# Can legal reforms rescue business back from greedy shareholders?

## *By Wayne Visser*

The notion of a social enterprise – a business that explicitly strives to create wider societal benefits, rather than focusing narrowly on shareholder returns – is not new. In the 1700s and 1800s, a charter of incorporation was only bestowed on those businesses that were socially useful – for example, water utilities or railroads.

As Joel Bakan, legal academic and author of The Corporation, explained to me: "The original notion of the corporation was that the sovereign would grant the status of corporation to a group of business people in order to acquit themselves of some responsibility to create something that was in the public good ... the notion that this was simply about creating wealth for the owners of the company was alien."

The 18th and 19th centuries also saw the birth of the co-operative and credit union movements, initially in Britain, France and Germany, and later spreading across the globe. Today, according to the International Co-operative Alliance, more than a billion people are members of co-operatives worldwide, with co-operatives providing 100m jobs (20% more than multinational enterprises).

The economic activity of the largest 300 co-operatives in the world equals that of the 10th largest national economy. In the US alone, there are more than 29,000 co-operatives, accounting for more than $3tn (£1.9tn) in assets, generating more than $500bn in revenue and $25bn in wages.

Despite these noble roots, and the existence of co-operatives as an institutional alternative, the modern corporation with its with short-term, shareholder-driven mission has come to dominate our global economic landscape. Multinationals especially are seen by a growing tide of critics as not only failing to act in the interests of the public good, but as being agents of wholesale value destruction in communities, economies and the environment.

Bakan goes so far as to argue that today's companies are pathological in nature, in the sense that "the corporation has a legally defined mandate to relentlessly pursue – without exception – its own self-interest, regardless of the often harmful consequences it might cause to others."

Partly in reaction to the growing power and impact of big business, we have seen the rise of another counter-movement over the past 40 years, focused on social and environmental entrepreneurs. Among early pioneers were the Ashoka Foundation (established in 1980), Fundes(1985) and the Social Venture Network (1987), with a new wave of momentum coming from high profile cash injections by the Schwabb Foundation (1998) and Skoll Foundation (1999) and books like The Power of Unreasonable People by John Elkington and Pamela Hartigan.

Within the big corporates over the same period, corporate social responsibility and sustainable development programmes have gained ground, moving through defensive, charitable, promotional and strategic stages, as I have described elsewhere. However, in the face of growing pressure to prioritise their fiduciary duty towards shareholders, these CSR and 'triple-bottom line' efforts have been widely criticised as little more than window-dressing and corporate spin, and largely ineffective in tackling our most pressing social and environmental crises.

### Legal solutions

The solution, say a new breed of business activists, is to change the legal obligations of corporations, in order to resolve the growing conflict between their fiduciary duty to shareholders and their ethical accountability to other stakeholder groups. Encouragingly, the regulators seem to be listening, as evidenced by a spate of new legal corporate structures being promulgated around the world which are specifically designed to recognise and support social enterprises.

The UK's community interest company (CIC) structure was among the first. In terms of the legislation, a CIC is a limited liability company in all respects, but has an explicitly stated social purpose and is committed to reinvest its profits and assets in furthering those social aims. According to the CIC regulator, more than 6,000 community interest companies had registered by January 2012.

The US followed in 2007 with the introduction of the benefit corporation, or B-Corp, as proposed by B Lab, a not-for-profit organisation, which initiated a certification system for companies interested in distinguishing themselves as socially responsible. Unlike other certification schemes such as the ISO 14001 or SA 8000, the B-Corp system has gone on to be legally recognised as a new institutional form in 12 US states, with 15 more states planning recognition in 2013.

According to Dermot Hikisch, B Lab's head of community development: "B-Corps are now found in virtually every industry with some like Agora Partnerships being set-up as social enterprises from day one, while others like Ben & Jerry's come from traditional industries and have found a way to do things better.

Last year Ben & Jerry's became the first wholly owned subsidiary in the world to be certified as a B-Corp. Chief executive Jostein Solheim noted: "When Ben & Jerry's was acquired [by Unilever], many folks thought it would be a challenge for the company to keep its values." Now, B-Corp certification is "the chance to affirm that we remain true to our mission and look to accelerate our social impact."

Arts & crafts e-commerce site Etsy, used its B-Corp certification to help secure funding of $40m. According to chief executive Chad Dickerson, it "gave us a framework to measure Etsy's success against rigorous values and responsible practices as we scale as a company."

In the US, there is also the option to register as a low-profit limited liability company (L3C), now legally recognised in nine states. It allows similar benefits to other social enterprise forms, but is specifically designed to qualify as a program-related investment (PRI), which is one of the ways foundations can satisfy their obligation under the Tax Reform Act of 1969 to distribute at least 5% of their assets every year for charitable purposes.

A further and more recent variation is the flexible purpose corporation (FPC) in California. It is intended to allow shareholders to determine for themselves their own preferred mix of social and economic corporate objectives. According to Hikisch: "It may help a larger company's executives have safe harbour for following a single social mission, but there's no requirement to consider all stakeholders and no requirement as to the scale of the impact."

However, Hikisch thinks it unlikely to be widely adopted by social enterprises because they aren't obligated to pursue generalised public benefit nor required to measure their performance against any third-party standard.

There are a number of major benefits in these new legal forms of incorporation for social enterprises and responsible companies. First, there is the possibility of brand differentiation, with its associated reputational kudos. Second, it may improve access to capital or funding, even though there are no direct tax benefits. Third, and perhaps most important, it can give directors a shareholder mandate to pursuit broader stakeholder value beyond financial returns. It may also be a weapon in the so-called 'war for talent' – a way to signal to potential and existing employees that the business has a more noble purpose than money-making.

Ultimately, if corporations are successful in shapeshifting – right down to their legally constituted core – perhaps business will even be able to discard the mantle of the psychopath and be accepted back into the community as a rehabilitated corporate citizen.

**Article reference**

Visser, W. (2013) Can legal reforms rescue business back from greedy shareholders? *The Guardian*, 23 February 2013.

**Source**

Published as part of Wayne Visser's International Sustainable Business column for *The Guardian*.

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