

# Social Enterprises' Institutional Rationale and Its Inspirations for the Modern Market Economy

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**Abstract:** *This study analyzes the ways in which social enterprises contribute to society's goals. In the new era of human development, many social problems cannot be resolved without the participation of social enterprises (SEs). The study on these enterprises is of great significance for theoretical research and practical observation. In a modern market economy, SEs have pro-social market vitality and compatibility with the market economy; their action gives a glimpse into the truth of human development. As can be seen from the socio-economic reality, numerous entrepreneurs nurture a desire to run SEs at a certain stage of their career development. The tendency of some entrepreneurs to run SEs is of great significance for this study. Social enterprises are hybrid enterprises as opposed to for-profit enterprises and SEs must address complex problems through organizational and institutional innovations. State owned enterprises (SOEs) and SEs share many topics of research and have much to learn from each other; and a key question for SOE reform is what makes SOEs efficient quasi-social enterprises. Both SOEs and SEs assume a social mandate, and their fulfillment of social responsibilities is underpinned by their economic efficiency (market competitiveness). The theoretical rationale and institutional mechanism of SEs - not least their innovation practice and formation of rules - stem from the relationship and coordination between economic and social exchanges under market-based conditions. Social enterprises focus on altruistic social exchange but need to be supported by a certain economic exchange to finance their operations. The biggest social problem for China is its failure to balance economic and social exchanges, as well as the method of reward. Research on SEs should promote the understanding of these questions and the quest for their solutions. Social enterprises may inspire more enterprises to pursue pro-social innovation and development.*

**Keywords:** *Social enterprises, altruistic behaviors, economic exchange, social exchange, pro-social behaviors*

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## 1. Introduction

Social enterprises (SEs) warrant a significant and long overdue attention from economists and management scholars. In the market economy, SEs are differentiated from for-profit enterprises in terms of ethics and behavioral objectives; however, SEs are hardly considered under mainstream frameworks of economics except as atypical exceptions. In the real world, however, SEs are resilient and have

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thrived in many countries. Although SEs, as enterprises, might be motivated to create economic surplus and pursue business sustainability and prosperity, their business operations are driven primarily by a commitment to increase public and community welfare rather than maximizing profitability.

While SEs accept contributions from market entities, they will not distribute dividends to capital contributors or shareholders in the same way as for-profit enterprises, which are referred to in this paper as “economic enterprises”, the bulk of SEs surplus is re-invested to support public and community welfare. Given their public interest nature, SEs are often entitled to tax credits in various countries. The Social Enterprise UK has defined SEs as those that “use commercial means to achieve social ends”. In the new era of human development, SEs play an irreplaceable role in addressing countless social problems. Social enterprises hold great promise for tackling various social issues in China as a civilization with a long history<sup>1</sup>. Investigating SEs reveals theoretical and practical insights into the modern market economy.

In China, SEs are thriving and take various forms and identities. Some are registered as enterprises while others are registered as social organizations<sup>2</sup>. Observation and research on SEs - which involve key theoretical questions - help make sense of the economic behaviors of people and companies underpinning the modern market economy. To some extent, the real-world market economy can be better understood through the lens of SEs.

## 2. Altruistic Behaviors of Social Enterprises

Research on SEs must be conducted from both the social perspective of values-based ethics and the standpoint of economic rationality. As far as the academic foundation of economics is concerned, it is the ethics of social values rather than an abstraction of economic rationality that underpins the fundamental workings of economic relationships. Ethics is, at least, one of the foundations of economics. In the history of economic development, economics used to be a branch of ethics or moral philosophy. Adam Smith, the father of modern economics, was a professor of moral philosophy. According to Sen (2014), a Nobel Indian laureate in economics, “engineering methodology is only concerned with the most basic logical questions and indifferent to such questions as the ultimate purpose of humanity, what it takes to foster ‘human virtues’ or ‘how should a person lead his life’”. It makes straightforward assumptions of human goals, and what it takes is only to pursue the most appropriate means to achieve those presumed goals”.

In the market-based economic system, instrumental rationality is based on the ethics of individualism, and businesses take it for granted to pursue self-interest. Their behaviors are theorized or institutionalized as driven by profit or wealth maximization for individuals and equated with the maximization of happiness or welfare, although happiness is subjective and immeasurable. Such presumptive instrumental rationality became the methodological premise for economic theories since it was derived from self-interest within human nature: Natural persons are considered as the ultimate stakeholders to the extent that personal interest is the fundamental interest from which collective interests are derived. In other words, businesses are conceived as personified economic organizations.

Based on such ethical values, corporations as legal persons are naturally self-interested, based on the precept “everyone for himself and the devil takes the hindmost”. Unless business self-interest is recognized, the order of the market economy and the rules of free competition cannot be logically coherent and consistent with ethical norms. Following the understanding of Adam Smith’s tenet, in the free competition of a market economy, business self-interest is the way of survival and source of

<sup>1</sup> This study primarily considers the ways in which SEs and entrepreneurs contribute to social objectives through market-based operations without discussing other ways in which they contribute to social goals by taking part in institutional reform and policy improvement.

<sup>2</sup> Data suggests that in 2019, 65% of certified SEs were registered as business entities, and 35% of them were registered as social organizations (Institute of Public Administration and Human Resources, the State Council Development Research Center. “Survey Report on the Development of Social Enterprises in China,” *National Governance Weekly* 2021, Vol.12 c, January 7, 2022).

competitiveness consistent with human nature. Based on such a logical premise, a market economy in which self-interested behaviors contribute to social welfare takes hold spontaneously. Not only is it logically impeccable, but it is also ethically irreproachable. In this manner, the “economic man” - natural persons or corporate legal persons - is the omnipresent rational man, if not the holy man, and reflects human nature.

