Creating Shared Value (CSV)

Operationalising CSV Beyond The Firm

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Table of Contents

About the Author

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About the CBR

The CBR, established in 1994, conducts interdisciplinary, evidence-based research on the determinants of sustainable economic development and growth. Current projects are examining inequality in cities, the effects of IMF structural adjustment policies, macroeconomic projections for the UK economy, social rights and poverty alleviation, law and finance in the BRICS, the role of universities in knowledge exchange, business development in the Cambridge region, and the relationship between contract forms and innovation in construction and infrastructure projects.

Chapter 1

Introduction

1.1 The Intellectual Context and Scope of Analysis

'How to fix capitalism and unleash a new wave of growth'. (Porter & Kramer 2011) This sentence, notably without a question mark, was on the front cover of the January/February 2011 issue of the *Harvard Business Review*. The concept of Creating Shared Value (CSV) was presented as 'The Big Idea' that can help cure capitalism's ills. CSV is therefore firmly embedded not just in the field of business strategy but, moreover, in the wider intellectual search for solutions to overcome the disappointing economic performance of advanced economies in the painful aftermath of the financial and economic crisis of 2007/2008.

With the near-collapse of the financial system and the resulting Great Recession (Christiano et. al. 2015) the discussion about the longevity and stability of capitalism has resurfaced in public and academic debates. Whether it is about often muted aspects of capitalism (Chang 2010) or neoliberal market fundamentalism (Crouch 2013) the very foundations of capitalism are being questioned. If anything, the discussions have become even more fundamental in recent years. Economic commentators such as Paul Mason (Mason 2015) and internationally acclaimed academics such as the economic sociologist Wolfgang Streeck have even predicted the imminent demise of the capitalist system. (Streeck 2016) CSV is therefore an important contribution to one of the most pressing economic debates of our time, deserving attention and further study.

The analysis presented here is, however, not concerned with the general question of how to fix capitalism or the macroeconomic implications of the Great Recession. The starting point of this report, moreover, is the concept of CSV itself and how to comprehensively operationalise it in practise. As will be shown, CSV predominantly focusses on elements of business strategy that are internal to the firm. Even though the fundamental aim of the concept is the creation of 'shared value', i.e. economic as well as broader social value, it does not clearly define social value nor does it provide clear answers as to how to operationalise CSV beyond the firm.

The argument here is that filling this gap requires, first of all, a deeper understanding of the locus of interaction. Under the CSV concept, firms participate in different markets to create social and economic value but Porter and Kramer do not analyse the nature of markets nor do they provide any explanation for how the creation of social value via market mechanisms is necessarily rooted in the social nature of markets themselves.

The standard neoclassical model of transactional markets that are driven by purely rational players is an ideal type in Max Weber's sense, i.e. an abstract model not to be found in this pure form. Any approach assuming the creation of social value by market mechanisms, however, should provide a deeper understanding of the social nature of markets themselves. This is a crucial backdrop to defining, creating and measuring social value: it is dependent on this context.

On this basis, in a further step, it is vital to develop an understanding of public policy and the government's role in markets. Public policy's character is not limited to basic regulation and market-fixing where market mechanisms left to themselves would produce externalities. Government policy, moreover, aims at market creation and incentive shaping. Understanding the interplay between companies and governments in markets that themselves are social in nature is therefore fundamentally important to understand social value and to move beyond the narrow organisational focus of Porter and Kramer. On this basis, in addition to the three operational dimensions within firms that Porter and Kramer describe, CSV can be more broadly operationalised using a corporate diplomacy approach and the tools of non-market strategy to provide a more holistic and comprehensive view of the CSV process.

1.2 Methodology and Structure

This report aims at solving a practical business problem by creating a more comprehensive way to operationalise CSV through the integration of different strands of analysis. Therefore, it is based on a multidisciplinary approach researching the existing academic literature in relevant social science fields comprising business studies, political science and economics. The author engaged comprehensively with the existing academic literature with a view to providing solid intellectual foundations for the concepts used and a clear framework for the additional analysis conducted in this report. The literature review itself is integrated into individual chapters rather than presented separately at the beginning. This approach allows for seamlessly assimilating the existing academic literature into the consecutive and integrative nature of the main argument.

The work presented here is built on four chapters that cover a critical evaluation of CSV establishing a firm understanding of the concept, its shortcomings and the need for a more comprehensive approach. Following this, two chapters addressing the social nature of markets and social value as well as a deeper understanding of the role of public policy provide further analytical dimensions relevant to CSV; these are then tied together and operationalised in the final chapter on how to expand CSV using a corporate diplomacy approach with the tools of non-market strategy. This report ends with a brief conclusion highlighting the key findings.

Chapter 2

A Critical Evaluation of Creating Shared Value (CSV)

2.1 What is CSV?

Porter and Kramer positioned CSV as a corporate response to the crisis of capitalism and provided a rather brief definition of their core idea:

> The concept of shared value can be defined as policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates. Shared value creation focuses on identifying and expanding the connections between societal and economic progress. (Porter & Kramer, 2011, p. 6)

They went on to define some of the operating practices by setting out three key ways in which companies can create shared value:

1. Reconceiving products and markets
2. Redefining productivity in the value chain
3. Enabling local cluster development (Porter & Kramer, 2011, p. 5)

When it comes to specific details the authors remain rather vague and resort to anecdotal evidence from their consultancy practice. The first point about reconceiving products and markets is based on the claim that too many companies have lost their focus when it comes to the fundamental question of whether their products are good for consumers and customers. Porter and Kramer observe the rise of demand for products and services with a clearer social value and back this observation up with several examples. A shift from pure taste to a bigger focus on nutritional value in the food industry and the emerging use of digital intelligence by technology companies to limit the use of electricity were specific examples put forward. (Porter & Kramer 2011)

Addressing these emerging needs with innovations, another key area of CSV that is an implicitly cross-cutting element rather than an explicitly stated core feature, in the eyes of Porter and Kramer creates a whole variety of new business opportunities that generate economic as well as social value.

