap.org/sites/default/files/CGAP-Focus-Note-Protecting-Microfinance-Borrowers-May-2005.pdf>.

158. Cf. *id.* (citing both "moral arguments" and "strategic reasons" for promoting consumer protection). This note does not explore the range of possible regulatory responses that might protect consumers of microfinance. For an example of such an exploration, see Eugenia Macchiavello, *Microfinance Regulation and Supervision: A Multi-Faced Prism of Structures, Levels and Issues*, 9 N.Y.U. J.L. & Bus. 125 (2012). Self-regulation, in particular, is

equality demands special consumer protection even in markets for goods like those sold by an organization such as Kick-Start, but the case is clearer in microfinance. Proponents of the Micro Finance Institutions (Development and Regulation) Bill proposed in the aftermath of the 2010 microfinance tragedy certainly thought a regulatory response would protect future consumers. Whether this regulatory response will be effective remains to be seen. One analyst, however, has described the proposed regulations as “a sound starting point for comprehensive regulation of microfinance institutions in India.”<sup>159</sup>

Pateman would likely agree that consumer protection can be an effective method of protecting political equality in the microfinance industry. For her, the mere fact that employers are dependent on their employees’ collective choice to continue exchanging their labor for wages does not show that employees’ choices are meaningful.<sup>160</sup> Recall, however, that Pateman asserts that political equality demands more than fair wages and safe working conditions. Similarly, political equality demands more than consumer protection regimes applicable to the consumer-beneficiary model of social enterprise. For Pateman, political equality demands that employees participate in the direction of their company in a more literal sense, by having a say in the sorts of decisions that the board of directors and upper management make. For borrowers of microcredit, in India or elsewhere, microfinance is arguably as central to day-to-day living as industry is to its employees. Microfinance, like industry, must have some kind of formal mechanism for participation by the people involved in the institution, *beyond participation-by-consumption*. The question then

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one example of a mechanism of accountability other than beneficiary participation that theorists of accountability in social impact work have focused on. See, e.g., Ebrahim, *supra* note 6, at 819-22, 825, cited in Kapur & Whittle, *supra* note 6, at 1153.

159. Muther, *supra* note 144, at 36.

160. Carole Pateman, *Self-Ownership and Property in the Person: Democratization and a Tale of Two Concepts*, 10 J. POL. PHIL. 20, 50-51 (2002) (rejecting the idea that the power to alienate one’s labor power is sufficient for true self-government; citing theories “of basic or fundamental rights—rights that are a necessary condition for the enjoyment of other rights—[that] provide[ ] a promising suggestion of how the right of self-government might begin to be reframed.” (citing HENRY SHUE, BASIC RIGHTS: SUBSISTENCE, AFFLUENCE, AND U.S. FOREIGN POLICY (1980))).

becomes: what additional mechanisms of the consumer-beneficiary participation in microfinance would satisfy the demands of political equality? In the background, it is worth considering whether any proposed mechanisms might have made a difference in Andhra Pradesh in 2010.

## B. *The Beneficiary-Control Arrangement*

### 1. *The Arrangement*

Consumer-beneficiaries of MFIs might also be protected by various arrangements that alter the relationship between the MFIs and their consumer-beneficiaries. Grameen Bank's model of participation offers one promising possibility. Grameen is almost entirely owned by its beneficiaries and reserves a majority of its board membership for current or former Grameen borrowers.<sup>161</sup> Beneficiaries own Grameen because Grameen requires borrowers to purchase Grameen shares as a precondition to receiving Grameen loans.<sup>162</sup> Critics claim that Grameen's beneficiary ownership rights are meaningless because its beneficiaries do not understand these rights.<sup>163</sup> They also claim that board representation is mostly meaningless because beneficiary members generally defer to non-beneficiary members.<sup>164</sup>

An arrangement derivative of the Grameen model, the "beneficiary-control arrangement", enables us to avoid these potential problems. In deriving this arrangement the concept

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161. See Todd Arena, *Social Corporate Governance and the Problem of Mission Drift in Socially-Oriented Microfinance Institutions*, 41 COLUM. J.L. & SOC. PROBS. 269, 290, n. 108 (2008) ("Grameen Bank is 90% owned by its clients and 10% owned by the government." (citing Rashmi Dyal-Chand, *Reflection in a Distant Mirror: Why the West Has Misperceived the Grameen Bank's Vision of Microcredit*, 41 STAN. J. INT'L L. 217, 233 (2005))). Cf. CAMFED GOVERNANCE, *supra* note 5, at 2-3, 11, 13, 44-46 (many members of Camfed's national-level management are former beneficiaries).

