Beyond Profit

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Etsy was a crown jewel of socially responsible businesses. It prioritized female entrepreneurship, its employees, and environmental stewardship. It was widely admired as a company pursuing social goals alongside profit goals. But after scaling up through an IPO, Etsy fell apart both socially and financially. Similar stories proliferate in the world of socially conscious business. What happened? Standard accounts point to greedy investors, capitalism, and short-termism as the culprits.

But this Paper identifies a more fundamental problem: business law is not designed to facilitate scale-ups for companies that articulate objectives beyond profit. It lacks a durable commitment mechanism for these companies to bind themselves to long-term pursuit of their multiple objectives. To help address this problem, the Paper argues for providing a voluntary commitment mechanism in business law. The proposed commitment mechanism would require multiple stakeholder board representation and socially conscious executive compensation for public benefit corporations that IPO, get acquired, or exceed a certain size. Such legislation could better enable companies to bind themselves to their objectives beyond profit at scale — facilitating large-scale social impact instead of just large-scale profit.

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INTRODUCTION

In 2015, Etsy was a crown jewel of the movement for socially conscious business, simultaneously pursuing multiple objectives beyond profit. It successfully operated for over ten years fulfilling its objectives to treat its employees well through its distinctive and compassionate company culture, to help entrepreneurs — and especially female entrepreneurs — make a living selling their homemade goods online, and to maintain high environmental standards.[1] Etsy was one of the largest certified B-Corps in existence, meeting rigorous standards set by a third-party nonprofit certifier for the pursuit of social and environmental goals in business. The company also did well financially.[2] After a decade it was ready to scale up, which it did through an initial public offering ("IPO"). Etsy's IPO was one of the first ever for a certified B-Corp.

But fast forward two years and Etsy had fallen apart both socially and financially, despite its attempts to preserve its multiple objectives through private ordering.[3] Several activist investors acquired stakes in the company and elected new members to the board, which abruptly laid off eighty employees and fired the beloved CEO in dramatic fashion.[4] The board appointed a successor with a single-minded profit

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1 David Gelles, *Inside the Revolution at Etsy*, N.Y. TIMES (Nov. 25, 2017), https://www.nytimes.com/2017/11/25/business/etsy-josh-silverman.html [https://perma.cc/GAN8-EJGZ]; *see also* Nikita T. Mitchell, *Etsy Made Mistakes, But Its Commitment to Social Responsibility Wasn't One of Them*, QUARTZ (Dec. 5, 2017), https://qz.com/work/1146365/etsy-made-mistakes-from-which-other-b-corps-can-learn/ [https://perma.cc/5NGM-UFHU]; Adele Peters, *Will Etsy Keep Its Commitment to Social Good After Its Management Shakeup?*, FAST COMPANY (May 4, 2017), https://www.fastcompany.com/40418325/will-etsy-keep-its-commitment-to-social-good-after-its-management-shakeup [https://perma.cc/9MPE-TNNH].

2 *See* Etsy, Inc., Registration Statement (Form S-1), at 2 (Mar. 4, 2015).

3 *See* Gelles, *supra* note 1; Mitchell, *supra* note 1; Peters, *supra* note 1. "Private ordering" refers to the development of firm-specific governance terms, which companies develop to achieve their individual organizational aims. Firms do so particularly through corporate governance measures, such as their articles of incorporation or bylaws, but private ordering could also include implementation of organizational practices or other forms of private enforcement. *See* Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CALIF. L. REV. 373, 378 (2018) [hereinafter *Governance by Contract*]; Jill E. Fisch, *Leave It to Delaware: Why Congress Should Stay out of Corporate Governance*, 37 DEL. J. CORP. L. 731, 743 n.80 (2013); D. Gordon Smith, Matthew Wright & Marcus Kai Hintze, *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 127 n.12 (2011); *see also* Ofer Eldar, *The Role of Social Enterprise and Hybrid Organizations*, 2017 COLUM. BUS. L. REV. 92, 165 [hereinafter *Role of Social Enterprise*]; Steven L. Schwarcz, *Private Ordering*, 97 NW. U. L. REV. 319, 321 (2002).