Yet the assumption that the behaviors of economic man are entirely driven by “economic rationality” does not mean that people in the economic reality are all considered as “rational” and capable of cost-benefit analysis for maximizing private interest. Without a doubt, economists know what the “economic man” means in the real world. Seldom is anyone content to be labeled as selfish or calculating. Just like selfishness is unwelcome, businesses cannot put profit before ethics if they are to gain competitiveness and sincere partnerships. Even in a market-based economy, selfishness and venality are derogatory terms. Ironically, the assumption is widely accepted as the underlying rationale of economics that individuals and corporations are driven by economic rationality to pursue maximal self-interest. It appears that no other universal and logically coherent proposition exists. As such, personal and corporate self-interest became recognized as the logical premise for mainstream economic theories.

Indeed, the obsession with economic rationality has to do with the fact that modern economics originated from the West and is deeply imprinted in Western culture. In particular, the individualism and rationalism of the Enlightenment era became the philosophical origin of mainstream modern economics. In the words of US historian Jonathan Daly (2021), “It is fair to say that the West has immensely and effectively advocated personal endeavors. Throughout human history, the central authorities of civilizations, big or small, were all capable of executing gigantic and complex projects from the pyramid in Egypt and Aztec to China’s Great Wall and Zhenghe’s fleet, Alexander the Great’s conquest and the religious unity of the Islamic world across a vast expanse of regions. However, only the Western culture achieved goals of similar grander primarily through personal endeavors and corporate efforts”. Western Enlightenment philosophers considered the world as a mechanical system, human nature as greedy, and progress as a material achievement. Such a cultural concept has supported the institutional framework and pragmatic commitment of modern mainstream economics.

The above logical purity and coherence are detached from reality. In the words of Western scholars, “People are not always after economic interests for themselves. Not only are they sincerely empathetic for others and willing to sacrifice some personal economic interests for the benefit of others, but they are also keen to prove to others or themselves that they are ‘good people.’ That is to say, one element of our altruism derives from our reputational concern. Such a desire for pro-social behaviors is manifested in the expectations of stakeholders that the business is run ethically. Investors could be loath to divert their savings to firms that deal with countries disrespecting human rights. Investors may have to shirk such projects even at the expense of some investment return. Similarly, consumers are willing to pay extra money for fair trade coffee, and employees take pride in working for a non-government organization (NGO) that supports child development in sub-Saharan Africa”. “In such circumstances, businesses become the vehicle for practicing pro-social behaviors and take social responsibility on behalf of various stakeholders, including investors, consumers, and employees. Such socially responsible behaviors are not contradictory with Adam Smith’s philosophy” (Tirole, 2020).

The above rationale explains why SEs have proliferated and are widely respected in the modern market economy. Some of them have gained global prominence. IKEA, a global furniture company owned by the Ingka Group of the Stichting Ingka Foundation, with hundreds of subsidiaries across the world, is a social enterprise. IKEA’s parent company, the Stichting Ingka Foundation, is a non-profit institution that endows the IKEA Group with a social mandate for public interest instead of putting profit first. IKEA’s internal organizational structure and business operations reflect the attributes of SEs. Another example is the Grameen Bank founded by Bangladeshi economist Muhammad Yunus for the rural poor, which is also a social enterprise with global influence. Across the world, small and medium-

sized SEs have flourished, which is proof of their pro-social market vitality and intrinsic compatibility with the market economy. Instead of struggling outliers, SEs coexist with the market economy and compete with and complement other economic entities. Some social or quasi-social enterprises have already become pivotal socio-economic forces, as discussed in my previous paper, harmonizing economic development with social priorities.

In the Western narrative, “empathy” lies at the heart of what SEs are all about. Empathy is widely used as a psychological term. “Do not do unto others what you do not want others to do unto you”. This famous quote from Confucius over 2,300 years ago is recognized by Western scholars as the essence of empathy and the golden rule for the relationship of human societies. Empathy is regarded as a physical and psychological phenomenon unique to the human race. An in-depth study finds the significance of empathy to be profound and extensive. Jeremy Rifkin, a famous contemporary US philosopher, declares that “the age of reason is being eclipsed by the age of empathy” (*Empathic Civilization: The Race to Global Consciousness in a World in Crisis*) (Rifkin, 2015). The “age of reason” refers to the period of flourishing in modern Western civilization after the Enlightenment movement, which put an end to ideological repression in the dark Middle Ages and advocated human self-interest and materialism, celebrating the liberation and freedom of human nature. Respecting human nature is the premise for human development. Social studies on the age of empathy suggest that “Only empathy is human nature. All other qualities deemed as the primary driving forces of the human society - such as belligerence, violence, selfishness, and greed - are secondary driving forces, whose effects become evident only when empathy is disregarded” (Rifkin, 2015).

In his book *The Theory of Moral Sentiments*, Adam Smith studied human emotions and considered humans as empathetic of the hardship experienced by others. Although self-interest is the logical premise and institutional fulcrum of the market-based economy in *The Wealth of Nations* - the “bible” of free market capitalism - Adam Smith recognized the prevalence and importance of altruistic emotions and behaviors.