162. See Arena, *supra* note 161, at 285.

163. See *id.* at 292-95.

164. See *id.* An interesting study might be made of how the Grameen board functions in comparison to the boards of for-profit companies studied in the U.S., which are sometimes said to be dominated by certain overly powerful members, like the CEO. See, e.g., David F. Larcker & Brian Tayan, *Is a Powerful CEO Good or Bad for Shareholders?*, STANFORD CLOSER LOOK SERIES (Nov. 13, 2012), available at [http://www.gsb.stanford.edu/sites/default/files/documents/28\\_CEOpower\\_0.pdf](http://www.gsb.stanford.edu/sites/default/files/documents/28_CEOpower_0.pdf) (discussing the literature on the upsides and downsides of having a powerful CEO).

of beneficiary *ownership* that is central to the Grameen model is abandoned. Instead, the arrangement is designed to give beneficiaries *control*. In for-profit companies, control and ownership are usually coincident, but they are split, by law, in non-profit organizations, where those who run the organization are not permitted to benefit from the organization's financial growth.<sup>165</sup> It is therefore reasonable to consider treating ownership and control separately in a social enterprise.

The key feature of the beneficiary-control arrangement is that a significant degree of control over the MFI's operations is held indirectly by its beneficiaries through a nonprofit representative entity that mediates between the beneficiaries and the MFI. The representative has seats on the MFI's board of directors and weighs in on questions such as the following: which populations to serve, which financial services to offer and on what terms, which complaint resolution mechanisms to put in place and whether to transform from a nonprofit entity into a for-profit entity. The representative is not necessarily composed of current beneficiaries (although it might be), but the task of the representative, perhaps even the sole purpose of the entity, is to represent the wishes of the MFI's beneficiaries. The representative would likely use voting mechanisms of some kind to ascertain the wishes of the MFI's beneficiaries.<sup>166</sup>

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165. See HANSMANN, *supra* note 13, at 12.

166. Here the analysis proceeds on the assumption that in most contexts at least, some attractive, reliable representational mechanism can be worked out that would cohere appropriately with local social norms, including any culture of voting. The analysis therefore leaves unanswered many interesting and important questions: How does a person qualify as a voting beneficiary? Would the person need to have been a beneficiary for a certain period of time? Would community members who are not borrowers but are affected by the borrowing of their fellow community members have any voting rights? Should institutions, as well as individuals, count as persons for voting purposes? These questions, too, are likely best answered in light of the functioning of local institutions and practices. This note also assumes it will be possible to design the relationship between the MFI and the nonprofit beneficiary representative in a way that does not violate provisions of corporate or nonprofit law. A Delaware court might not like a for-profit MFI to bring on board members from a nonprofit whose mission is to represent the wishes of the MFI's clients, but pursuing this line of questions would take the discussion too far from its central purpose of assessing the costs to beneficiaries associated with the beneficiary-control arrangement.

The advantage of the beneficiary-control arrangement over possible alternatives is that the incentives of the representative are relatively easily aligned with the interests and meaningful choices of the beneficiaries.<sup>167</sup> This is not to say that the profit-seeking MFI need no longer concern itself with benefiting and respecting its beneficiaries. To the contrary, it would seem that the arrangement would be most effective where the parties share a commitment to the beneficiaries. In fact, bringing the representative into the structure should be viewed as the factor that makes meaningful participation-by-consumption possible.