A critical interpretation of this new view of products and markets would ask questions about the drivers of change. Demand in new areas is identified but there is no explanation given as to why this demand is rising. What are the key drivers behind these changing market and consumer preferences? Is not a firm understanding of the key forces behind these transformations important to serve markets efficiently and anticipate future developments? Is such an understanding not also necessary to define what social value is in real terms and how it can be measured? The latter question will be dealt with further below but it is important to state that Porter and Kramer's first core element of CSV leaves several analytical gaps and significant questions unanswered.

The CSV approach is more straight forward when it comes to rethinking productivity in the value chain. It is argued that a company's value chain is necessarily exposed to numerous societal issues such as use of resources, health and safety as well as workplace conditions and that these issues can produce costs in a company's value chain. This is certainly a valid point but it is surprising that the authors chose to state that "so-called externalities" also produce costs within the firm (Porter & Kramer, 2011, p. 8) given the long-standing economic definition of externalities as social and environmental costs of production and consumption that are not reflected in price mechanisms. (Ayres & Kneese 1969) Their key feature hence is that they do *not* create direct costs.

The core argument, however, is that reducing resource use - for instance by using less packaging and optimising deliveries as well as treating suppliers not just as a cost factor but as a provider of inputs that ought to be as productive and not as cheap as possible - can eventually reduce costs and create social benefits at the same time. Porter and Kramer also revive what might be seen as a Fordist tradition (Neilson & Rossiter 2008) by stressing the advantages of living wages and other benefits for workers themselves and for productivity more broadly.

The third and final core element of CSV identified is enabling local cluster development. The argument about the importance of local entanglement of companies draws heavily on earlier work by Michael Porter. (Porter 1998; Porter 2000) In more recent research there have even been attempts to create systematic empirical frameworks to measure the impact and performance of regional clusters paying tribute to their continued importance in academic debates. (Delgado et. al. 2014)

At its core the concept of clusters relates to geographically confined agglomerations of related and mutually reinforcing businesses including suppliers, service providers and logistical infrastructure. Silicon Valley in the area of information technology or southwest Germany in the area of car manufacturing are oft-quoted examples for successful local clusters. (Porter & Kramer 2011) The discussion about the economic importance and relevance of clusters is a vital part of economic debates and not exclusive to CSV. The inclusion of clusters within CSV is therefore more of a restatement of an existing body of work under a new framework than a genuine novelty.

The integration of existing research within the CSV framework also links to the more general question of how Porter and Kramer's concept is embedded in the academic literature and what kind of criticism it has spawned.

2.2 Academic Context and Key Criticisms

On the one hand, it is fair to say that CSV has made a significant impact in terms of academic influence and when it comes to practical application in consultancy work. At the time of writing, a Google Scholar search for the key CSV article shows the astonishing number of 6616 citations and CSV has also spawned or inspired its own institutions, for instance the Shared Value Initiative and the FSG consultancy firm founded and led by Mark Kramer, which both rely heavily on CSV ideas. There have also been attempts to further refine and compare business models based on CSV (Michelini & Fiorentino 2012) and wide-ranging intellectual discussion on the overall value of CSV. (Habip et. al. 2011)

On the other hand, there has been significant criticism undermining the academic credibility of CSV and the way in which Porter and Kramer present their work. In essence, these criticisms refer to the originality of CSV as well as the concept being superficial about a company's role in society and naïve about the trade-offs between social and economic goals and business compliance. (Crane et. al. 2014)

The CSV critics argue that the concept is a continuation of previous collaborative work by Porter and Kramer on corporate philanthropy (Porter & Kramer 1999) and on strategy and society (Porter & Kramer 2006) that is rather unoriginal as it either ignores or misrepresents the existing academic literature:

> Porter and Kramer present CSV as a novel contribution, yet its core premises bear a striking similarity to existing concepts of CSR [Corporate Social Responsibility], stakeholder management, and social innovation. This argument only holds up because they caricature the CSR literature to suit their own ends and simply rehash the existing stakeholder and social innovation literatures without due acknowledgement. (Crane et. al. 2014, p. 134)

It was further noted that CSV also bears a striking resemblance to the concept of "blended value" (Emerson 2003) and previous academic work by Stuart Hart (Hart 2005) without due acknowledgement. Hart himself reportedly termed CSV "intellectual piracy". (Crane et. al. 2014, p. 135)

Apart from the questioning of the academic credibility of CSV, two more fundamental criticisms are relevant for the issues addressed in this report. First, Porter and Kramer were accused of not providing a comprehensive conception of a company's role in society. Rather than reflecting on the social embeddedness of corporations, CSV simply provides guidelines for various social activities rather than undertaking a redefinition of a company's purpose – the underlying intention of CSV:

> Furthermore, while claiming to deliver a broad framework to include various discussions on the business and society interface, the concept of CSV remains unconvincing since it avoids any deeper thoughts about the systematic responsibility of corporations in soci-

> ety. (...) While CSV might be a good way of integrating various activities into one social strategy, it fails to deliver orientation for a responsible corporate-wide strategy. It thus fails in Porter and Kramer's aim to redefine the purpose of the corporation. (Crane et. al. 2014, p. 139)

Second, Crane et. al. also find Porter and Kramer's argument that CSV moves "beyond trade-offs" unconvincing and accuse them of just ignoring this problem. (Crane et. al. 2014) Indeed, the areas of shared value described by Porter and Kramer could be better labelled as exclusively relating to rather obvious win-win situations. It is clearly economically as well as socially beneficial if a company can cut costs using less packaging and at the same time have a leaner environmental footprint. But what about situations that are not win-win but necessarily involve trade-offs between economic and (different) social aims? Is CSV only useful for the rather small area of win-win situations? There is also a question about shared value itself. It is clear what the economic value part of shared value is: a better bottom line for corporations. But beyond the obvious win-win situations, what is social value and how does one define and measure it? What are the trade-offs involved?

