

# Social Enterprise and Economic Growth: A Theoretical Approach and Policy Recommendations

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**Abstract** *Social Enterprise is a fast emerging discipline that generates social impact through an entrepreneurial approach. This study examined social enterprise and its contribution on economic growth. The theoretical analysis provides that social enterprises are essential for economic growth and play a significant contribution in local economies through job creation, improving quality of life for the local people and provision of valuable social services. The potential of social enterprises to contribute to economic growth depends on broader system of different layers in the society to influence and increase impact as change agent. Therefore, social enterprises should be included into economic processes such as in doing business, in economic policy making and in financial policy. However, a number of basic policy and legal measures are necessary to create an appropriate environment for social enterprise development that can improve the impact of social entrepreneurship in the society. The principle requirement is to create a favorable legal context which treats social enterprises similar to business organizations.*

**Key words** Entrepreneurship, social enterprise, economic growth, policy recommendations

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## 1. Introduction

According to “*the special report on the world’s young population statistics (2012)*”, the population aged below 30 accounted for more than half of the world’s population. The size of this young population continue to grow at a robust pace, particularly in developing economies where an unprecedented number of children are moving into adolescence. The size of population aged below 30 continue to increase and reached 3.5 billion in 2012, up from 2.7 billion in 1980. Emerging and developing countries particularly in the Middle East and Africa have a younger population than developed economies. Data from the International Labor Organization (2010) reveals that 81.0 million out of the 620 million of economically active youth from ages 15 to 24 globally or 13.0% of that age group was unemployed in 2009. According to a survey conducted by the World Bank, about 40% of those who join rebel and terrorist movements are motivated by the lack of jobs. Sub-Saharan Africa remains the region of the world most affected by unemployment. The causes of unemployment include the lack of real growth, government sector layoffs, fewer new openings, but also the lack of vision of the local decision-makers.

In an attempt to address unemployment, most policy-makers, economists and academicians support the view that entrepreneurship is becoming a crucial factor in the development and well-being of societies to reduce the unemployment rate among people. Interest in the study of entrepreneurship re-emerged with greater intensity in the late '70s, with an emphasis on economic theories through empirical findings and theoretical reflections. Entrepreneurship is an individual’s ability to turn ideas into action, which offers new competition, and as such promotes improved productivity and healthy economic competitiveness.

Audretsch and Thurik (2004) found that the change in consumption patterns, the rise in more flexible production processes and more competition among small and medium enterprises were striking in the transition from an economy of management to an entrepreneurial economy. According to this view, the field that is linked to entrepreneurship is social entrepreneurship. It is referred to as the field in which entrepreneurs tailor their activities to be directly tied with the ultimate goal of creating social value. It is attracting growing amounts of talents, money, and attention. However, along with its increasing popularity,

there have been inconclusive discussions about what actually a social entrepreneur is and what its impacts to the society. In connection to this understanding, Social enterprise applies an entrepreneurial approach to address social issues and creating positive community change. Social enterprise is more responsive and does not rely on the shifting priorities of government and major foundations; it is about making the change that is needed within a community and (sometimes) grows to affect whole cities, countries, and regions.

Just like all businesses, social enterprise needs to make investment and sales in order to grow and meet needs and priorities of the communities it serves, as opposed to traditional non-profit programs which are often limited to the funds available from government and philanthropic funders. It actively engages stakeholders and gives the people it helps a direct voice in the operation of the business—as owners, employees and paying customers.

The economic theory of entrepreneurship is endowed with some factors of production, so entrepreneurship contributes to production through a combination of productive factors (capital and labor), and therefore more entrepreneurial resource allocation implies greater production and well-being.

This paper seeks to examine theories and provides a descriptive analysis of social enterprises' role in promoting economic growth. The main purpose is to explore issues related to policy decisions and how social enterprises can be major agents in influencing economic growth. Furthermore, the study shall provide policy recommendations necessary for policy makers. We believe that, exploring these issues are of the great importance to identify the link between social entrepreneurship and economic growth. Therefore, conducting this study will help to fill the gap in literature on social enterprise. Next to the introduction we provide theoretical review of literature on social enterprises, followed by methodology of the study and then analysis theories and discussions of the empirical studies before we conclude and give recommendations.