If the beneficiary-control arrangement has the potential to mitigate the information and bargaining power asymmetry problems outlined above, the analysis provided by the analytical framework (showing that participation-by-consumption can constitute high-quality participation) becomes relevant. How can inserting a nonprofit representative into the relationship between the MFI and its beneficiaries mitigate the information

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167. It is worth noting that a similar advantage may also be obtained where there are Change Approval Boards (below) and in what Bill Drayton and Valeria Budinich call Hybrid Value Chains ("HVCs"). Bill Drayton & Valeria Budinich, *A New Alliance for Global Change*, HARV. BUS. REV., Sept. 2010, at 56, 58. For one of the first discussions of the concept of value chains—though not hybrid value chains—see MICHAEL PORTER, *COMPETITIVE ADVANTAGE: CREATING AND SUSTAINING SUPERIOR PERFORMANCE* (1985). An HVC is a partnership between a profit-seeking company and a community-based social impact organization—what Drayton and Budinich call a citizen sector organization (CSO)—that creates a company/customer relationship between the business and a target disadvantaged community. Drayton & Budinich, *supra*, at 167. The partnership is valuable to the company because the CSO, with its understanding of the needs and values of the members of the target community, is a market-enabler. *Id.* at 58-61. The CSO can confirm beyond the company's own research that a particular product would be of use to the target community, and the CSO can even act as a mediator between the company and the community, helping educate the community regarding the value of the company's products. *Id.* at 60. The partnership is valuable to the community (and therefore to the CSO) if it gives that community easier access to goods or services that it wants. *Id.* In this model, the profit-seeking company and the CSO *together* form the HVC, and the customers of the HVC are also its beneficiaries. *Id.* at 58. The representative also functions like the Change Approval Boards that Oren Bar-Gill and Kevin Davis suggest should be added as parties to consumer contracts. See Oren Bar-Gill & Kevin Davis, *Empty Promises*, 84 S. CAL. L. REV. 1, 37 (2010). The representative also seems to function somewhat like a union. Further research might show what could be learned from this similarity.

and bargaining power asymmetries that appear to undermine the meaningfulness of consumer-beneficiary participation? The asymmetries can be mitigated because the beneficiaries have a relatively sophisticated entity on their side that can educate beneficiaries, that can process and communicate complaints regarding the MFIs' procedures and that can even communicate the collective concern with dangerous products that individual beneficiaries might not identify as such. The right nonprofit representative would be sufficiently independent from the interests of the MFI that it could devote itself, with all the focusing powers of the nonprofit forms, to the task of representing beneficiary views and interests.

With something like a nonprofit representative in place, the SKS tragedy might have been averted. The representative would have helped to mobilize the communities in opposition to the heightened risks associated with SKS's relaxation of its borrower criteria. Further, as communities began to see the harm done, they would have used the representative's control rights in SKS to force the changes in policy and practice, thereby limiting the dangerous lending. In fact, it might be that with such representatives in place, SKS would not have even tried to increase lending as much as it did, knowing that communities would reject such efforts.

## 2. *First Steps in Cost-Benefit Analysis of the Beneficiary-Control Arrangement*

If the beneficiary-control arrangement mitigates the problematic asymmetries, then it enables the consumer-beneficiary social enterprise model to achieve political equality in its social impact work. The consumer-beneficiary model of social enterprise, with a consumer protection regime in place and supplemented by a beneficiary-control arrangement, appears to be normally characterized by political equality. Many questions about the beneficiary-control arrangement have been left unanswered, however. For instance, what guarantee is there that beneficiaries would want to make use of such a representative? How does one determine who counts as a beneficiary for the purposes of the relationship with the representative? What specific methods of "participating" in the representative would be effective? How are nonprofit representatives supposed to come into existence and enter the relationships between MFIs and

their beneficiaries? What would the costs be of such a shift in procedure?

This note cannot answer all of these questions. It can, however, anticipate concerns about three ways in which beneficiary welfare could suffer as a result of a shift (voluntary on the part of social enterprises or mandated by government) toward adoption of the beneficiary-control arrangements. First, a shift might affect which class of people receives the benefit in question. For example, a shift might discourage people in rural areas from seeking the MFI's services while encouraging people in urban areas to seek those services. This might cause people who should receive the services not to receive them. Second, a shift might change the absolute number of people receiving the benefit in question. This change could occur even where the composition of the customer base remains largely the same. Third, a shift might affect the quality of the benefit offered to customers, even if the number and composition of the customer base remain the same.