Yet individualist orientation was the most progressive way of thinking and rational ethics at the “age of reason” and became the foundation for the modern market economy. According to the rational logic of the Enlightenment movement, “I think, therefore I am” in the words of René Descartes, means that the real world can be logically deduced and explained through the pure rationality of human nature. Rationalists attempted to fit the real world into an empty box of “scientific” paradigmatic frameworks created by pure rationality to form a logically stringent belief system and narrative.

Over the years, such a philosophical tendency became the dominant pathway of ideological change for Western civilization, i.e. classical liberalism. According to British philosopher Thomas Hobbes, people are belligerent and selfish, and tend to seek material gains for themselves at the expense of others. Although British philosopher John Locke held a milder view of human nature, he considered that greed, as part of human nature, could drive progress. The evil nature of human beings is a traditional idea in Western beliefs. Utilitarianists led by Jeremy Bentham endorsed John Locke’s view of human nature; they considered human nature as intrinsically materialistic to the extent that people always try to alleviate their pain and satisfy their self-interest. In the words of Austrian psychologist Sigmund Freud, “Civilization only has one goal, i.e. to serve as the means for humans to control others, seek self-interest and satisfy sexual desires” (Rifkin, 2015).

However, many people are sanguine about humanitarian “concerns for human survival and prosperity” that took hold during the Enlightenment. They believe that rationality and science may broaden morality and propel moral progress, as manifested in the maxim quoted by Martin Luther King that “the arc of the moral universe is long, but it bends toward justice” (Shermer, 2016). That is to say, the moral future of human development is promising and progressive. Believing in individualism, they consider individual autonomy as the criterion to assess the correctness of behaviors, which depends on “whether those behaviors have increased or reduced the survival and prosperity of individual conscious

beings”. Nevertheless, they are also convinced that with the extension of morality, humanity becomes increasingly concerned with more groups and social circumstances beyond individuals to the extent that incorporates all the “conscious beings”, including animal rights (Shermer, 2016). In other words, egoism may logically evolve into altruism and pro-social collaboration with a broadening scope.

With an inductive rationale, evolutionism has constantly evolved ever since its birth. Traditional evolutionism focused on the fierce competition between species for resources and procreation. Yet new studies have found that apart from physical strength and competitiveness, socialization and collaboration also play an equally significant role in the survival of some species. New findings have revealed the biological origin of socializing behaviors and started to influence our view about the surrounding biological world and the role of humanity in the history of life on Earth. According to Charles Darwin, the survival of the fittest requires not just competition but also cooperation and symbiosis. The most survivable species tend to be the most cooperative. Such views of Charles Darwin may leave traditional evolutionists stunned (Shermer, 2016).

Regarding evolutionism, British sociologist Wilfred Trotter theorized that humans are social animals driven by a desire to protect each other, making it more likely for individuals and their tribes to survive (Trotter, 2016). According to Trotter, altruism is rooted in human nature as a way for humans to express their social instincts. “I think, therefore I am” as in the words of René Descartes should be rephrased into “I participate, therefore I am”. In the words of Shermer (2016) “each of us exists only in our relationships with others”, and “we may understand ourselves only from our relationships with others”. These then-new interpretations contrast with Western rationalism characterized by the individualistic concept of human nature.

### 3. Social Enterprises: Innovative Explorations

Under the psychoanalytical framework of traditional economic theories characterized by an abstract concept of human nature, altruistic SEs seem to be incompatible with general theories on profit-driven economic enterprises. In other words, the viability and logical coherency of SEs cannot be simply derived from the abstract theoretical concept of self-interested individualism in modern mainstream economics that lacks inclusiveness. Instead, those attributes may only be proven by the practice of real-world enterprises, i.e. facts speak more eloquently than theories. Otherwise, it would be hard for those obsessed with the “pure system” of mainstream economics to accept the formal status of SEs in economics. For all their creative endeavors and organizational innovations, they have yet to be recognized as logically coherent. That is why economists devoted to SEs find it hard to be awarded a Nobel prize for economics but may be eligible for a Nobel prize for peace. While the former recognizes theoretical contributions, the latter awards creative achievements.

The organizational behaviors of SEs will be faced with at least three questions that must be answered through practical explorations. First, how can the social mandate be embedded into corporate mechanisms as a primary goal for the organizational behaviors of SEs? Second, what makes it possible for altruistic SEs to operate with sustained vitality? Third, how should businesses cooperate effectively with all stakeholders to co-create economic and social value? Those stakeholders include, *inter alia*, capital contributors, producers, other business operators, consumers, aid recipients, social collaborators, market competitors and partners, and government agencies.

A fundamental change to the relationship between the original and instrumental rationality of economic activity - and thus to the way firms operate - is required to address those questions. Traditionally, instrumental rationality took hold in the market economy. Economic interest is the means to improve social welfare rather than an end in itself. Yet, in reality, the means is often confused with the end. The market economy should go beyond economic rationality and focus on social priorities, aligning economic interest with the fulfillment of social endeavors. Given the heterogenous value propositions



and concerns of various stakeholders, SEs should form an integrated inclusive system to accommodate priorities.

Social enterprises bespeak the greatness of the market economy, whose vibrancy is driven by instrumental rationality. Nevertheless, instrumental rationality, however potent, is the means rather than the end in itself. The market economy cannot create value for value's sake; the goal of value creation is to improve the welfare of people. Reversal between the means and the end in the market economy can be straightened out in the research on SEs, whose practices give a glimpse of what human development is really about.