4 Gelles, *supra* note 1; *see also* Mitchell, *supra* note 1.

focus, who cut projects and laid off an additional 140 employees.[5] Online sellers' dissatisfaction and mistrust of the company grew.[6] Employees felt betrayed.[7] And in a culminating move, the company announced it would not seek recertification as a B-Corp, tolling the formal loss of the social purpose objectives.[8] Etsy has since bounced back and experienced conventional financial success — but it never reclaimed its previous commitment to multiple objectives.[9]

The story of a company losing its multiple objectives after scaling up is a common one, whether the company chooses to scale through an IPO like Etsy, or through another avenue such as an acquisition.[10] Take, for example, Kashi's demise after it was acquired by Kellogg,[11] Plum Organics' stagnation after it was acquired by Campbell's, or Hello Fresh's difficult post-acquisition integration of Green Chef.[12] This Paper examines why companies that explicitly articulate objectives other than profit maximizing face such challenges in scaling up. And it shows that part of the problem (and solution) is found not in market demand or the firm's operations, but rather in the structure of business law.

[5] *See* Gelles, *supra* note 1; Mitchell, *supra* note 1.

[6] *See* Gelles, *supra* note 1; Mitchell, *supra* note 1; Peters, *supra* note 1.

[7] *See* Gelles, *supra* note 1; Mitchell, *supra* note 1; Peters, *supra* note 1.

[8] *See* Gelles, *supra* note 1; Mitchell, *supra* note 1.

[9] Etsy, YAHOO! FINANCE, https://finance.yahoo.com/quote/ETSY/history/?guccounter=1&guce_referrer=aHR0cHM6Ly93d3cuZ29vZ2xlLmNvbS8&guce_referrer_sig=AQAAAKYgB1_qyVr4lE-aF5Fmex3tHYokS6ZfH1AehruNNMtRD7vbAAfdUPYPrZwj95wd4XGwfe2tfZa4Zbzs8qjQbjYAuUwXrHblqRKPIuKYQtKQhekzi5nfGyRP76JxKoDr3wfuzai2mSglyauTJm2krVd5pU_r9T7r-h-dbE5ryNnP (last visited February 27, 2021) [https://perma.cc/A2KQ-WNZQ]. It should also be noted that Etsy experienced significant increases in its share price beginning in March 2020. From March 2020 to August 2020, its share price doubled. This boost coincides with the pandemic and stay at home orders, suggesting it may relate to increased online shopping during this time period rather than representing a permanent boost.

[10] Although it is difficult to quantify because there is no central repository of IPOs and acquisitions of companies that pursue social purpose alongside profit, interviews with fourteen field sites, as well as with venture capitalists, suggest a considerable perception among practitioners that these acquisitions and IPOs lead to a loss of the pursuit of multiple objectives. *See* Part I.C.

[11] David Kesmodel & Annie Gasparro, *Inside Kellogg's Effort to Cash in on the Health-Food Craze*, WALL ST. J. (Aug. 31, 2015), https://www.wsj.com/articles/inside-kelloggs-effort-to-cash-in-on-the-health-food-craze-1441073082 [https://perma.cc/8F3E-EACH].

[12] Interviews with employees — from interns to executives — at fourteen different companies gave insights into some of these and other acquisitions. *See* Emilie Aguirre, Pairing Purpose with Profit (dissertation, Harvard Bus. Sch.) (forthcoming 2021).

Companies with objectives beyond profit offer significant potential for social and economic impact.[13] They can leverage economies of scope to help solve some of society's most pressing problems and address untenable externalities, sometimes even more effectively and efficiently than current approaches by the government or charitable sector, and other times as an important complement to these sectors.[14] For example, these companies can help address the labor inequality, burnout, and worker commodification they may generate, in ways tailored to the unique needs of their own firms and industries.[15] Companies with objectives beyond profit can often also address social and environmental externalities that both they and other firms generate. For example, a company may use data it already collects to improve the environmental or social impact of its products or its customers in ways

[13] *See* Alicia E. Plerhoples, *Social Enterprise as Commitment: A Roadmap*, 48 WASH. U. J.L. & POL'Y 89, 104 (2015) [hereinafter *Social Enterprise as Commitment*].