As a general matter, the following analysis will show that predictions regarding the third effect (on quality of benefit) militate in favor of a shift toward adoption of the beneficiary-control arrangement. This is largely due to what Henry Hansmann calls the *costs of contracting*.<sup>168</sup> Such a shift raises concerns about undesirable changes involving the class of people receiving the benefit and the overall number of beneficiaries. These concerns can be explained by reference to the *costs of control* associated with such a shift.<sup>169</sup> The effects on the quality of the benefit received will be analyzed first; the effects on composition and number of beneficiaries will be analyzed second.

It is necessary to point out that the consumer-beneficiary model, when supplemented with consumer protection and the beneficiary-control arrangement, is characterized by political equality notwithstanding any costs involved in adopting the beneficiary-control arrangement, identified by the cost-benefit analysis that follows. Recall that the concern with the asymme-

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168. HANSMANN, *supra* note 13, at 24-34.

169. Hansmann writes about "costs of ownership," *id.* at 35-49, where ownership is understood to include rights to control, *id.* at 11. The focus here is control, not ownership, but much of Hansmann's analysis applies to control as well as to ownership.



tries addressed above was that they undid any political equality advantage in the consumer-beneficiary model (at least in MFLs), because the asymmetries compromised the quality of participation in the social impact work. That is, the asymmetries show that the consumer-beneficiary model is not normally characterized by political equality after all or, indeed, that it might be particularly disrespectful of beneficiaries. With one exception,<sup>170</sup> none of the costs to be identified below threatens the assertion that the consumer-beneficiary model of social enterprise is characterized by political equality. Instead, any identified costs must be considered against the fact that the consumer-beneficiary model is characterized by political equality. The weighing will be accomplished by the all-things-considered judgment described above, which is not made in this note.<sup>171</sup>

a. Quality of Benefit—Participation, Costs of Contracting and Costs of Control

i. *Participation*

On the benefit side of the cost-benefit analysis, there may be that all sorts of benefits that accrue to beneficiaries through participation quite apart from whether a structure permitting participation is respectful of beneficiaries. For example, it may be that various activities that constitute participation are enjoyable in themselves for beneficiaries. As Hansmann puts it, participation may be a consumption good.<sup>172</sup> It may also be that beneficiaries are better off when they feel an extra degree of control over their financial rights and obligations, which is a very important aspect of their lives.<sup>173</sup> Hansmann also points to Pateman and similar theorists for the idea that participation may be a form of education in democracy, which may be desirable to beneficiaries in addition to benefiting society.<sup>174</sup>

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170. See discussion *infra* Part III.B.2.c.

171. For a brief discussion of the all-things-considered judgment, see the very end of Part I.B.2.

172. HANSMANN, *supra* note 13, at 43.

173. See *id.*

174. *Id.* (citing Pateman and others).

## ii. *Costs of Contracting*

A shift from the traditional model to the beneficiary-control model will generally improve the benefits received by MFIs' beneficiaries because giving control to beneficiaries mitigates a number of costs associated with the traditional model. Particularly relevant here are costs flowing from five common and problematic phenomena associated with contracting: market power, ex post market power, asymmetric information, compromise among diverse patron preferences and alienation.<sup>175</sup> It is important to address each concept in turn.

In monopolistic industries, providers can charge higher prices for their goods or services, which may lead to underconsumption.<sup>176</sup> The conventional wisdom is that monopoly pricing transfers to sellers a portion of the contractual surplus that would have gone to consumers in a competitive market.<sup>177</sup> Such a transfer is clearly disadvantageous for the consumer.<sup>178</sup> In some places, like Peru, the microfinance industry is quite competitive,<sup>179</sup> but everywhere else it is likely that microfinance is at least somewhat monopolistic. One way to mitigate the costs of monopoly to consumers is to make consumers the owners of the seller.<sup>180</sup> When the consumers are the owners, they either recoup the transferred surplus, or they simply exercise their control rights to make sure prices are not monopolistic. In the beneficiary-control model, MFI beneficiaries do not own the MFI, so the first solution is not available to them; however, the MFI beneficiaries possess control rights in the beneficiary-control model, which they could use to make sure MFIs do not retain monopolistic advantages.