Given their relevance to human existence and development, SEs involve more stakeholders compared with economic enterprises. In contrast to the research methodology of economics, which shows economic enterprises as a "black box" for the exchange of economic value, SEs may only be envisioned as a "white box" or multidimensional network. Under this paradigm, the objects of exchange and reward in the market and society are not just economic value but myriad social attributes from emotions to time, assistance, reputation, dignity, decency, identity, ecological environment, meaning in life, the opportunity to experience, and exercise of physical functions (research indicates that the full exercise of physical functions - which stems from an equilibrium between what a person is capable of and the extent of challenges facing him - is considered as the greatest source of happiness and value of existence. Notably, social attributes are priceless and cannot be measured by a ratio of investment return. They are less about monetary worth and more about ethics and public expectations.

In a market economy, economic enterprises create value that underpins economic growth, as reflected in the increase of wealth and income, which accrue to GDP. On the other hand, social organizations are responsible to fulfil social priorities. While economic enterprises are of indirect instrumentality, SEs are of direct utility. They are hybrid actors of economic and social organizations. With their vigorous pro-social mission, they contribute to social harmony, environmental sustainability, and economic dynamism.

#### **4. Entrepreneurs' Zeal for Social Enterprises**

The desire to run SEs is extensively shared among entrepreneurs once they reach a certain stage of their careers. It is not uncommon for them to quit as business leaders and devote themselves to SEs or charity. The question is: What drives entrepreneurs to run SEs? Answering this question helps reveal their inner workings.

According to some researchers, businesses embrace social responsibilities because of empathy. Their transformation into SEs reflects an extension of their pro-social tendencies and business innovation. As shown by extensive observations, entrepreneurs tend to embark upon social endeavors beyond the apex of their commercial success. Such a desire is shared among other key business founders and partners, though still for-profit in nature, who start to devote more time and resources to social priorities. Such broadmindedness is considered a virtue of entrepreneurs, a typical example of whom is Bill Gates.

Social enterprises cannot be regarded as inefficient and carefree about financial performance and profitability. Nor are they non-competitive organizations with guaranteed access to resources and markets. Instead, they represent a new form of organizational efficiency and competitive pressures. Social enterprises must also prove their vitality and business sustainability. There is a certain competitive relationship between social and economic enterprises, both of which are faced with operational challenges. All enterprises are, finally, responsible for their profits and losses, and SEs are no exception; they cannot rely solely on donations. Instead, they should generate business revenues to operate sustainably. Businesses must survive and thrive before they can contribute to society. Self-development and contribution to the broader good are the two sides of the same coin. In trying to explain what drives people to help others, we must look at the social context of personal behaviors and the social values and

norms that influence people's altruistic behaviors.

Psychology offers three basic explanations of altruistic behaviors: The theory of social exchange, social norms, and evolutionary psychology.

According to the theory of social exchange, altruistic behaviors are a broader form of social exchange, i.e. eventually, altruism is rewarded either directly or indirectly. Mutual assistance and reciprocity are consistent with social expectations and values<sup>3</sup>. Moreover, the social exchange of help and reward may escalate. David Myers (2006) writes: "One helps others in exchange for material return at first, followed by social reward and finally self-reward". In addition to material and social rewards, helping others also gives the benefactor a sense of self-satisfaction, making him feel good and less guilty.

Self-satisfaction from compassion turns out to be a form of self-reward for social exchange. Mutually beneficial social exchange in the society may also explain the connotation and nature of social capital defined in economics, which derives from the social norms and customs for mutual communication, exchange of information, rapport, and cooperation. Those elements are fundamental for socio-economic organizations to function properly. Without social capital, it would be hard for the roles of material and human capital to be brought into effective play. Without a basic expectation for the consequences of personal behavior, there will be no minimum requirement of social order that governs personal behaviors. Although the market economy is based on self-interest, what lays the groundwork for social exchange are altruism and empathy. It is hard to imagine that those who deceive others and go back on their word will ultimately win business in a market economy.

All societies are governed by a code of conduct, which is a set of universal social expectations on appropriate behaviors and due obligations in social relations and social life. Researchers of altruism have identified two types of social norms that drive or recognize altruistic behaviors: Reciprocity and social responsibility. Reciprocity refers to the social expectation and recognition of altruistic social exchange.

The social responsibility norm means that "people should help those who need help without expecting anything in return". Myers (2006) argues that "The social responsibility norm drives people to help those who need and deserve help the most".

Following the understanding of evolutionary psychology, altruistic behaviors are driven by biological and social evolutions. According to evolutionary psychology, "life is all about passing on our genes, which evolve to maximize the chance of our survival". In this sense, our biological evolution will follow the directions of altruism and mutual assistance even from the perspective of self-interest. "Self-interest in our biological instincts also portends reciprocal behaviors". "Those who contribute expect to benefit in a later stage and refusing to help others begets punishment". "When social groups compete, those in which members help each other will outlast those in which members take no altruistic actions" (Myers, 2006). In other words, altruistic behaviors take hold in human psychological evolution; self-interest and altruism are complementary rather than antagonistic.

This proves the role of human empathy in promoting altruistic behaviors. Empathy makes people put themselves into the shoes of others and they feel gratified when their altruistic behavior is rewarded.

According to David Myers "When we feel empathy, we will care about the pains of victims instead of obsessed with our pains". "Compassion drives us to help others for their immediate interests. Such empathy occurs naturally. To some extent, this suggests that empathy is our innate ability" (Myers, 2006).

