

Perspectives/Initiatives

Designing Social Value Architecture for the For-Profit Company

CAROL LIAO

University of British Columbia and Tyze Personal Networks Ltd.

For-profit companies are typically excluded from analyses of the social economy, and with good reason. The concept of shareholder primacy is deeply rooted within the modern corporation's organizational design – pursuing anything other than shareholder wealth is tantamount to bad governance (Berle & Means, 1932). Social gains that occur as a result of corporate actions are always ancillary or subordinate to the primary goal of profit-making. But what is to be said about the emergence of international corporate structures that embed non-profit characteristics into their governance models? Entities such as the “low profit limited liability company” and “benefit corporation” in the US and the “community interest company” in the UK are some alternative models for businesses that produce ongoing social value in addition to profits. If shareholders face restrictions on the amount of dividends they can receive, if directors are obligated to consider community interests when determining the best interests of the company, should these companies be excluded from the social economy conversation? What if a company has a built-in asset lock that requires all of its assets and profits be used only for community purposes? Conceptual boundaries surrounding the social economy are being challenged as hybrid corporate models begin to grow and gain recognition.

To date, these hybrid corporate structures are not recognized in Canada, nor are any policies in place to support and maintain social value creation by private Canadian companies. The increased use of social appeals by the private sector has left many confused as to what to make of the seemingly virtuous for-profit company. “Greenwashing” (where companies spend significantly more time and money on “green” advertising than on environmentally-sound practices) and other negative trends have caused many to question the sincerity of these businesses. This is unfortunate for earnest entrepreneurs who, in addition to generating profit, seek to improve human welfare through their work and would like to identify themselves as trustworthy social businesses in the marketplace.

So how do for-profit companies govern themselves in the act of social value creation when there are no existing policies in place? This article offers three initiatives as a starting point for Canadian social entrepreneurs who (a) are eager to use the engine of a for-profit business to market their goods and services and (b) consider the contribution of social value essential to their companies' success. The three initiatives provide the foundations for basic, yet fundamental, architecture for interested companies. In addition to providing practical information for social entrepreneurs, these initiatives highlight a gap in Canadian policy. The emergence of hybrid corporate models on the international stage suggests a unique sector of the social economy is

beginning to form. It is critical that Canadian federal and provincial governments address growing demands by establishing policies to govern businesses in the dual mission of profit and social value creation.

The placement of this article within this special issue is to contribute to a scrutiny of the tensions facing the interdisciplinary study of corporate law and social policy. Just as for-profit companies have been omitted from the social economy, policies governing corporate actions have not generally been regarded as “social” policies. The advancement of corporate social responsibility (CSR) and its convergence with the Green movement causes one to question this exclusion, as governments continue to endorse local and international policies that promote social, economic, and environmental sustainability from companies. Social policy can be understood as guidelines for the changing, maintenance, and/or creation of living conditions that are conducive to human welfare. Under that definition, should policies that encourage companies to reduce their carbon footprint, for example, be classified differently from policies that encourage reductions from citizens? Even if CSR policies are not accepted as social policies, those that support new corporate forms and result in social gains should not be met with such resistance. Excluding businesses from the conversation had its place in the past – resources are scarce and there are legitimate concerns that public financing may be redirected away from those in greatest need. But if companies are willing to change their mandates to include the dual pursuit of economic and social value, it may unlock an unprecedented influx of private cash towards social good. As the need for new policies and greater access to capital become increasingly apparent in Canada, it is important to explore ways for businesses to contribute to the nation’s evolving social economy.

Select Initiatives

Codify Stakeholder Interests

In order for businesses to effectively embed social value creation in their architecture, it is vital that company directors be permitted to consider stakeholder interests in corporate decision-making. In this context, stakeholders are defined as constituents other than shareholders, including end-users, clients, customers, employees, suppliers, and creditors, as well as the broader community and environment.

In the US, directors are discouraged from considering external stakeholder interests, but the situation is different in Canada. The 2008 decision of the Supreme Court of Canada (SCC) in *BCE Inc. v. 1976 Debentureholders* confirmed that directors owe their fiduciary duty to the corporation in all circumstances. In deciding what constitutes the best interests of the corporation, the SCC provided directors with flexibility to consider the interests of other stakeholders. Further, the court held that best interests are not confined to short-term profit or share value. Where the corporation is a going concern, the board should focus on long-term interests. This is in contrast to the duty applied by the court in the often-cited Delaware case in the United States of *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* (1986), where directors were found to owe a fiduciary duty to maximizing shareholder value.

The legal distinction made by the SCC means a Canadian company can confidently amend its constating documents to permit its directors to consider stakeholder interests. A company may also choose to identify particular stakeholder interests it finds central to its mandate, such as the interests of the community in which it operates. These changes can ease directors’ concerns regarding the determinations of a company’s best interests, while also making the board more effective in supporting a company’s dual mission.

Codifying stakeholder interests also mitigates the risk of shareholder claims that could be

made as a result of stakeholder interests being given a higher priority than the maximization of share value. In this sense, the legal amendment does challenge the traditional understanding and identity of the for-profit company. In addition, codifying these interests helps to reinforce and communicate to investors a seemingly more “Canadian” way of governance that is not particularly evident in the common law.