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175. *Id.* at 24-33. Hansmann discusses other phenomena, as well, which are left out here.

176. *Id.* at 24-25.

177. This is often referred to as deadweight loss. JOHN J. FLYNN, HARRY FIRST & DARREN BUSH, *FREE ENTERPRISE AND ECONOMIC ORGANIZATION: ANTI-TRUST* 86-88 (7th ed., drft. 2012). An MFI might set interest rates artificially high or refuse to offer services that would be offered in a competitive market but that are less profitable than other services that consumers will take where no alternative is available.

178. HANSMANN, *supra* note 13, at 25. To the extent that the transfer causes underconsumption, it arguably results in a social cost, as well. *Id.*

179. KATHLEEN DISCHNER & MIKE GABRIEL, *GRAMEEN FOUND., MICRO-FINANCE INST. LIFE CYCLE CASE STUDY 2* (2009).

180. HANSMANN, *supra* note 13, at 24-25.

To the extent that consumers of traditional microfinance typically benefit from a long-term relationship with their MFI, the problem of market power can resurface, even in competitive markets. In such circumstances, borrowers may be reluctant to bear transactions costs associated with switching to a different MFI, and their original MFI may therefore change the terms of their relationship (not the terms of loan agreements already made, necessarily, but of future loans the borrower will come back for) in a way that benefits the MFI but not the borrower. This is called the “lock-in” problem.<sup>181</sup> Beneficiary control would mitigate this problem just as it would mitigate the market power problem.<sup>182</sup>

The next problem is one created by asymmetries of information.<sup>183</sup> Suppose that a particular borrower takes out a particular loan, which she will be able to repay but without having achieved the growth in her business that, in her mind, would make the loan worthwhile. If all parties had perfect information, the MFI might be interested in making this loan (because it gets repaid) while the borrower would probably not want the loan. In the real world, the MFI is more likely than the borrower to identify a loan of this nature because the MFI will have experience with many borrowers. Much depends on the degree of diligence the MFI performs, how financially savvy the borrower is and other variables; however, where the MFI knows and the borrower does not know that a given loan is of the kind just described, the MFI has an incentive to make the loan at the borrower’s expense. Beneficiary control would again mitigate this problem because beneficiaries could insist that the MFI decline to make loans where it believes the loan will not benefit the borrower.<sup>184</sup>

Where there is no beneficiary control, MFIs will have an incentive to cater to the preferences of the marginal customer, even though catering to the preferences of the mean-average

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181. *Id.* at 25-27.

182. *Id.*

183. *Cf. id.* at 27-29.

184. It is perhaps worth noting that the problem of asymmetrical information may cut the other way, as well. To the extent that borrowers have relevant information that the MFIs lack, borrowers may have an incentive to exploit this asymmetry to the MFIs’ detriment. Notice, further, that control, without ownership, may increase this incentive by giving borrowers additional tools to exploit the asymmetry.

customer would be better for the beneficiary population as a whole.<sup>185</sup> Notice that this could be the case with either for-profit or nonprofit MFIs, since both will seek a greater base of borrowers.<sup>186</sup> Beneficiary control would ensure that MFIs would be more likely to cater to the preferences of the *median* customer. While the preferences of the median customer might diverge from the preferences of the mean-average customer, the median customer's preferences are more likely than the marginal customer's preferences to be similar to the mean-average customer's preferences.<sup>187</sup>

Finally, there exists the possibility that borrowers may dislike having an adversarial relationship with their MFI. They might prefer a relationship that is "more cooperative, trusting, or altruistic."<sup>188</sup> Transacting with a nonprofit MFI might satisfy this preference, but transacting with an MFI (whether nonprofit or for-profit) that one helps control might also help satisfy this preference.