## 2. Theoretical review

### *Defining social enterprise*

There is no universal definition of social enterprise (SE). Generally, an SE is a business to achieve specific social objectives such as support service for the elderly, develop products or service needed by the community, creating employment and training opportunities for the socially disadvantaged, protecting the environment and so on. In other words the primary objective of SE is to achieve its social objectives rather than maximizing profits for distribution to shareholders.

There is an ongoing discussion over what precisely social enterprise is and who actually is a social entrepreneur. Dees *et al.* (2001), recognize that a social entrepreneur plays the key role of a change agent in society through: (i) Adopting a mission to create and sustain social value; (ii) Searching for and pursuing new opportunities to serve that mission; (iii) Continually innovating, adapting, and learning, in pursuit of the mission; (iv) Acting boldly without consideration of resources current in hand; (v) Being accountable for outcomes of activities.

Many social entrepreneurs will exhibit these characteristics in different ways and in different degrees and very few will exactly fit this mode of an 'ideal' social entrepreneur. What do we really mean when we discuss social enterprise? We know for a fact that there is no legal business form that is called social enterprise. Again, we also know from scanning the major social enterprise sites, that there is no common international definition of social enterprise: the following are different definitions from different sources (Wronka, 2013).

Table 1. Definition of a social enterprise

Definition	Source
<i>A social enterprise is an organization that applies commercial strategies to maximize improvements in human and environmental well-being, rather than maximizing profits for external shareholders. Social enterprises can be structured as a for-profit or non-profit, and may take the form of a co-operative, mutual organization, a social business, or a charity organization.</i>	Wikipedia
<i>Social enterprises are businesses whose primary purpose is the common good. They use the methods and disciplines of business and the power of the marketplace to advance their social, environmental and human justice agendas.</i>	Social Enterprise Alliance, USA

Definition	Source
<i>Social enterprises are businesses owned by nonprofit organizations, that are directly involved in the production and/or selling of goods and services for the blended purpose of generating income and achieving social, cultural, and/or environmental aims. Social enterprises are one more tool for non-profits to use to meet their mission to contribute to healthy communities.</i>	Social Enterprise Council of Canada
<i>A social enterprise is a business that trades for a social and/or environmental purpose. It will have a clear sense of its 'social mission': which means it will know what difference it is trying to make, who it aims to help, and how it plans to do it. It will bring in most or all of its income through selling goods or services. And it will also have clear rules about what it does with its profits, reinvesting these to further the 'social mission.'</i>	Social Enterprise, UK
<i>Social enterprises are private organizations dedicated to solving social problems, serving the disadvantaged and providing socially important goods that were not, in their judgment, adequately provided by public agencies or private markets.</i>	Dees J. G. (1998)
<i>Social enterprise differs from the traditional understanding of the nonprofit organization in terms of strategy, structure, norms, [and] values, and represents a radical innovation in the nonprofit sector.</i>	Dart, R. (2004)
<i>Social enterprise is a collective term for a range of organizations that trade for a social purpose. They adopt one of a variety of different legal formats but have in common the principles of pursuing business-led solutions to achieve social aims, and the reinvestment of surplus for community benefit. Their objectives focus on socially desired, nonfinancial goals and their outcomes are the nonfinancial measures of the implied demand for and supply of services.</i>	Haugh, H. (2006)
<i>Social enterprises - defined simply - are organizations seeking business solutions to social problems.</i>	Thompson, J., and Doherty, B.(2006)
<i>They are orthodox businesses with social objectives whose surpluses are principally re-invested for that purpose in the business or in the community, rather than being driven by the need to maximize profit for shareholders and owners.</i>	Hartigan, P. (2006)
<i>Social enterprise is a non-loss, non-dividend company designed to address a social objective within the highly regulated marketplace of today. It is distinct from a non-profit because the business should seek to generate a modest profit but this will be used to expand the company's reach, improve the product or service or in other ways to subsidize the social mission.</i>	Yunus, M. (2008)
<i>A social enterprise is a business created to further a social purpose in a financially sustainable way.</i>	NESsT
<i>Social enterprises define as organizations that are driven by a public or community cause, be it social, environmental, cultural or economic. Derive most of their income from trade, not donations. Use the majority of their profits to work towards their social mission.</i>	Social Traders
<i>Social enterprises are organizations with an explicit aim to benefit the community, initiated by a group of citizens and in which the material interest of capital investors is subject to limits. They place a high value on their independence and on economic risk-taking related to ongoing socioeconomic activity.</i>	EMES (2012)