Take clusters for instance. Deciding to open a factory or service business as part of a cluster creates economic and social value in the cluster area. But it creates opportunity costs at the same time as the choice to open a factory in location A is at the expense of location B where new jobs and other social benefits are not created. There are hence social opportunity costs involved in such decisions that might be of less relevance for the company but of great interest to policy-makers.

These fundamental criticisms of CSV align with the author's view that CSV does not adequately conceptualise the social nature of markets (and the role of companies within them) and that shared value needs a better understanding of what social value is and how to measure it if CSV is to be useful beyond the obvious win-win areas that can be easily identified.

2.3 The Blind Spot of Government Relations

As already indicated the author also believes that one of the critical shortcomings of CSV is that the concept does not develop an approach on how to engage with governments. This omission is even more surprising given the first sentences in Porter and Kramer's *Harvard Business Review* publication:

> Capitalism is under siege... Diminished trust in business is causing political leaders to set policies that sap economic growth... Business is caught in a vicious circle... The purpose of the corporation must be redefined around Creating Shared Value. (Porter & Kramer, 2011, p. 2ff.)

Evidence for the assumption that some of the core tenets of capitalism have been questioned in recent years has already been established in the introduction. There is a rich and growing body of academic literature and even a superficial look at economic debates in key international media shows that this is a valid description of the state of economic affairs. The next statement, however, is far-reaching and yet unsubstantiated.

Porter and Kramer establish, without any supporting evidence, a causal chain between a lack of trust in businesses and specific policy outcomes. There is empiric evidence for the lack of trust in businesses as well as in governments and NGOs, even though trust levels have been recovering of late. (Edelman 2016) The claim, however, that this lack of trust is *causing* governments to introduce economically disadvantageous policies that stifle economic growth and undermine competitiveness is wholly unsubstantiated. If this relationship were true, would recovering trust in businesses, by itself, lead governments to set completely different policies? Policy is hence just a function of trust in business? Such a naïve belief would explain why CSV does not conceptualise business relations with policy-makers and at the same time show a lack of understanding of real world processes. It is also striking that even academic articles critiquing CSV praise the concept's understanding of the role of government as a step forward. (Crane et. al. 2014)

CSV states in a rather simple way that "the right government regulation can encourage companies to pursue shared value; the wrong kind works against it and even makes trade-offs between economic and social goals inevitable". (Porter & Kramer, 2011, p. 14) As already indicated there are often necessarily trade-offs between economic and social goals but this statement by Porter and Kramer insinuates that these only exist when the wrong kind of policies are pursued – policy-makers effectively create these trade-offs.

So, what roles do Porter and Kramer see for governments? Beyond encouraging innovation, they define five roles:

1. Set clear and measurable goals
2. Set performance standards but do not prescribe methods to achieve them
3. Define phase-in periods for meetings standards
4. Put in place universal measurement and performance systems
5. Audit results but do not impose compliance (Porter & Kramer 2011, p. 14)

There is no mention of the role of governments in directly creating or incentivising social value and their active part in the economy. Again, Porter and Kramer also seem to just assume that it is self-evident what social value is and how to measure it. Social value is, however, neither objective nor fixed or stable and therefore difficult to define and measure. (Mulgan 2010a) So even the prescribed role of setting clear and measurable goals is not straight forward.

Porter and Kramer adhere to an economically neoclassical view. Public policy's role is limited to setting a legal and basic standards framework. This view is too simplistic and reduces real world complexity to such an extent that CSV does not provide a useful guide for operationalisation beyond the company and obvious win-win situations. This is a shortcoming this report seeks to overcome.

2.4 The Value of CSV

Despite the shortcomings this critical evaluation of CSV has identified, its strengths are also undeniable, especially when it is not seen as a contribution to academic debates but as a way to operationalise strategy refocusing within companies. Rethinking value chains and cluster formation not just with a view to economic benefit but also with due regard to creating social value is a useful change of focus. The operational weakness is external to the firm and lies in the concept's lack of understanding of socially embedded markets and stakeholders, an insufficient understanding of social value and a misguided understanding of public policy.

CSV was clearly devised as a strategy consultancy tool to be used in real-life business contexts and it has indeed found frequent practical application in firms. If the acknowledged shortcomings can be rectified the practical usefulness of CSV would be even further enhanced. How this can be achieved is discussed below.