### iii. *Costs of Control*

While granting beneficiaries control tends to mitigate contracting costs, as shown above, it introduces a number of costs of control, including agency costs and costs associated with collective decision-making. Beneficiary control may actually reduce the quality of the benefit received by MFI consumers, either because the beneficiary representative fails to act in the beneficiaries' best interests (an agency cost problem) or because whatever collective decision-making mechanisms are in place are costly to operate or fail to produce the best decisions. Let us take examples of each pitfall in turn.

Imagine, first, that the beneficiaries' representative is co-opted by the MFI itself or is just generally disinclined to do what beneficiaries tell it to do. This first option is an example of the threat of managerial opportunism. The threat that the agent (in this case, the representative) will attempt to benefit

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185. See HANSMANN, *supra* note 13, at 30-31.

186. Admittedly, some nonprofit MFIs will not have this problem, because their funding will depend on the quality of service provided rather than on the number of borrowers they have. However, many MFIs have tended, some notoriously, to focus exclusively on the number of borrowers. See Arena, *supra* note 161, at 289 n. 104.

187. See HANSMANN, *supra* note 13, at 31.

188. *Id.* at 32.

himself or herself at the expense of the principal (in this case, the beneficiaries) is prevalent.<sup>189</sup> Certain structural design elements will mitigate this threat. For example, the third party representative should not be an owner of the MFI; if it were, its incentives would align too closely with the MFI's, in possible conflict with beneficiaries' interests. Even where there is no threat of managerial opportunism, however, there is still the possibility that the individuals responsible for representing beneficiaries' interests will be disinclined to do as the beneficiaries want, either out of principle or simply because they are inclined to "shirk" their duties. To prevent shirking the beneficiaries must monitor the representative. Such monitoring can be very costly.<sup>190</sup>

One undesirable consequence of having high monitoring costs is that the monitoring costs may fall unevenly across the beneficiaries. Thus, some subgroup of beneficiaries may be able to monitor the representative to make sure it represents their interests—if, for example, they are closer to the representative's physical location—while the rest of the beneficiaries are unable to afford the monitoring<sup>191</sup> and are thus unable to mitigate the risk that the representative will act against their wishes. The overall quality of the benefit received by the beneficiary population as a whole will be reduced because the benefit is tailored to the preferences of the subgroup.

Similar concerns arise in relation to whatever collective decision-making procedures might be in place to translate beneficiaries' preferences into directives for the representative.<sup>192</sup> Some beneficiaries might have less access to these procedures (physical distance could again be a factor) so that some subgroup exercises disproportionate control, possibly to make the MFI choose the services it offers (and the terms on which it offers those services) based on the preferences of the subgroup and to the detriment of the rest of the beneficiaries. Even if no subgroup is able to wrest control from the larger beneficiary population, majority voting (a very widely used

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189. *Id.* at 37.

190. *Id.* at 36-37.

191. For the poor populations that MFIs tend to serve, travel costs—the price of transportation and/or the opportunity costs associated with spending time on the road—can very easily become prohibitive.

192. See HANSMANN, *supra* note 13, at 39-42.

mechanism of collective decision-making) tends to result in decisions preferred by the median voter rather than the mean voter.<sup>193</sup> This would result in a decrease in the quality of the benefit from the perspective of the mean beneficiary, which is the beneficiary we care about when trying to maximize beneficiary welfare.

Another concern—even more serious, from the intrinsic features focus adopted in this note—would be any of the scenarios just described in which the representative fails to represent the opinions of the beneficiary population. In such a scenario, the MFI's structure fails to be adequately respectful of the beneficiaries because beneficiaries are no longer participating effectively. Such a failure would undermine the conclusion that the consumer-beneficiary model of social enterprise is normally characterized by political equality.<sup>194</sup>

#### b. Class of Beneficiaries—Costs of Control

Where costs of control result in a reduction of benefit quality from the perspective of some beneficiaries, it is likely that at least some beneficiaries will choose no longer to borrow from the MFI in question. Where there is strong competition, the beneficiaries may be able to switch to another MFI that provides the service they want on the terms they prefer (unless they are “locked in”). Where competition is not strong, however, the beneficiaries may have to choose either the service offered on terms favorable to an unrepresentative subgroup or no service at all. Where beneficiaries drop the service altogether, the composition of the beneficiary population will change. This change in composition may be undesirable. One needs to look at the nature of the change to determine whether those in greatest need of microfinance are still members of the beneficiary population.