Create a Dual Mission Statement

While a mission statement is valuable for any business, it is imperative that a company seeking to establish itself as a dual mission company say so publicly. This initiative is meant to go beyond typical CSR declarations that have come to populate present-day mission statements. The company should make it explicit that creating social value and generating a return for investors have equal value within the company. In particular, a company should state how it is contributing social value to the community (in a manner that is specific to that company) and pinpoint how this mission is reflected in its governance structure. This second element is important; corresponding actions (such as those found in the other two initiatives) need to occur for the dual mission statement to be meaningful.

Using basic concepts echoed within the CSR movement, it would not make business sense for a company to deviate from a dual mission statement that it voluntarily publicizes. Failing to adhere to its own set principles would be bad for business. Thus, disseminating its dual mission statement to customers, suppliers, and other constituents – on its website and through other means (such as marketing materials, annual reports) – would have an operational impact on the company, and be a visible cue to investors both social and otherwise. Since such statements (if properly imprinted within the corporate culture) could form an integral part of the business, it could extend the life of the dual mission upon a change of control or exit of key players.

Create an Annual Social Audit Report

A company may choose to be the subject of a social audit report that echoes some of the provisions found in the benefit corporation laws of Maryland and Vermont. Those laws require companies to create a benefit report that is mailed out to shareholders at the end of the fiscal year (Maryland, 2010; Vermont, 2010). The details of a report can be loosely based on those suggested in the benefit corporation laws as well as other sources (Mulgan, 2010; Tuan, 2008), including:

- (a) a description of the way the company pursued social value during the year and the extent to which the social value was created;
- (b) a description of how the company measured its social value creation;
- (c) a description of any circumstances that hindered the company from creating social value, and ways the company could improve; and
- (d) an overall assessment of the social impact and performance of the company.

There are particular challenges facing companies attempting to create a social value report. International hybrid models have left it largely up to the company to provide the methodology for calculating their social value (Maryland, 2010; Vermont, 2010; United Kingdom Companies, 2004). Several big picture issues involved with measuring and/or evaluating social value include: (a) inconsistent use of language; (b) lack of common measures in the social sector; (c) lack of quality data on social impacts, outcomes, outputs, and cost; (d) lack of incentives for transparency; (e) unintended consequences; (f) inadequate utilization; and (g)

the cost of measurement (Tuan, 2008, p. 18). These concerns should be kept in mind by companies looking to provide credible self-governance of their social value creation, and by Canadian policymakers and legislators who seek to hybrid models in the future.

To enhance the accuracy of findings in the annual social value report, and to assist the board and management in their duties and responsibilities to the company, companies should give due consideration to stakeholder feedback. Under the United Kingdom community interest company (CIC) governance structure, CICs are recommended to form stakeholder advisory groups for the CIC's benefit (United Kingdom Companies, 2004). Each CIC crafts its own individualized stakeholder process and is required to describe its stakeholder efforts in an annual report which the CIC Regulator reviews. There are a myriad of ways for businesses to obtain stakeholder feedback, such as collecting detailed information from individual clients, using incoming and outgoing client surveys, and conducting employee interviews both internally and through third parties.

The social audit report can be adapted to fit the financial capabilities of the particular company. For example, a new company's report can be relatively simple and produced in-house, but as the company grows, it can reach the level of complexity that may involve outside auditors if the company so chooses.

A Starting Point

While corporate law and social policy understandably make strange bedfellows, there is value to be unearthed from such an alliance. With public dollars stretched thin, it is critical to engage the for-profit sector in the creation of social value. Policies need to be put in place to foster this development and governments elsewhere seem to be moving in this direction. Until policies are implemented in Canada, the above initiatives provide a framework for interested entrepreneurs to engage in a "DIY" method of governing their companies' own social value creation.

A Canadian way is important. Our highest court has confirmed that Canadian corporate governance fundamentals are distinct from those in the US. While there are encouraging American examples of privately certifying "good" companies, Canada should not have to look southwards for direction in this area. Establishing the corporate pursuit of both profit and social value creation is not only feasible, but within our grasp. In addition to governmental action, the effective development of this unique and embryonic sector of the Social Economy will require an ongoing, participatory dialogue among social and corporate sector proponents. Cross-sector dialogue is the critical first step.

References

- BCE Inc. v. 1976 Debentureholders*, [2008] 3 S.C.R. 560.
- Berle, A. & Means, G. (1932). *The modern corporation and private property*. *Maryland Benefit Corporations Act*, s. 690 (implemented April 13, 2010).
- Mulgan, G. (2010) Measuring social value. *Stanford Social Innovation Review*, (8)3, 38-43.
- Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).
- Tuan, M. (2008) Measuring and/or estimating social value creation. Prepared for the Bill and Melinda Gates Foundation. Retrieved from <http://www.gatesfoundation.org/learning/documents/wwl-report-measuring-estimating-social-value-creation.pdf>.
- UK Companies (Audit, Investigations, and Community Enterprise) Act 2004*, c. 27. *Vermont Benefit Corporations Act*, s. 263 (implemented May 19, 2010).