Chapter 3

The Embedded Market and Social Value

3.1 The Social and Institutional Dimension of Embedded Markets

The idea of the social embeddedness of economic activities goes back to the work of political economist Karl Polanyi. In his book *The Great Transformation*, Polanyi describes how, in his view, economic activity during the rise of market economies had been fundamentally transformed. He argued that the development of the modern market economy and the modern state go hand in hand and introduced the concept of a 'market society' as an expression of this link. (Polanyi 2002)

According to Polanyi, the rise of the market economy removed economic activity from its social framework. In the pre-industrial barter economy, economic conduct was rooted in personal relations and kinship whereas the rise of markets changed this and made market participants more impersonal and rational. (Polanyi 1957) The advance of capitalism and the commodification of labour in particular, according to Polanyi, created disembedded markets and thus the demand for institutional reforms to address this broken link. This is what he termed the 'double movement': first, there is dislocation created by markets and then those affected will use the state to push for institutional change to protect themselves. The rise of welfare states and institutional regulation of economic activity serve as examples for this kind of change. (Polanyi 2002)

More recently, scholars have added two important dimensions to Polanyi's work. First, Mark Granovetter argued that even in market economies there is a social embeddedness of economic activities as they necessarily take place in social networks and not in the abstract and purely rational way neoclassical economics conceptualises markets. (Granovetter 1985)
Second, political economist Mark Blyth argued that the double movement described by Polanyi does not stop after the first round of market dislocation leading to institutional change but that there is a constant and dynamic relationship between these two forces:

> After all, if disembedding the market led to a double movement where labor demanded protection through an institutional reembedding, then was it not reasonable to expect, in turn, another reaction against those "embedding" institutions by those most affected, namely capitalists? In fact, the political struggle between disembedding and reembedding the market continuous today, even though the contours have shifted. The contemporary neoliberal economic order can be seen as merely the latest iteration of Polanyi's double movement. (Blyth 2002, p. 4)

The above arguments lead to important conclusions. First, there is a robust case that there is always a strong social dimension to market activity as at the end of the day it is social human beings who engage in economic exchanges.

Second, the continuous double movement described by Polanyi and Blyth provides a theory of institutional change and a role for public policy in creating those institutions that shape the social embeddedness of markets. It also provides a tool to locate the discussion about CSV in the broader context.

In Blyth's logic, the search for a new way to shape capitalism in the wake of the financial and economic crisis is just the latest iteration of the double movement which has already led to institutional changes, for instance within financial regulation, and is likely to lead to more reforms before the pendulum swings back again. From this point of view, positioning CSV as a corporate response to these discussions without having a solid understanding of the social nature of markets and the wider institutional framework is a significant omission.

In recent literature on embedded markets this omission has been spelled out in further detail. The British economist John Kay in his prize-winning book *The Truth About Markets*, looks at empirical evidence from across the world and concludes that rich countries are characterised by active government and that poor countries usually have weak or malfunctioning public institutions that do not effectively intervene. The most obvious reason for government intervention is the negative impact of market activities such as the already mentioned externalities or classic instances of market failure. But Kay also aptly describes how this function directly melts into other economic functions of governments:

> Many services cannot be provided in competitive markets: public goods like lighthouses, environmental protection, police and defence, and the framework of rules within which the modern market economy operates. There are natural monopolies, in water and electricity distribution, road and railway networks, air traffic control. Other services, such as education and health, could be provided by competitive markets but are not, for reasons that most people find compelling. It is desirable to find pluralist structures for these industries, but acceptable market solutions will not emerge spontaneously. (Kay 2003, p. 338)

The insight that market solutions for specific needs do not appear spontaneously points to the role of governments in shaping the market incentive structure and context. But given that governments also operate in socially embedded markets, economic policy is much more complicated than a simple top-down approach to shaping markets, as Kay explained:

> Because markets are embedded in social institutions, it is not only, or mainly, by voting that we influence the development of the market economy. Economic policy is not a list of things the government should do. We make economic policy as consumers, employers, entrepreneurs and shareholders. We influence economic policy when we conform to, or resist, the norms and values of the market economy. Economic policy is as much about social attitudes and customary behaviour as about law and regulation. (Kay 2003, p. 339)

Kay's argument again highlights the key point: in order to understand real-life market dynamics you have to move beyond a mechanical understanding of how they work and try to analyse the complex web of constant social interactions and institutional changes that characterise functioning and adaptive markets.

Changing preferences emanate from this complexity too. This is difficult to conceptualise for economists as economic models usually just take preferences as given. But Porter and Kramer rightly refer to changing preferences in the market that companies fail to anticipate and are often slow to respond to. The author has already raised the need to understand the drivers behind these changes and the socially embedded market offers an entry point for analysis.

In an interview with the author John Kay acknowledged this shortcoming of neoclassical economics, even calling the assumption of purely rational markets "absurd", as preferences are in no way exogenous. Changing preferences are, moreover, the result of an elaborate interplay of information and institutions in given markets. New research on the nutritional value of certain foods might be the trigger for governments to change official recommendations and for consumers to change commercial preferences. It is in understanding the social and institutional aspects of specific markets and constantly evaluating them that sensibility for these shifts can be developed. This also shows that developing a deeper understanding is highly contextual: an oil company will have a completely different kind of social embeddedness to deal with than a food producer. (Kay 2017)

The lack of a one-size-fits-all approach to embedded markets makes the matter complex and difficult but there are ways to analyse the context on a case by case basis as will be shown below. But understanding the specific context is also a prerequisite to create social value beyond obvious win-win situations. As John Kay also acknowledged, without a firm understanding of the social nature of markets as the locus of exchange creating social value beyond obvious cases is not possible. This leads to the question of what social value is and how one measures it.

3.2 What is Social Value and How to Measure it?

As opposed to the clear-cut definition of economic value as 'improved company bottom line', social value is notoriously difficult to grasp and measure. In fact, there is no generally accepted definition but a common understanding is that it broadly refers to non-financial impacts of organisations and interventions on individuals and communities as well as on social capital and the environment. (Mulgan 2010b)

This conceptual vagueness is, however, no excuse to use social value without further clarification or better categorisation. It merely makes clear that this part of shared value is not generic but, as with embedded markets, highly dependent on the specific situation and the specific setting. It also provides a communication opportunity for companies: if social value is situational and contextual there is an opportunity for them to help define the very understanding of social value itself, which could help communities and deliver reputational advantages at the same time.