Among the above three explanations, the theory of social exchange has the most fundamental explanatory power, although the other theories also consider the factor of social exchange. As discussed before, economic behaviors are underpinned by values-based ethics, and changes in values transform the behavioral conditions for social exchange. According to psychological and sociological research, successful entrepreneurs are more likely to run SEs. For them, material wealth contributes less to their

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<sup>3</sup> There is also negative exchange or return. For instance, it is unethical to requite kindness with enmity and be ungrateful for the hard work of others. In social evolution, ethical behaviors will ultimately replace unethical behaviors. Ethics will determine the evolution of human society.

sense of happiness, and social exchange replaces economic exchange as their primary concern.

As shown by extensive research on human values, when some individuals, including successful entrepreneurs, become more productive and wealthier in an industrial society, their values shift from materialism to self-expression. With improving economic conditions, concern for survival gives way to material desires and finally to the quality of life in all respects. For society, the quality of development will outweigh the speed of economic growth and wealth accumulation, that is, people should not be the means of development, but rather the goal of development should be to improve people's welfare.

Research also identified a critical threshold for the change of behavioral preferences. "Once people reach a rather high level of living standards, additional wealth accumulation will not increase their sense of happiness". Psychological research has concluded that "people with a strong desire for wealth and property are not as psychologically healthy as those less interested in such goals". "The more our life is based on materialistic values, the more our quality of life will decrease". Research indicates that, as Jeremy Rifkin writes (2015), "affluent people are not as happy as 50 years ago despite a twofold increase in their average salary".

The Enlightenment philosophy that a constant increase in wealth makes people feel more independent, freer, and happier seemingly contradict reality. In an affluent society, perceived happiness stagnates and even declines as income and material wealth far exceed what is needed to maintain adequate living standards. For most of the extremely poor, materialism has priority over self-expression, but sociological and psychological studies also suggest that "it only takes a modest income to purchase essential products and maintain a comfortable way of life, above which any increase in wealth will reduce the sense of happiness for the society as a whole". Certain economic conditions, unless being so bad as to threaten livelihoods, are possible to create a great society in which empathy is elevated to a new level. At a certain level of economic conditions, people become more sensitive to the dilemmas facing others and take the initiative to help them. Further improvement in the quality of life and sense of happiness is a common aspiration that can only be achieved through collaboration. Such aspiration cannot be attained naturally merely through the improvement of personal material conditions.

The motives for entrepreneurs to run SEs can be demonstrated from economic, social, psychological, and physiological perspectives. What is often overlooked, however, is that the recognition of "selfishness" as human nature is the premise for economic research. Yet in real life, no one would claim to be a selfish person. Not even economists would recognize selfishness as part of their personality. Hence, economists must concede that the self-interested man in economics is an abstract entity.

The question is why economics must assume that everyone is self-interested. Does it mean that economists lack the academic ingenuity to establish a new academic pantheon based on the common good? Economics is probably the only discipline of humanities that relies on the ethical principle of self-interest. Whether such adherence to the assumption of selfishness stems from the purity of formal logic in economics or is it an inextricable curse of the original sin? Is this the reason for economics to achieve logical coherency and become the "jewel in the crown"? Such inscrutable theories of economics are probably beyond the comprehension of entrepreneurs. Just like economists, no entrepreneur wants to be seen as selfish. The tendency of entrepreneurs to establish SEs thus poses a threat to economic theories. Instead of blaming social entrepreneurs for their "ignorance of economics" or "negligence of economic principles", economists should join hands with social entrepreneurs to update economics and consider world realities.

## 5. Implications of Social Enterprises for SOE Reform

If for-profit economic enterprises are regarded as self-interested, SEs are a hybrid form of enterprises. Despite their assumption of social responsibilities, for-profit enterprises strictly follow economic rationality or business rules to stay competitive. In comparison, SEs are run differently as they



must deal with complicated relations for institutional and operational innovation; the factors of concern in social exchange are more complex than those in purely economic exchange. As such, they must pursue organizational and institutional innovations to address their countless challenges. For instance, they should fulfill their social mandate while achieving economic sustainability, balance the intent of owners with the behavioral tendencies of business managers, and collaborate with other social and government organizations.

First, the establishment of SEs is not intended to maximize profitability. Despite modest expectations for profit margins, SEs must use capital safely and effectively to bolster their economic and technical capabilities. In the absence of dividend distribution, they are expected to thrive on capital appreciation and accumulation to gain enough resources to fulfill their social responsibilities. They also need to stay financially afloat and offer decent remuneration to attract highly qualified employees. The altruistic values of SEs require a congenial corporate culture, but it does not mean that all their employees must be completely altruistic; employees of SEs may and should expect fair remuneration. Satisfactory reward to all, even volunteers, is vital to ensure their sustainability. On the other hand, they need to attract capital to fund various programs. In the absence of dividend distribution, social enterprises should create a social reward mechanism for investors. It takes innovation for SEs to balance their social mandate with economic sustainability. Operational equilibrium determines their feasibility and vitality.

Second, SEs must cooperate with other organizations in various endeavors. For instance, they should partner with for-profit businesses, nonprofit social groups, and government-affiliated institutions. In any case, there must be compatibility arrangements for them to work with different types of organizations.

Third, SEs engage in heterogeneous activities ranging from economic exchange and market competition to social exchange and public-interest activities subject to different laws, regulations, and rules. In their operations, they must tread carefully in order not to overstep the line, which is akin to obeying traffic rules while maximizing traffic efficiency. What appears to be well-intentioned and reasonable acts could violate laws and regulations. For SEs, compliance is a key challenge that needs to be addressed with organizational and institutional innovations. China is reforming and improving rules for its market economy, and the absence of laws and regulations on SEs makes a compelling case for constructive institutional arrangements and innovations. Moreover, SEs take various forms and identities, as mentioned before. In China, some SEs are registered as for-profit industrial and commercial enterprises, and others are registered as non-profit “social organizations”. There is no ready rule for SEs of various types to follow in their daily operations. Some innovations may work, and others may not. It is only with a constructive spirit of innovation that they may explore a broader space for development.