[14] Leveraging economies of scope refers to the practice of bundling production of a *variety* of products — rather than a quantity of products, as in the case of economies of scale. So, for example, one can think of Patagonia as leveraging economies of scope in producing both jackets and environmental benefit. *See* John C. Panzar & Robert D. Willig, *Economies of Scope*, 71 AM. ECON. REV. 268, 268 (1981). Companies that pursue objectives beyond profit can offer solutions that may be more efficient — that cost less or require less regulation and external monitoring to achieve. *See* M. Todd Henderson & Anup Malani, Essay, *Corporate Philanthropy and the Market for Altruism*, 109 COLUM. L. REV. 571, 602 (2009); Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017, 2064-67 (2007). *But see* Eldar, *Role of Social Enterprise*, *supra* note, 3 at 177-79; Brian Galle, *Keep Charity Charitable*, 88 TEX. L. REV. 1213, 1214-15 (2010); James R. Hines Jr., Jill R Horwitz & Austin Nichols, *The Attack on Nonprofit Status: A Charitable Assessment*, 108 MICH. L. REV. 1179, 1182-84 (2010). For more on the inefficiency of regulation to achieve social goals, see, for example, Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient Than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667, 667-69 (1994).

[15] In some cases, these companies can do so more effectively than outside players or outside regulation because they have the ability to directly set employee policies in ways outside players cannot. For example, a company is well-suited to hire a more diverse workforce or create a more diverse internship feeder program; or change employee policies around parental leave, hours worked, and vacation time; or to implement an organizational practice that values or empowers employees or solicits employee feedback. Employees also generally prefer to work at companies with objectives beyond profit, leading to better workplace fulfillment and labor outcomes. In fact, employees frequently trade lower salaries to engage in work with a sense of purpose. *See* Jing Hu & Jacob B. Hirsh, *Accepting Lower Salaries for Meaningful Work*, 8 FRONTIERS PSYCHOL. 1649, 1649 (2017); Shawn Achor, Andrew Reece, Gabriella Rosen Kellerman & Alexi Robichaux, *9 Out of 10 People Are Willing to Earn Less Money to Do More-Meaningful Work*, HARV. BUS. REV. (Nov. 6, 2018), https://hbr.org/2018/11/9-out-of-10-people-are-willing-to-earn-less-money-to-do-more-meaningful-work [https://perma.cc/QZD7-MB8B]; *see also* Gelles, *supra* note 1 (stating that employees took lower salaries to work at Etsy because it provided meaningful work).

that government regulation and nonprofit activity cannot achieve on their own.[16] In addition, current approaches often rely on significant piecemeal command and control legislation, such as in employment law, environmental law, or tax law, that can be inefficient in achieving social goals.[17] Multiple objective companies usually do not require much additional punitive or incentivizing legislation outside of business law to motivate their pro-social behavior because it forms part of their core organizational goals.[18] Government and charitable sector approaches also often require significant government or donative funding, due to the absence of self-sustaining revenue. In contrast, like all for-profit ventures, these companies are designed ultimately to succeed in self-sustaining ways that are not primarily reliant on donations, grants, or government support.[19]

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[16] Take, for example, Patagonia, which created entire supply chains of organic cotton production through its decision to source organic cotton in its products. FOREST REINHARDT, RAMON CASADESUS-MASANELL & HYUN JIN KIM, HARV. BUS. SCH., PATAGONIA 4 (2010). To take another example, another company in the tech sector uses data collected from its restaurant customers to help reduce their food waste much more effectively than a government mandate or external nonprofit organization could do on its own. In fact, that company partners with a nonprofit specializing in food waste to help produce this outcome — underscoring that the nonprofit would not be well-suited on its own without the data stewardship of the tech company. *See* Emilie Aguirre, *The Social Startup* (forthcoming 2022).