In spite of different legal forms and different areas of activity, there are common themes across all definitions: it is all about businesses; it creates community impacts and social values; and it limits or prohibits the distribution of profits and assets to individual shareholders. It reflects the pursuit of opportunities to catalyze social change and/or address social needs and serve social missions; it contributes to a more efficient market competition and encourages solidarity and cohesion; it is the result of an initiative involving people belonging to a community or to a group that share a certain need or aim, and it pursues an explicit aim to benefit the community or a specific group of people. By doing so, social enterprises directly and indirectly promote a sense of social responsibility at local level. So rather than a defined thing, social enterprises are much more a means to achieve a certain standard.

#### *Characteristics of a social enterprise*

The Social Enterprise UK, (2012) provides seven characteristics of a social enterprise below:

### *Social and/or environmental mission*

The social enterprise community agrees that the primary aim of all social enterprises must be a social or environmental one. We can't prescribe what constitutes a social or environmental mission. Creating a list of 'approved' social missions would limit the very entrepreneurial spirit we want to encourage and make us closed off to the future. What we do believe is that an organization's social mission must be explicit in the organization's governing documents and that social enterprises should be able to explain and justify the value of the social change they aim to bring about.

### *Trade*

Social enterprises are businesses. So they must generate the majority (more than 50%) of their income through trade. We recognize however, that many start-up businesses of any form need funding to get off the ground and turn to readily available sources. With this in mind we usually expect that within two years of operating, genuine social enterprises generate more than 50% of their income through their own trading activities.

### *Profits*

What a social enterprise does with its profits is a critical way in which social enterprise is distinct from standard businesses. We believe the majority (more than 50%) of an organization's profits should be reinvested to further its social or environmental mission. We recognize that reinvesting profits alone does not necessarily equate to the creation of social value, and we acknowledge there are other ways an organization can extract finance should it choose to. However, we believe that alongside other factors, the reinvestment of profits is a clear indicator that an organization is not set up primarily for owner or shareholder value.

### *Autonomy*

Social enterprises are autonomous organizations that are independent of the state. However, we recognize that some social enterprises are on a journey to independence. For example, where social enterprises spin-out from the public sector, the social enterprise may operate at arm's length from the public body for a transitional period of time while it establishes itself. We believe that when this occurs it must be for a specified transitional period.

### *Ownership and control*

Ownership and control are essential questions in social enterprise and we believe that ideally social enterprise should be owned and controlled in the interest of its social or environmental mission. In the cases of social enterprises with shares, the majority of these should be owned in the interest of the social mission. This could be through a golden share issue. A Golden Share is a nominal share which is able to outvote all other shares in certain specified circumstances.

This is becoming increasingly important in times when new models of investment are being explored for social enterprise based on equity and shareholding, and when the government is actively promoting the mutualisation and employee-ownership of public services. And as the social enterprise sector grows and explores new markets, some markets will have high capital requirements.

We acknowledge that shares and equity may well be a critical part of the sector's future and we would not in any way want to limit its potential growth. Where shares in a company are to be sold to raise equity investment, we do not believe that this should account for more than 49% of ownership and the controlling stake of the organization should be held in the interest of the social or environmental mission.