Unsurprisingly, actors in the non-governmental and non-profit third sector have been active in trying to conceptualise social value and develop tools for measuring it. Think tanks and governments have also attempted to adapt business accounting tools for measuring social value. Hence there exist methods to measure Social Return On Investment (SROI) which try to emulate the Return On Investment (ROI) measure for the social value space. (Wood & Leighton 2010)

Geoff Mulgan, a former head of the UK Prime Minister's Strategy Unit and now CEO of the National Endowment for Science Technology and the Arts (NESTA) narrowed the meaning and measuring of social value down to two related categories:

> Outputs: These are the activities done by an organisation, usually listed in an action plan or set of objectives. For example providing homeless people with food and shelter or organising a conference to discuss long term care services for the elderly.
>
> Outcomes: These are the long term observed effects of the outputs and are often the 'real' changes that organisations are trying to make. For example homeless people no longer live on the street and now in employment is an outcome. Likewise a new policy implemented by a government or a new project that improves the quality of long term care for elderly people is an outcome. (Mulgan 2010b, p. 1)

The categorisation of social value as a combination of direct outputs and long-term outcomes provides the starting point for operationalising the pursuit of social value. First of all, stakeholders in a specific area need to communicate and agree on desirable long term outcomes and appropriate short term outputs. Once this is done, the way to measure both outputs and outcomes also needs to be mutually agreed. In the absence of a generally accepted way of defining and measuring social value its legitimacy rests on the mutual agreement between involved parties on the main aims as well as the right way to evaluate results depending on the specific context.

An attempt to create environmental value for instance would involve different stakeholders and different ways of measuring success than in Mulgan's example of trying to combat homelessness. It also becomes clear that the monitoring of outcomes has to be long-term if you want to evaluate whether a certain output has been truly transformational. The tools for measuring could then be quantitative, such as attempts to calculate SROI, as well as qualitative as it is highly unlikely that the desired outcomes are fully quantifiable.

This more detailed understanding of social value shows why it is imperative to engage with governments, which are involved in all areas of social value, as well as with other relevant stakeholders in a certain social space. This is a prerequisite to move beyond clear win-win situations and expand CSV into areas that might not be immediately obvious based on the examples put forward by Porter and Kramer. In this light and accepting that trade-offs between economic and social value cannot always be avoided, categorising social value in three separate ways is helpful. First, there is the area of low-hanging fruit where there are obvious ways to create shared value. These are mostly the examples put forward by Porter and Kramer. Second, there is a grey area where CSV could play a fruitful role but does not because of the analytical gaps addressed in this report and a misalignment of private and public interests. And third, areas in which there necessarily are irreconcilable interests between economic and social value. Discussions about the building of oil pipelines or the expansion of airports would be examples for this.

The key argument here is that by using the approach developed below the scope of CSV can be greatly expanded by aligning private and public interests and can thus create social value as conceptualised above. Creating this alignment of interests, however, also requires a contemporary understanding of public policy and its fundamental aims.

Chapter 4

Public Policy, Markets and Shared Value

4.1 Public Policy and Public-Private Relations

The starting point for understanding the role of public policy in the wider CSV context is a definition of public policy itself. Recent descriptions reveal interesting parallels to the business world and also the close relationship between the two:

> Public policy is a set of decisions made by governments and other political actors to influence, change, or frame a problem or issue that has been recognized as being in the political realm by policy makers and/or the wider public. (…) Today, there are still high expectations about the problem-solving capacities of public policies, even though, in the last couple of decades, many policy problems could not be solved. Trust in government is also declining and problem solving has been increasingly taken up by private sector initiatives. These can be found in the form of social enterprises, charities, or business activities. (Hassel 2015, p. 569)

Based on the above definition it becomes clear that public policy operates in the same space as businesses, especially when it comes to CSV. Public agents too have been suffering from declining levels of trust in their problem-solving capacities and hence in some areas increasing private sector activity has taken place. Given the trust issues of businesses that Porter and Kramer used as their point of departure it becomes apparent why there is such a fundamental discussion about the very future of capitalism: both public and private actors have been perceived as incapable of solving the economic, social and environmental issues of modern economies. It is therefore in the interest of both to improve their performance.

This description of public policy also points to a dynamic relationship between private sector activities and public policy. The relationship is, however, framed as one of competition: expansion and retreat in different areas of the social realm. In essence, though, the aim of both private and public activities in this space lies in understanding and solving problems. Understanding this dynamic relationship as complementary rather than competitive therefore provides a good starting point to increase the scope of CSV.

There have of course been many attempts to learn from or emulate lessons from one sector or the other. The term 'New Public Management' (NPM) for instance describes the often criticised transfer of private sector management techniques to the public sector (Boyne 2002) and 'Public Private Partnerships' (PPP) (Osei-Kyei & Chan 2015) describe joint initiatives that are often difficult to evaluate and measure (Burger & Hawkesworth 2011). In the context of CSV, it appears useful not to focus on organisational changes or a full range of traditional PPPs but on the joint aim of problem solving.

The author already mentioned that innovation in CSV is presented as a crucial cross-cutting element. As will be shown below, the area of innovation and market creation is also one of the key areas of the latest public policy thinking. Focussing on joint innovation initiatives with a clear focus on problem solving therefore provides a space that can be used to better align private and public interests.