Fourth, research on SEs in China naturally involves the reform of SOEs, which involves the relationship between what SEs pursue and government agencies. State owned enterprises and SEs share numerous common or similar topics of research. With the attribute of quasi-social enterprises, SOEs are responsible to create satisfactory profits under the premise of fulfilling their social mandate. At the fundamental level, SOEs are both altruistic and profit-seeking market entities; they face the persisting dilemma of balancing economic rationality with social mandate. For instance, SOEs ran “mini-societies” in the pre-reform era, offering their employees everything from life-long employment to amenities such as canteens and theaters. Onerous non-economic functions drained SOEs of their competitiveness. Since the reform and opening-up policy adopted in 1978, China has taken painful steps to revamp SOEs and ease their burdensome social functions, but the nature of SOEs as SEs remains. It is fair to say that SOEs are essentially kind of SEs disguised as for-profit businesses. It is neither possible nor realistic for SOEs to follow economic rationality, i.e. profit maximization as an overarching priority. In other words, it is unlikely for SOEs to put commercial interest above the expectations of their owner (the whole people) and owner’s representative (the government). No such SOE is known to exist.

Social enterprises share a great deal in common with SOEs. That is why the SOE reform must rely on groundbreaking innovations and cannot follow the old rut for ordinary economic enterprises. There

is no ready model for SOEs to follow just like there is no ready model that works for all SEs. At the heart of the SOE reform, the question is how SOEs can become efficient quasi-social enterprises. Both SOEs and SEs, therefore, share a similar challenge, i.e. how to become vibrant and sustainable altruistic enterprises. For both SOEs and SEs, economic efficiency and competitiveness are the means to fulfill their social mandate.

State owned enterprises are unique in the sense that they are expected to conform to the theoretical rationale as for SEs; SOEs exist for the fulfillment of state-mandated social priorities rather than profit maximization. It would be illogical for SOEs to be set up for the sole purpose of making money. Without their social mandate, SOEs could be even seen as degenerative or corrupt.

On the contrary, some SOEs are less competent and innovative. Their performance of social responsibilities often comes at the expense of efficiency. Some of them generate more liabilities than revenues for the state. Their woeful financial status has led to state asset depreciation. For fear of social instability, the government is scrupulous about closing loss-making SOEs. As a result, they have become inextricably associated with inefficiency. How to strike a balance between social responsibilities and economic efficiency represents a permanent challenge for SOEs and an unrelenting goal for the SOE reform. Such duality is an intrinsic attribute of both social and quasi-social enterprises.

In China, SOEs play a unique role in the national economic system. Chinese SOEs are typically much larger than their peers in other market economies. Chinese SOEs' unique status stems from China's socialist system. A key question in this study is whether "social interest" exists; this problem concerns the fundamental status of SOEs in China's market economic system.

According to the extremist view of Mises (2015) of the Austrian School, "no society exists in isolation from people's thoughts and actions. The society itself has no interest nor purpose". In his view, only individuals have interests and purpose. Most Western economists consider personal interest to be real and collective interest to be virtual or derivative. Since neither the collective nor the society care about interest, decisions made in the name of the collective or society are merely a "public choice" following a voting procedure and cannot represent real collective interest. Those decisions are, in effect, compromises reached by a group of individuals. Brexit, for instance, is a decision of public choice by referendum and may not represent collective interest. It is the result of a compromise, and no one cares about whether it stands for Britain's social interest. Based on such values, there is no room for enterprises to follow social interest as their foremost priority.

Such a "public choice" is hard to comprehend by Chinese values. How come the collective social interest is disregarded? Since real social interest does exist, the collective social interest should be represented. In China, it is the Communist Party of China (CPC) and SOEs under its leadership that represent such collective social interest. That is why Chinese SOEs are "enterprises owned by the whole people" and underpin China's institutional rationale. As discussed before, SOEs are essentially social or quasi-social enterprises. Given their public ownership, SOEs must follow a social mandate and represent "social interest".

China's high-speed railway is a perfect example of a social enterprise. As a transportation infrastructure, the high-speed railway is built by SOEs. The construction of the high-speed railway primarily reflects social interest with a strong attribute of social exchange. For the high-speed railway, economic revenue comes second, i.e. concern for social exchange is far above economic exchange. That explains China's commitment to the construction of the high-speed railway even if some lines generate perennial losses. From this perspective, the high-speed railway is a product of China's socialist system. Some countries in the developed world are hesitant about the construction of such a high-speed railway despite their economic affluence and technological sophistication. The absence of such high-speed railways in those countries doesn't suggest their inferiority to China in economic might or technology; for those countries, their institutional rationale of "public choice" is not based on public interest but only on economic rationality.

## 6. Pro-social Corporate Development in the New Era

The world today is experiencing profound changes unseen in a century, as manifested in a new era of rules-based competition. The rules-based competition reflects tectonic shifts in the global economic landscape and is consistent with the tremendous progress in science and technology. Humankind must reshape the system of rules of the market economy to navigate the world amid the profound changes. In this new era, firm behavior will change in profound ways. It is unrealistic to consider or believe that firms may seek an optimal solution and maximize their value by free choice following economic rationality in a laissez-faire market. In the current world, firm behavior requires not just rationality, including economic rationality, but adaptability to the external social environment.