### *Assets and asset-lock*

Many social enterprises choose to ensure that their assets are legally protected and permanently retained for social or environmental benefit (this means they cannot be bought-out and privatized). We believe that there are some situations in which having an asset lock is critical for a social enterprise. When it comes to the transfer of public services and public assets to social enterprise, it is essential that these are

locked and protected for social or environmental benefit. An asset-lock can be effective in ensuring that a social enterprise operates in the wider interests of society for perpetuity and is not at risk of sale. But we recognize that many social enterprises receive no public funds or assets. Some have benefited from considerable personal investment on the part of the entrepreneur and need the money back. Others simply lack knowledge on the technical elements of being a social enterprise at the point of concept, and so adopt a standard company structure without an asset-lock

While we believe an asset-lock is a desirable feature for all social enterprises, we recognize that there are some cases where it is not required, provided other protections are in place. Should social enterprises at any point like to adopt an asset-lock, but are unsure of what this means for their own personal investment, Social Enterprise UK can advise on how this may be extracted in a fair and ethical way.

#### *Accountability and transparency*

As they're organizations operating in the wider interests of society, we believe that transparency and accountability are critical for social enterprises. While we believe that account structures are desirable, we recognize that there are many different ways in which organizations can protect their social mission.

Social enterprises that are part of the co-operative movement are accountable to their members – consumers, staff or community members. Other social enterprises take a more traditional 'company' structure with a board of directors that are legally accountable for the organization's social mission as well as its financial performance. Some organizations may choose a legal form that is regulated – such as the community interest company (CIC) – to protect their social mission, and they may not choose an additional accountable board.

Other entrepreneurs are attracted to social enterprise because it allows them the flexibility to be responsive and dynamic. So they may choose to have a small number of company directors but no independent board, because their accountability arguably lies with their customers. In these cases and in all other we believe that transparent financial, social and environmental reporting is absolutely essential, allowing the sector, customers, employees and investors to make the judgment on an organization's social credentials.

#### **2.1. Empirical literature on social enterprise – economic growth relationship**

There are several studies that establish a direct link between entrepreneurship and economic growth. A study conducted by Salgado-Banda (2005) presented a new variable based on patent data as a proxy for productive entrepreneurship and alternatively a proxy based on data of self-employment. The main conclusion they obtain was that there is a positive relationship between the proposed measure to productive entrepreneurship and economic growth and the alternative measure based on self-employment appears negatively correlated with economic growth.

Van Stel *et al.* (2005) using the Global Entrepreneurship Monitor (GEM) database at different periods conclude that the effect of the activity entrepreneurship rate on economic growth affects the level of economic development positively. Another study by Wenneker *et al.* (2005) used the country's entrepreneurship level as an independent variable, expressed by the Rate of Embryonic entrepreneurs defined in the GEM 2002 database on 36 countries. The main conclusion was that the flow of new entrepreneurs tends to decrease with a development level at a certain point, only to grow again from that point (U function). With data from GEM 2008, Bosma *et al.* (2008) achieve the same conclusions. On the other hand, Wennekers *et al.* (2008) provides an alternative analysis of the "income-entrepreneurship" relationship in a group of developed countries. They employ OCDE data and an entrepreneurship rate based on the total proportion between businesses owners and the active population between the years 1972 and 2004. In this case, the graphic is L-shaped in the long term, so the proportion of entrepreneurial activity would not increase according to income levels, instead it would tend to remain stable. Using the GEM 2002 database concerning 37 countries, Wong *et al.* (2005), start from a Cobb-Douglas production function to explain entrepreneurship and technological innovation as determining factors of growth and concluded that a rapid growth of new enterprises generates job creation in small and medium business in developed countries. Martin *et al.* (2010) examined the relationship between entrepreneurship, income distribution and economic growth by developing the ideas of Schumpeter and testing them empirically

through the GEM database. The main conclusions of the paper are that fiscal policy has a positive effect on investment in different ways: increasing public investment and reduces imperfections in the credit market or end up with restrictions that adversely affect investment in physical and human capital and that there is a negative effect of interest rate and the positive effects of public services and the rate of entrepreneurship.