4.2 The Entrepreneurial State and Market Creation

One of the recent and widely discussed approaches to public policy - and economic policy in particular - is the work of Mariana Mazzucato. At a very basic level the framing of her approach is strikingly similar to CSV. The financial and economic crisis not only sparked discussions about businesses and the stability of capitalism but also about the role of economics as an academic discipline and the failure of public policy to prevent the crisis. Policy-makers wrongly thought that they had tamed the business cycle and Queen Elizabeth II famously asked economists when visiting the London School of Economics and Political Science (LSE) why nobody saw the crisis coming. (Giles 2008) So the starting point for recent reflections on economics and public policy is the same: in what way must the role of economics as a social science and public policy be rethought given the recent economic problems? Mazzucato and her co-author Michael Jacobs argued that:

> (...) these failures in theory and policy are related. Mainstream economic thinking has given us inadequate resources to understand the multiple crises which contemporary economies now face. To address these crises, we need a much better understanding of how modern capitalism works – and why in key ways it now doesn't. A reappraisal of some of the dominant ideas in economic thought is required. And in turn this needs to inform a set of new directions in economic policy-making which can more successfully tackle modern capitalism's problems. (Mazzucato & Jacobs 2016, p. 2)

The foundation of Mazzucato's approach to public policy was set out in her 2013 book *The Entrepreneurial State: Debunking Public vs. Private Sector Myths*. Citing a plethora of empirical evidence, Mazzucato made the case that it is a damaging myth that innovation is squarely located in the private sector. Moreover, it is in the interplay between the private and public sectors where real advances can be made. She cited the iPhone as one of those examples. Even though it was a massive commercial success for Apple alone, it heavily relied on components such as GPS and touch screens that were developed through government sponsored research. The key message of the book is hence that the state has an entrepreneurial role, that it should be fully aware of this role and that this awareness should also be reflected in public policy. (Mazzucato 2013)

In the discussion sparked by the book it became apparent that public-private cooperation in the area of innovation does not work well even though some of the biggest societal issues, such as the switch to renewable energies, can realistically only be achieved with public sector involvement. (Wolf 2013) Even though the examples used by Mazzucato are mostly in the area of core technology, her argument generally exposes the disjointed nature of public and private activities and points to the potential added value if mechanisms are found to bridge this schism.

While Mazzucato included a list of beneficial policies and actions in her book she only later developed the idea of the entrepreneurial state into a full public policy framework. That framework represents a more expansive public policy approach as the state is not merely seen in a market fixing role but also as a market creator and a provider of mission-oriented directionality. Four questions in particular represent the pillars of this new public policy approach:

1. How can public policy be understood in terms of setting the direction and route of change; that is, shaping and creating markets rather than just fixing them (Directionality)
2. How can this alternative conceptualization be translated into new dynamic indicators and evaluation tools? (…) (Evaluation)
3. How should public organisations be structured (…)? (Organizations)
4. How can public investments along the innovation chain result not only in the socialization of risks, but also of rewards, enabling smart growth to also be inclusive growth? (Risks and rewards) (Mazzucato 2016, p. 142)

The third question about the structure of public organisations is not of concern in this report but the other elements set out a new way in which a dynamic relationship between the private and the public sector can be conceptualised with governments setting a macro-level framework. It provides a useful way to create social value as it helps break down challenges into problem-solving missions in the specific context of socially embedded markets:

> While identifying key societal challenges is straightforward – climate change, aging, resource security, housing, urbanization, etc. – translating challenges into concrete missions will require the involvement of an array of stakeholders concerned with sectors and socio-technical fields affected by the challenge itself. Therefore, defining the direction of investments should be based on sound diagnosis of each challenge by the state together with other stakeholders. (Mazzucato 2016, p. 153)

Putting together these different elements leads to a refined stakeholder view of strategic management. (Freeman 2010) Socially embedded markets are composed of stakeholders and addressing key societal challenges, i.e. creating social value, requires their involvement in the definition of the problem, the design and pursuit of outputs and the joint evaluation of outputs and outcomes. There is also a general common interest of private and public institutions to improve their problem-solving capabilities.

The area of innovation is the crucial area of private and public engagement for two reasons. First, the persistence of many key social problems suggests that existing tools and approaches to tackling them have not been successful, so new innovative ways of addressing them are needed. Second, one of the key economic problems that form the backdrop for both CSV and new approaches to public policy has been fairly sluggish economic growth. There is even a global discussion about so-called ‘secular stagnation’, which is the idea that the world has entered a period of structurally weak economic growth. (Summers 2016) If economies are to return to a more satisfactory growth performance, fostering innovation, especially in areas that could provide solutions to some of the most pressing social problems, is a key task.

The author has established the similar background of CSV and recent thinking in public policy as well as the mutual and dynamic relationship between the private and the public sector. Furthermore, the importance of the social context and stakeholders in understanding markets and the wider arena to create social value has been stressed. The remaining question is how businesses can practically operationalise this broader view of CSV to expand the possible areas of shared value. The key here is a mutual understanding and alignment of interests. The concept of non-market strategy allows for utilising this richer contextual understanding and translating it into clear operational activities.