“Laissez-faire market” and “free trade” touted by economists are rather contradictory concepts. Anyone in the business community knows clearly that their participation in trade is subject to a set of rules in a complex socio-cultural environment. That is why firms are by no means “micro-economic entities” with “freedom of choice”. In this sense, “free enterprise” is just an economic assumption. We are not convinced that an entrepreneur can make a “free choice”. Even if in the most ordinary economic sectors, not to mention more advanced financial, information, and high-tech sectors, an entrepreneur must familiarize himself with relevant laws, regulations, and informal rules, such as customs and conventions, before entering the market. Otherwise, it would be hard to do business without serious consequences.

As organizations for economic exchange, businesses, even if already enjoying relaxed regulation, are expected to be given more freedom. The government has vowed to “streamline administration and delegate power” to help firms create more economic wealth. Actually, no business may exist in isolation from society and do whatever it wishes. The “pro-social” nature of businesses is an important attribute that reflects the adaptability of corporate behavior.

The economy consists of all sorts of organizations in various domains, ranging from for-profit enterprises to SOEs, SEs, and infrastructure enterprises. They also include medical institutions, research institutions, non-profit organizations, public institutions, and government agencies. In this spectrum of organizations, some enterprises are more focused on economic exchange whereas others concentrate on social exchange.

For-profit enterprises are typical economic exchange organizations, and public authorities are typical social exchange organizations. Apart from these prototypical organizations there are others with different characteristics. Human society needs such a heterogeneous ecosystem of organizations.

Enterprises based on economic exchange cannot lose sight of the importance of social interest. Despite differences in their functions and mechanisms, social or economic organizations of various types share common intrinsic mechanisms. While for-profit enterprises are characterized by strong instrumental rationality, the means should be at the service of the end. The emergence of SEs and the division of labor among various social or economic organizations provide the tools for meeting people’s needs.

Amid social and economic development and rising levels of shared interests, for-profit enterprises will become increasingly pro-social and adopt more social initiatives. Most outstanding enterprises have abandoned corporate ethics of extreme self-interest. Instead, businesses have started to care more about social interests and the social environment. This reflects their adaptability in the new era.

The pro-social behaviors of firms are reflected in the following aspects: First, to extend assistance to social groups that need help. One such social group is vulnerable people such as women, children, people with disabilities, and the elderly. Such social assistance also includes the empowerment of workers via education, healthcare, and employment. Second, firms fulfill their responsibilities as corporate citizens by contributing to environmental protection, disaster relief, and community welfare. Third, firms follow social order and cultural customs in the localities where they operate and express opinions in positive

ways to increase their public influence.

In the new era, social priorities increase with the level of economic development. Businesses show great adaptability to a changing society, which is shifting from materialism in the era of poverty to a greater emphasis on the quality of life in the era of prosperity.

As mentioned before, the new era is characterized by great transformations in socio-economic rules and rules-based competition, and the reshaping of the system of rules will pose a challenge to the adaptive behaviors of firms. International competition, such as the “competition” between China and the United States, forces enterprises to enhance their social responsibility and fight for their opportunity in a complex social environment of rules-based competition. As the saying goes, “a just cause attracts much support, and an unjust one finds little endorsement”; this is the golden rule for pro-social ethics.

Pro-sociality is the requirement of the new era because many economic issues are essentially social issues. In the words of Sen (2014), “The extensive assumption of extremely narrow-minded selfish behaviors has seriously restricted the scope of forecast economics, making it hard to investigate extensive economic relationships arising from diversity”; and the reason, he adds, is that “any behavior naturally carries a certain element of sociality. Reflections on strategic questions such as what we should do or what should be ours are indicative of our social identity, including our identity with the goals of others and our interdependence with each other”.

In other words, many socio-economic questions must be addressed as common challenges for society as a whole. If enterprises operate with “economic rationality” with disregard to personal and social interests, we would be left without a solution to problems that require social cooperation. That is why businesses should follow a pro-social development path in the new era. The social environment, including the legal and policy environments, will become more favorable if firms embrace a pro-social orientation. Major social issues must be addressed with extensive business participation. Corporate behavior thus becomes actions of social cooperation. It takes the joint efforts of a society to accomplish national goals such as reaching carbon neutrality, delivering common prosperity for all, coping with an aging society, and containing the COVID-19 pandemic.

Recently, the CPC Central Committee has called for curbing “unchecked capital expansion”, which refers to the excessive expansion of enterprises controlled by big capital that seriously violates social ethics and market order, negatively affect public interest, and even threatens national security. This is an important reminder of the CPC Central Committee to the business community: A pro-social orientation is the only correct path forward for business development. The state may help businesses thrive, but businesses behavior must be pro-social. No business is tolerated to become an antisocial force that bullies the weak, dominates the market for unfair gains, and threatens security.

By GDP aggregate, China has become the world’s second-largest economy. Over the years, businesses have amassed tremendous economic wealth and power. The business community has also contributed to society by creating jobs, offering various types of products, achieving technological innovations, and raising people’s living standards. In effect, businesses have become a tremendous pro-social force. According to mainstream economics, businesses contribute to the common good despite their self-interested motivations. Actually, things are not that simple and reasonable. As discussed here, SEs suggest that businesses could also be altruistic, and such altruistic business operations are sustainable. When self-interested enterprises find it hard to tackle social problems, altruistic SEs should emerge and fill the void.