Another authors Li *et al.* (2009) analyzed the impact of entrepreneurship on economic growth using panel data for 29 regions of China in a period of 20 years. Combining the theoretical definition of entrepreneurship with the characteristics of Chinese entrepreneurs, the authors defined two measures: (1) employment ratio of people with jobs or who own businesses in total employment (ratio or measure of private employment) and (2) employment ratio owners who own business in total employment (ratio or measure of private businesses). Both measures were defined to capture the entrepreneurial spirit. The results suggest a positive impact of entrepreneurship on economic growth, and this result is more robust when the institutional and demographic variables are controlled.

In the article by Mojica *et al.* (2009) the connection between entrepreneurship and economic growth is achieved by adopting the regional economic growth models of measures of entrepreneurship. Thus, these models capture the influence of the level of entrepreneurship in economic growth while measuring the effects of other factors that have traditionally made the link between entrepreneurship and development. They concluded that there is positive contribution of entrepreneurial activity to economic growth. The regions with the highest number of new business owners exhibit higher levels of population growth. The growing number of owners and the largest number of jobs in new business demonstrates its positive influence on employment growth.

So, as we can see, social capital and entrepreneurship plays a key role in development. Social capital is an important factor in the disseminating knowledge across the society in general, and business in particular, by facilitating the flow of information and the transfer of innovation and entrepreneurship; this affects economic development by increasing the income level or reducing the level of unemployment. Koo and Kim (2009) point out those RandD policies need to be discussed in the broader context of related regional issues, such as entrepreneurship, university research, human capital, and social capital and industry structures. These are interrelated policy issues that need to be examined in a more comprehensive policy framework. Koo and Kim (2009) proposed a model of economic growth in which the rate of regional economic growth is a function of the growth rate of economically useful local knowledge, combined with the growth rates of capital and labor. Their results indicate that entrepreneurship plays a significant role in regional growth. Moreover, for any given level of industry RandD spending, the level of entrepreneurial activity determines how much benefit a state can gather from its research activity.

Vázquez-Rozas *et al.* (2010) tested the effect of entrepreneurship on economic growth using the ratio of businesses created in each region over the total number of businesses for nine years (2000 to 2008) as a proxy of entrepreneurial capital, with data from Iberian Balance Sheet Analytical System. They estimated a regional panel econometric model, and they found a positive effect of the entrepreneurship variable on GDP growth, in per capita terms and in absolute values. Also they find that Human capital and social capital are significant.

### **3. Methodology of research**

This study is based on detail review of theories and analysis of empirical studies underpinning social enterprise for the better understanding and how this can be applicable to promote economic growth. Firstly, we examine the theories on social enterprise and then review on the empirical findings on previous studies and case studies in order to establish the link between social enterprise and economic growth.

### **4. Discussion and descriptive analysis**

Established social relations in the society create necessary trust and knowledge, this has a role to facilitate communication and enhance cooperation. Non-profit organizations for example provide vital resources to communities everywhere. Their presence in those areas where public services are poor or lacking is particularly important. At times, these agencies fill massive social service gaps in regions where

resources are exceedingly scarce, populations are dense, and in-depth individualized needs must be met to prevent exacerbation of societal ills.

The social enterprise sector can be viewed as a crucial driver of economic translation. Social enterprises capitalize on growing consumer demand for values-oriented goods and services. They offer an opportunity for non-profits with revenue-generating activities to sustain and expand their services and products. For many entrepreneurs and small businesses with social mission, a social enterprise model makes it possible to make ends meet and begin to fill the gaps in rural social and environmental services. In persistently distressed communities, social enterprises can explore and grow market opportunities that wouldn't exist otherwise. And by pursuing double or triple bottom line results, social enterprises and social entrepreneurs acts as change agents, gradually shifting the economy toward one that promotes sustainability and broadly shared benefits.

However, social enterprises seek to add to economic development through the creation of jobs and entrepreneurial ventures. This in addition provides social services that support the economy by improving quality of life for the local workforce (e.g. health care for the poor, vocational job training for high school graduates, substance abuse counseling for ex-offenders etc.).