Chapter 5

Operationalising CSV Beyond the Firm: Non-market Strategy and Corporate Diplomacy

5.1 Understanding Non-market Strategy and Corporate Diplomacy

The academic field of strategic management has traditionally been divided into two approaches. The *outside-in* approach, also often referred to as Market-Based View (MBV), takes external factors such as consumer preferences and market conditions as a starting point and develops strategies from this point of departure. On the other hand, the *inside-out* approach or Resource-Based View (RBV) starts with a firm's internal capabilities and develops strategies from there. It has been argued that the lack of integration between both approaches has often been an obstacle to further knowledge advances and thus a more holistic view of the process is desirable. (Baden-Fuller 1995)

Both approaches, however, miss another crucial element of strategic management: the non-market environment that plays an increasingly important role in the semi-globalised economies that characterise contemporary capitalism. (Ghemawat 2012) This important omission was addressed by David Baron, who argued that comprehensive strategic management, or integrated strategy as he called it, needs to conceptualise market as well as non-market components. He also provided a clear outline of what the non-market environment includes:

> The nonmarket environment includes those interactions that are intermediated by the public, stakeholders, government, the media, and public institutions. These institutions differ from those of the market environment because of characteristics such as majority rule, due process, broad enfranchisement, collective action, and publicness. The interactions in the non-market environment may be voluntary, such as when a firm adopts a policy of developing relationships with government officials, or involuntary when government regulates an activity or activist groups organize a boycott of a firm's products. (Baron 1995, p. 47)

This broader view of the elements of strategic management is also closely related to the emerging field of corporate diplomacy. Traditional lobbying comprises the direct representation of corporate interests to the outside world whereas the notion of corporate diplomacy includes the senior level development of lasting relationships with external stakeholders. Crucially, as Witold Henisz defined corporate diplomacy, building these relationships serves the pursuit of economic value by helping those stakeholders deliver *on their own aims*. (Henisz 2014a) Who are the relevant stakeholders in this context? The answer provided by Henisz shows a clear similarity to CSV:

> There is both a short and a more subtle longer answer to that. The short answer is the stakeholders who can do you the most financial harm are the most important. (…) A fuller answer is we want to focus on the stakeholders with whom a productive relationship — a relationship in which we're helping that stakeholder obtain his or her objectives — is delivering on shareholder values. (Henisz 2014b)

At its core, corporate diplomacy in this definition is about shared value: economic value for the corporation and wider social value by helping external stakeholders pursue their aims. This focus also provides clear criteria for the selection of stakeholders – those who can damage you and those who can help you progress in the medium to long term – and alludes to the key component for increasing the space for CSV: the alignment of private and public interests.

In operational terms, David Baron's four Is approach – addressing issues, institutions, interests and information – provides a valuable tool for operationalising CSV beyond the firm. (Baron 1995) The focus here is, however, on the concrete steps of Baron's approach as his general distinction between a market and a non-market environment does not correspond with an understanding of markets as socially embedded. His operational categories are nevertheless also applicable to an embedded market view.

In essence, these elements allow you to map and understand the dynamics between the specific stakeholders of socially embedded markets and develop concrete action plans. Adopting a pro-active corporate diplomacy approach is also advisable as those stakeholders who can hurt a company's bottom line are often also those that can force a company into involuntary interaction in the non-market environment to use David Baron's language. Building lasting relationships with a view to minimising economic risk and maximising future potential is hence compatible with the aim of expanding the scope of CSV.

Understanding the dynamics of the non-market environment is also crucial as aims and preferences of key stakeholders are not given but are endogenous to the environment itself and therefore the result of dynamic interaction. The agenda of public policy is for instance directly shaped by public information, elections and the way in which policy-makers interact with stakeholders such as businesses and civil society groups. This permanent pattern of action, feedback and reaction also makes it necessary to understand engagement in the non-market environment as a permanent mission and not as ad hoc interaction. As demonstrated social value can often only be evaluated after a certain period of time when the full impact of outputs and long-term outcomes become measurable. A systematic CSV approach therefore also requires permanent engagement with the non-market environment. Core ideas around the concept of corporate diplomacy can be a useful guide on how to develop this permanent engagement and the required internal structures and procedures. (Watkins et. al. 2001)

5.2 The Non-market Strategy Pyramid and the Four Is

David Baron argued that the non-market strategy system is based on four steps set out in his Non-market Strategy Pyramid. The very first step is what this report seeks to help provide: a choice of conceptual frameworks that assist managers in understanding the specific environment, their own organisation in this context and the dynamics at play. The second step involves scrutiny of a company's core strategies such as its mission and values, market strategy and its general approach to interacting with external stakeholders. Third, concrete policies need to be formulated that guide action in decentralised organisations. And fourth, action plans to directly address non-market issues need to be developed and executed. (Baron 1995b)

The dynamics, according to Baron, are based on the so-called rent-chain and distributive politics. Analogous to the value-chain in competitive strategy, the rent-chain describes who has something to gain - or lose - as a result of non-market issues. The critical role of public policy is also acknowledged by Baron as it is public institutions that ultimately are the key decision-makers in non-market issues:

> The outcome of many nonmarket issues is ultimately determined by the distribution of costs and benefits that flow from the alternatives addressed by public institutions. The basic principle of distributive politics is that the greater the rents affected by a non-market issue, the greater the incentives to act to protect or increase those rents. The basic principle of the rent chain is that a company can increase the aggregate amount of action (...) by enlisting the participation of those earning rents. The relationship between policy alternatives and those rents is then the link to strategy. (Baron 1995b, p. 80)

The two steps above provide a guide for operationalising non-market strategies including CSV inside and outside a company. Within the firm a suitable process is following the stages of the Non-market Strategy Pyramid. In the wider stakeholder environment building alliances of those who expect positive rents or those who seek to avoid negative rents, i.e. those players who have common interests, is a crucial step. In the context of CSV public policy institutions should be considered crucial external stakeholders due to their critical role in determining and creating social value as well as their decision-making power. The alignment of private and public interests should also be seen as a strategic activity rather than something that is or is not given. This is particularly important when it comes to the creation of future value and addressing pressing social issues through innovation.