#### c. Number of Beneficiaries—Costs of Control

A shift to the beneficiary-control arrangement might also reduce the absolute number of beneficiaries reached by microfinance. This reduction could come about through a change in the benefits offered (as described above) or if the

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193. *Id.* at 40.

194. See discussion *supra* Part I.B.2 (discussing all-things-considered judgment).

model's structure creates disincentives for funding of MFIs or for MFIs' entry into the market.

Funders of MFIs include equity and debt investors, entities providing grants (in the case of nonprofit MFIs), and so on. Although the specific interests of these funders will vary with the circumstances, all of these funders will likely share concern about beneficiary control of an MFI they are thinking about funding. Some funders will be convinced that beneficiaries are parasites who will use their control to jeopardize the MFI's financial wellbeing (and, thereby, the funders' investments). Others would be unsure what the effect of beneficiary control would be on the MFI's financial wellbeing. In both instances, beneficiary control would likely cause the funders to hesitate in funding the MFI. Funders already have agency costs (and sometimes collective decision-making costs) to contend with. Introducing beneficiary control adds further layers of the same costs.

One reason funders' concerns must be taken into account is that an MFI's beneficiary population is not likely to remain the same over the life of the MFI. So, to the extent that an MFI's beneficiary population is interested in the MFI's financial wellbeing, it will be interested in its wellbeing over a relatively short period of time. A similar problem, called the "horizon problem," appears in the context of employee-owned firms.<sup>195</sup> The concern is that the employees (or, in this case, the beneficiaries) will refuse to use their control to support choices that benefit the institution in the long-term if those choices do not maximize benefit in the short-term.

Many of the concerns raised above might also affect MFIs' choice to enter or not enter the market. Generally speaking, MFIs will not support beneficiaries gaining control of the MFIs' operations. Moreover, MFIs will be hesitant to enter the market if they feel funders are hesitant about the beneficiary-control model. If MFIs choose not to enter the market, fewer beneficiaries will be served.

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195. HANSMANN, *supra* note 13, at 79.

3. *Conclusion Regarding Costs Associated with the Consumer-Beneficiary Model, as Supplemented with the Beneficiary-Control Arrangement*

It is unclear whether the beneficiary-control model increases or decreases costs to beneficiaries in the end. On the one hand, the beneficiary-control model should alleviate a number of contracting costs associated with market power, information asymmetries and the like. On the other hand, the model introduces agency costs and costs of collective decision-making that would likely reduce the quality of the benefit received and the number of beneficiaries, while also changing the composition of the beneficiary population in an undesirable manner.

V.

CONCLUSION

The three-dimensional framework developed from Pateman's, Goulet's and Crocker's work helps us to measure quality of participation in various contexts, and it shows us that participation-by-consumption in the consumer-beneficiary model of social enterprise can be of particularly high quality (upstream, thick and inclusive). The 2010 SKS tragedy discussed above suggests that this analysis is incomplete, however, when applied to hard cases like MFIs (a subset of social enterprises on the consumer-beneficiary model). What happened in India in 2010 shows that consumer protection is required for consumer choice in microfinance to count as any kind of meaningful participation. In fact, even more than consumer protection is required if we are to conclude that MFIs are normally characterized by political equality. One way in which microfinance beneficiaries might participate explicitly in the operation of their microfinance institutions is through a third-party nonprofit representative in the beneficiary-control arrangement. Such an arrangement appears to ease the asymmetries that necessitated consumer protection and renders consumption a meaningful form of participation, so that the virtues of the consumer-beneficiary model can flourish. If consumer protection and contractual innovations like the beneficiary-control arrangement ensure meaningful participation in a hard case like microfinance, we can be more confident that, with safeguards of various kinds in place, the consumer-



beneficiary model of social enterprise will normally be characterized by political equality. We should care that the consumer-beneficiary model has this intrinsic feature because a model of social enterprise characterized by political equality is respectful of its beneficiaries, just as a democratic government is respectful of its citizens.