By taking the case of Greyston Bakery in Yonkers, New York, an established gourmet bakery that has been in business since 1982. Since the mid-1980's, the Bakery has dedicated itself to hiring the chronically unemployed, offering on-the-job training, housing, child care, and health care to displaced workers and the homeless. Under the guidance and vision of an award-winning chef, the Greyston Bakery is now the second highest rated bakery in New York City and one of Ben and Jerrys largest suppliers. All after-expenses revenues from the Greyston Bakery go to the Greyston Foundation, a nonprofit organization dedicated to helping the poor and afflicted.

In addition, Rubicon Programs Incorporated as a non-profit organization that, since 1973, has built and operated affordable housing and provided employment, job training, mental health, and other supportive services to individuals who have disabilities, are homeless, or are otherwise economically disadvantaged. Its primary vehicle for doing so, however, has been through two successful social enterprise ventures which employ Rubicon clientele: Rubicon Landscaping Services and Rubicon Desserts. The profits for these businesses are funneled back into Rubicon's social service programs, which aim to support the very individuals that work for them.

## 5. Conclusions

To conclude, the previous studies on social enterprise – economic growth have largely proved that SE have positive effect on economic growth through job creation and increasing income levels. The studies found that social capital and human capital are significant factors for SE success.

For years, social enterprises have been playing an integral role in local economies worldwide. These enterprises employ creative and innovative methods of helping the poor and disenfranchised. They also offer a self-sustaining means of providing a valuable social service. While the economic benefits of these entities is substantial, services and support must be available to social entrepreneurs that lack the business know-how needed to operate in a competitive marketplace.

## 6. Recommendations

Perhaps the most obvious challenge to social enterprise stems from the fact that the individuals that seek to begin these enterprises possess a nonprofit management background rather than a business background. Thus, many social enterprises can run into problems as soon as the start-up phase if they lack the necessary business fundamentals. This section is dedicated to highlighting the common challenges social enterprises face and general recommendations on how to best address these.

### *Problem 1: Introducing a For-Profit Entity in a Non-profit Atmosphere*

Non-profits oftentimes find it hard to develop a for-profit mindset, as their usual *modus operandi* involves a commitment to administering services for free. Successful social enterprises know how to departmentalize their operations. If a workforce development agency opens up a for-profit temping service, there should be clear segmentation in the organizations management structure, so as to avoid a clash between social service delivery and competitive business activity. If a social enterprise is completely

dependent on the performance of its client employees, it must develop a culture of helping those with a demonstrated commitment to help them.

*Problem 2: Behaving Like a Business*

For social enterprises that are 100% dependent on profit revenues (i.e. those whose annual budgets do not include a substantial amount of donations or grants) or who are aiming at complete self-sustainability, getting accustomed to a dual-environment where (a) they must make money to survive and (b) maintain a commitment to effectively assist clients can be challenging. Operating like an efficient business and developing a for-profit culture takes time and training. Fortunately, there are a number of organizations that offer comprehensive training and technical assistance programs geared to assist non-profit managers in creating a successful for-profit ethos within their larger organization.

*Problem 3: The Absence of Business Skills and Knowledge*

As has been mentioned above, the majority of social entrepreneurs have a non-profit background rather than a business background. These individuals thus lack knowledge and skills in a number of important, business-related areas: business plan development, marketing strategy, financial management practices, and capital sourcing. Fortunately, it is not at all necessary for non-profit managers and future social entrepreneurs to attain a business degree to accomplish their social enterprise goals. They have to be trained and equipped with necessary skills to manage social enterprises.

*Problem 4: Maintaining Competitiveness*

In order to successfully compete in the open market, goods and services need to be of the highest quality while appealing to a wide audience. Because social enterprises are socially focused and give priority to their clients' needs, they often do not focus like they need to and compromise on product standards. While a handful social enterprises bring on private consultants to evaluate their operations, this option is typically not financially feasible.

In order to achieve their objectives and handle the above challenges, there is a need to create a legal framework and policies which treats social enterprises similar to business entities. This will be a motivation to accomplish their social goals.

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