[17] *See, e.g.*, Kaplow & Shavell, *supra* note 14 (arguing that redistribution is accomplished more efficiently through the income tax system than through legal rules).

[18] *See generally* Stuart Albert & David A. Whetten, *Organizational Identity*, 7 ORGANIZATIONAL BEHAV. 263 (1985) (exploring the concept of organizational identity); Julie Battilana & Silvia Dorado, *Building Sustainable Hybrid Organizations: The Case of Commercial Microfinance Organizations*, 53 ACAD. MGMT. J. 1419 (2010) (analyzing the pro-social goals of microfinance organizations); Mary Ann Glynn, *When Cymbals Become Symbols: Conflict Over Organizational Identity Within a Symphony Orchestra*, 11 ORG. SCI. 285 (2000) (discussing implications for managing organizational forms); Anne-Claire Pache & Filipe Santos, *Inside the Hybrid Organization: Selective Coupling as a Response to Competing Institutional Logics*, 56 ACAD. MGMT. J. 972 (2013) (exploring the internal logistics of hybrid organizations); Wendy K. Smith & Marya L. Besharov, *Bowing Before Dual Gods: How Structured Flexibility Sustains Organizational Hybridity*, 64 ADMIN. SCI. Q. 1 (2019) (discussing sustainable hybrid organizations); Tyler Wry & Jeffrey G. York, *An Identity-Based Approach to Social Enterprise*, 42 ACAD. MGMT. REV. 437 (2017) (exploring social enterprises as a tool for addressing social and environmental problems).

[19] *But see* Eldar, *Role of Social Enterprise*, *supra* note 3, at 182. This analysis is not to suggest that for-profit companies — even those committed to social purpose alongside profit — should replace robust government and charitable activity to address societal problems, nor to suggest that traditional companies are completely unable to achieve these outcomes. Rather, it is to suggest that companies with objectives beyond profit can serve as an important complement, increasing social impact. *See generally* Albert & Whetten, *supra* note 18 (exploring the concept of organizational identity);

Founders can privately order companies in many ways to try to preserve their multiple objectives over the long term.[20] For example, they can incorporate as traditional general corporations, but add specific provisions to their charters articulating their objectives beyond profit.[21] They can incorporate as public benefit corporations ("PBCs"), which are legally required to pursue both social purpose and profit.[22] And regardless of their legal incorporation, they can privately contract to achieve social good, including for example by seeking B-Corp certification.[23] But — crucially — it seems that no matter how they privately order themselves, they cannot durably commit to their multiple objectives over the long term. The problem is particularly acute when these companies scale up: no matter which scaling avenue they pursue, they cannot systematically tie themselves to the mast of their multiple objectives. The inability to reliably scale limits their potential for larger social and economic impact. It requires them to choose between staying small in size or abandoning the multiple objectives in order to scale up.

Standard accounts of the failure to scale point to market forces. In this narrative, greedy investors, capitalism, and short-termism are the culprits, or the failure is simply accepted on the grounds that there is no demand for these companies.[24] These accounts often claim companies with multiple objectives must simply have inferior

Battilana & Dorado, *supra* note 18 (analyzing the pro-social goals of microfinance organizations); Glynn, *supra* note 18 (discussing implications for managing organizational forms); Pache & Santos, *supra* note 18 (exploring the internal logistics of hybrid organizations); Smith & Besharov, *supra* note 18 (discussing sustainable hybrid organizations); Wry & York, *supra* note 18 (exploring social enterprises as a tool for addressing social and environmental problems).

[20] *See* Plerhoples, *Social Enterprise as Commitment*, *supra* note 13, at 95.

[21] *See* DEL. CODE. ANN. tit. 8, § 101 (2020).

[22] DANA BRAKMAN REISER & STEVEN DEAN, SOCIAL ENTERPRISE LAW: TRUST, PUBLIC BENEFIT, & CAPITAL MARKETS 52-53 (2017); Dana Brakman Reiser, *Benefit Corporations: A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 597 (2011); *see also State by State Status of Legislation*, BENEFIT CORP., https://benefitcorp.net/policymakers/state-by-state-status (last visited Dec. 20, 2020) [https://perma.cc/Y2T2-L9LF] (showing that the thirty-seven states with benefit corporation statutes includes the District of Columbia).