Political equality cannot be the only value that matters, of course. It is not even the only *democratic* value that matters.<sup>196</sup> It is surely not the only intrinsic feature that matters. While beneficiary welfare has not been the focus of this note, it is certainly one value that matters in the context of social impact work. The final section of this note therefore anticipated a few of the concerns that might arise in a cost-benefit analysis of the beneficiary-control arrangement that focuses on effects on beneficiary welfare. That section could only sketch the beginnings of an analysis; but the hope is that it identified some of the main concerns that might be taken up in later work.

While an all-things-considered evaluation of the consumer-beneficiary model of social enterprise is beyond the scope of this note, showing that the consumer-beneficiary model of social enterprise is normally characterized by political equality is a step toward completing such an evaluation. First, knowing whether the consumer-beneficiary model is normally characterized by political equality is a necessary part of an all-things-considered evaluation. We should care whether different models of social enterprise that we found and support are respectful of their beneficiaries. Second, demonstrating how one might elaborate a normative evaluation of social enterprise based on intrinsic features may open up new avenues of analysis. Perhaps an analysis of social enterprise focused on political equality should turn out differently than the one offered here. More might be learned by comparing the focus on intrinsic features herein with the focus on human dignity in certain evaluations of human rights organizations.<sup>197</sup> Perhaps other methods of achieving accountability to benefi-

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196. Recall that beneficiary participation is only one mechanism of downward accountability, which in turn is only one form of accountability. See *supra* notes 6-8 and accompanying text.

197. See *supra* note 32. Consider also the growing literature on treating the social impact organization's relationship to its beneficiaries as an agent-principal relationship like the lawyer-client relationship. *E.g.*, Hortsch, *supra* note 5.

ciaries<sup>198</sup> should be subjected to a political equality analysis. Perhaps other models of social impact work should be subjected to a political equality analysis. Focusing on a different intrinsic feature (like diversity or distributive justice) might yield additional contributions to an ultimate all-things-considered evaluation of the consumer-beneficiary model and its social enterprise alternatives and thereby open up even more new avenues of analysis.

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198. See *supra* notes 6-8 and accompanying text.

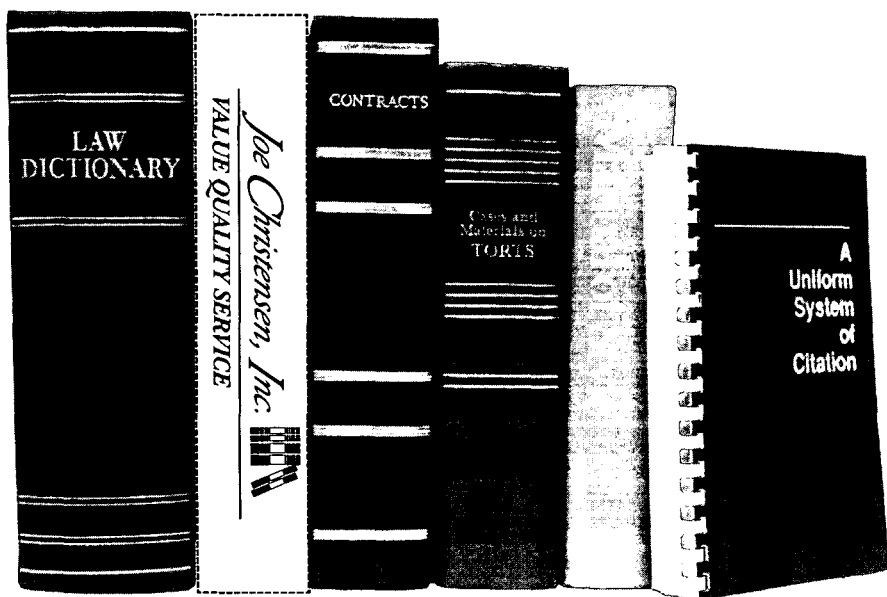












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