On the basis of this procedural guideline, the four Is put forward by Baron allow for tailoring the expansion of CSV activities. At the beginning, the definition of *Issues* is a requirement. What are the social issues that a company would like to or can address? And what is the link between these social issues and potential economic value for the company? These issues could vary significantly from company to company and even from place to place in the case of globally operating firms. Is the social issue addressed a macro problem such as the generation of green energy solutions? Or is it a localised issue such as the involvement of companies in specific communities? The latter element also relates to the cluster component of CSV. It is quite feasible that companies engage in different issues in countries where they have production facilities compared to where they are headquartered. The choice of issues is a critical first step for the creation of social value and hence CSV.

Second, the *Institutions* involved need to be identified and analysed. The author already made the point that public institutions necessarily need to be part of institutional alliances for expanding the scope of CSV but depending on the issue there are of course also many more potential allies in the pursuit of social value. If the issue is clean energy, alliances with environmental NGOs for instance can be valuable. If the issue is some sort of social value for workers the inclusion of the social partners – trade unions and employer associations – could be very important. It is also paramount not only to consider direct alliances but also second order effects in other institutional contexts. In economic systems based on tripartism for instance, the social partners have other formal consultation, negotiation and cooperation partnerships with governments and building first order alliances around an issue can also help to influence interactions in other institutional settings in which the company is not directly involved. Mapping the key stakeholders, of course, also involves identifying potential adversaries that could create costs rather than value.

Third, on the basis of this institutional analysis, the *Interests* of key players need to be understood. This is a dynamic process and in the case of public policy involves being active in the policy development process that precedes the formulation of specific positions towards an issue. For the pursuit of social value the alignment of interests is crucial and necessarily involves a negotiation process. As was established above, the definition of what social value is as well as the means to measure it require agreement amongst the key players in order to be legitimate. This process of interest alignment is hence quite different from mere external interest representation and allows for building positive long-term relationships as indicated by the corporate diplomacy literature.

Fourth, the role of *Information* is critical for the formation of interests and the creation of social value. A company can be proactive in identifying and framing social problems it would like to address and approach the relevant stakeholders with this information. Especially when innovation is the connective tissue between private and public initiatives to address pressing needs, information is key. This involves being active in knowledge generation and dissemination as well as interacting with other information providers. Media campaigns, traditional marketing and newer forms of content marketing based on high value information (Rowley 2008) could also be included in information related activities.

Operationalising CSV beyond the firm in this way is also a step to appreciate the general external affairs function of firms, especially vis-à-vis governments. According to the fifth McKinsey Global Survey on external affairs, 42% of all executives surveyed stated that regulators are important stakeholders and even two thirds think that the role of government and regulators will become yet more important in the coming years. (McKinsey & Company 2016)

At the same time, companies have been struggling with their own external affairs capabilities:

> When asked how well their companies tailor their narratives to individual stakeholders, only 17 percent of respondents say they are very effective, down from one-quarter of respondents in 2012. (...) What's more, few executives report that their companies are actively engaging with stakeholders. Just one-quarter say that in the past year, their companies have taken a very active approach to engaging with governments and regulators; 30 percent, by contrast, say their approach is either very or somewhat passive. (McKinsey & Company 2016)

Fully engaging in CSV beyond the firm, and doing it effectively, can therefore also be a real competitive advantage in an economic environment that is becoming more complex and difficult to navigate.

Chapter 6

Conclusion

The analysis presented in this report started with a clear business problem: how can the scope of CSV be expanded by providing a clearer understanding of how to operationalise the concept beyond the firm?

To address this problem, the author first of all explained the general context of CSV as an attempt to redefine the purpose of companies in the wake of the general discussion about the future of capitalism before critically examining the concept itself. It became clear that the strength of Porter and Kramer's idea lies within the firm and in the way in which CSV helps to reconfigure competitive strategy. However, it also became apparent that there are significant gaps in the conceptualisation of the environment beyond the firm that in effect limit the application scope of CSV, not least because there is no serious attempt by Porter and Kramer to define social value.

In the following chapter, the author explained the shortcomings of CSV's market concept and why deeper scrutiny of socially embedded markets is necessary to start building a better understanding of the role of stakeholders, changing institutional structures and the dynamics at play. Shifting consumer preferences too, identified by Porter and Kramer as not acted upon needs, can only be analysed if they are understood as endogenously created in socially embedded markets rather than exogenously given. Based on this understanding the author argued that in the absence of a general definition, social value consisting of outputs and outcomes can only be legitimately created and measured if there is agreement amongst relevant stakeholders, which crucially includes public policy-makers.

In the analysis of recent public policy thinking, the mutual relationship between private and public activities was examined. The failure to prevent economic hardship has also been the starting point for rethinking the role of public policy and led to the need to re-establish problem-solving capabilities. At the most basic level, this need to recapture the ability to address social needs by both private and public players creates a basic alignment of interests that can be harnessed in specific CSV settings. Mariana Mazzucato's recent work explained how added value can be created if the macro-micro role of public policy is more aligned with the micro-macro role of businesses, especially in the area of innovation.

The introduction of new conceptual frameworks directly relates to the first stage of Baron's Non-market Strategy Pyramid and leads into a clear guide for the operationalisation of CSV beyond the firm based on corporate diplomacy principles and the concrete tools provided by Baron's four Is framework that can be amended by quantitative as well as qualitative measurement tools as required by the specific context.

In essence, the author sought to show how a deeper contextual understanding of CSV can help expand its application scope and make it also interesting for public policy-makers, who could then perceive it as actively assisting towards their own aims. This in turn would provide companies with the opportunity to widen as well as deepen their stakeholder engagement and thus appreciate their external affairs capabilities in times in which active stakeholder engagement is fast becoming a crucial business activity.

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