The relationship between businesses and society has been extensively investigated by sociologists with valuable findings, which are referred to as “economic sociology” or “new economic sociology”. According to socio-economists, in the words of Mark Granovetter (2019), the “intentions of people’s purposeful behaviors are embedded in a network of specific and developing social relations, which constitutes the backbone of the intermediate layer between personal behaviors and culture”, and “social network plays a critical role as an intermediate variable at the macro and micro levels”. The concept

of embeddedness thus enters the discourse, i.e. economic activities are embedded in social relations (Granovetter, 2019). This study partially draws upon the concept of “embeddedness” to further observe the pro-social attribute of corporate behavior<sup>4</sup>.

Since corporate behaviors are embedded in social relations or the social network, pro-sociality is pivotal for businesses to survive and thrive. “It makes little sense to organize an industry against the mainstream national logic”, claimed some economic sociologists, and “economic and management practices inconsistent with the prevalent institutional rationale will not be easily recognized and integrated into the corporate organization” (Granovetter, 2019).

In the new era, profound changes have occurred to a country or a society in various ways. The fundamentalist market economy has ceased to exist, particularly amid the contest between “opening” and “decoupling”, and “cooperative” and “isolative” among countries. As market competition based on rules is more profound, the pro-social behaviors of businesses will also become a major question for this century.

## **7. Concluding Remarks: Economic and Social Exchanges Mechanisms Promote Corporate Pro-Social Behaviors**

The theoretical rationale and institutional mechanism of SEs and the formation of their innovation practices and rules are fundamentally rooted in economic and social exchanges and their relationship and coordination in methods of reward. The market economy is based on the exchange at equal values and the balance between supply and demand.

The behavioral relationship with a longer history of human development is the social exchange, which takes various forms and is ubiquitous. Social exchange does not follow the principle of equal values for economic exchange. Instead, it is a sort of “priceless” exchange and does not usually take the form of supply and demand balance. Social exchange is an exchange of behaviors in a social network, and the payment and reward of the parties in the exchange may not be equivalent. Social exchange is an interpersonal reciprocity and sacrifice-reward behavioral system. It is often intangible but perceivable. Such interpersonal exchange and sacrifice-reward behaviors are based on the intertwined emotions of selfishness, altruism, empathy, and conscience.

For SEs, the relationship between economic exchange and social exchange is a key topic that they must balance discreetly and smartly. While they are altruistic and focus on social exchange, they should also be supported by some degree of economic exchange in a market economy. Without economic income from the economic exchange, it would be difficult for SEs to fulfill their social mandate and maintain social exchange sustainably. In particular, social exchange under formal institutional arrangements requires financial support. Yet if the functions of economic exchange exceed those of social exchange, SEs will morph into economic enterprises.

Economic enterprises, though dominated by economic exchange, also bear certain social responsibilities, and SEs, though focused on social exchange, also need to be supported by a certain economic exchange mechanism. There is a need for social and economic enterprises to work with each other. The relationship of exchange has economic and social attributes that are common to human development. The market economy and the rules of social life should demarcate the boundary between economic and social exchanges and accept different methods of reward, which are subject to various institutional arrangements, ethical norms, and identification criteria. Confusion between economic and social exchanges should be avoided.

On the other hand, the relationship between economic and social exchanges should be balanced.

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<sup>4</sup> This paper only mentions the “embeddedness” of economic behaviors from the perspective of pro-social corporate behaviors without further discussions. More extensive research on the social embeddedness of corporate behaviors is to be otherwise discussed in another paper.



In the modern market economy, the sustainable operation of any organization, whether for-profit or non-profit, must rely on the mechanisms of both economic exchange and social exchange. Thoughtful arrangements, therefore, should be made to promote economic and social exchanges and yield foreseeable social returns.

Sustainable social and economic development and improvement of living standards must be underpinned by economic efficiency and social ethics. The nature and manner of exchange and reward should be well appreciated. The absence of effective exchange and reward mechanisms leads to both inefficiency and immorality.

While individuals may devote themselves to charity without expecting anything in return, no society may function without mechanisms for social exchange and reward. Morality and conscience are the social capital foundation for market economic efficiency.

The biggest social problem in China today is the failure to balance the relationship between economic and social exchanges, as well as the method of reward: In areas where economic exchange should hold sway, there is a lack of efficiency and fair order due to the interference of various non-economic factors; in areas where social exchange and reward should otherwise be the norm, economic exchange is mistakenly allowed to hold ground at the expense of social ethics. Key inspirations may be drawn from systematic research on SEs.

Put simply, the modern market economy is a system of universal exchange, including economic and social exchanges.<sup>5</sup> While economic exchange is “hard exchange” at an equivalent or negotiated price, social exchange is priceless “soft exchange”. With different orientations of concern, hard exchange and soft exchange must be coordinated and complement each other to bring about orderly, efficient, and ethical economic development and improve people’s quality of life. Like a moral compass, SEs are poised to inspire more enterprises to pursue pro-social innovation and development. ■

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<sup>5</sup> The universe is characterized by the indestructibility of matter, the conservation of energy, and the exchange of matter, energy, life, value, thought, and emotions. Without exchange, there is no movement, no life, and no human development. Exchanges of matter, energy, and life of various forms in the universe constitute the realms of exchange. In human development, the exchanges of economic value, social relations, and inner psychology maintain human development and effective socio-economic operation. Research on the nature and mechanism of economic and social exchanges is beyond the topic of our study and will be discussed in a future paper.