[23] *See Certification*, CERTIFIED B CORP., https://bcorporation.net/certification (last visited Dec. 20, 2020) [https://perma.cc/Q4FC-W83T].

[24] *See, e.g.*, Marc Gunther, *B Corps: Sustainability Will Be Shaped by the Market, Not Corporate Law*, GUARDIAN (Aug. 12, 2013), https://www.theguardian.com/sustainable-business/b-corps-markets-corporate-law [https://perma.cc/CU85-56SC] (describing the maximization of profits as a market force).

underlying business models, or that pursuing objectives beyond profit is not possible or desired at scale.

But this Paper finds that these accounts miss a fundamental problem: business law is not designed to facilitate scale-ups for companies with multiple objectives.[25] Most importantly, business law lacks a durable commitment mechanism to enable long-term pursuit of multiple objectives beyond profit.[26] This problem is particularly acute when scaling up because of a dual-pronged loss of strategic and managerial control that founders experience over the board and the day-to-day operations of the company, respectively.[27] This Paper argues that no matter how these companies choose to legally incorporate, privately order themselves, or scale up, business law fails to provide them with a durable commitment mechanism to help counter these losses of strategic and managerial control at scale.

This commitment problem reduces these companies' potential for social and economic impact and limits founders' abilities to privately order themselves how they wish — in this case, to use a for-profit legal entity to pursue objectives beyond profit.[28] The lacking commitment mechanism also undermines contracts with key third-party stakeholders, who rely on the company's pursuit of objectives beyond

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[25] For example, the public benefit corporation law in Delaware was drafted especially with privately held companies in mind. Professor Haskell Murray refers to the 2015 DGCL public benefit corporation amendments as "the Etsy Amendments," due to a belief that a main motivation behind them was to make it easier for Etsy, and others, to become Delaware PBCs after going public. *See* J. Haskell Murray, *Amendments to Delaware PBC Law ("The Etsy Amendments")*, BUS. L. PROF BLOG (July 3, 2015), https://lawprofessors.typepad.com/business_law/2015/07/amendments-to-delaware-pbc-law-the-etsy-amendments.html [https://perma.cc/7WAP-3CWC].

[26] *See* Plerhoples, *Social Enterprise as Commitment*, *supra* note 13, at 91-92.

[27] The company usually experiences a loss of strategic control because it has accessed outside equity capital to scale, meaning the founders give up some ownership shares in the company in exchange for a capital investment. This dispersed share ownership leads to loss of control over the board — the body that makes high-level strategic company decisions. A company may also seek debt rather than equity financing. These companies can also experience losses of control due to the terms attached to restrictive covenants. *See* Robert P. Bartlett, III, *Shareholder Wealth Maximization as Means to an End*, 38 SEATTLE U. L. REV. 255, 257-58 (2015) [hereinafter *Shareholder Wealth*]; *infra* Part IV.B.1. At the same time, the company also experiences a loss of managerial control because of the scaled-up company's larger size, which reduces oversight and monitoring of day-to-day company decision-making that occurs at the managerial level. Such decisions include, for example, hiring, human resources, suppliers, distribution channels, customer relations.

[28] *See* J. Haskell Murray, *Social Enterprise Innovation: Delaware's Public Benefit Corporation Law*, HARV. BUS. L. REV., 345, 366-7 (2014); Plerhoples, *Social Enterprise as Commitment*, *supra* note 13, at 91-92.

profit.[29] There is even evidence that some investors and lenders will give favorable financing terms to companies that can credibly commit to the pursuit of multiple objectives beyond profit, due to lower long-term risk assessments.[30]

To help address this problem, the Paper advocates for providing a voluntary commitment mechanism in business law. The proposed commitment mechanism would consist of a two-pronged proposal that would require multiple stakeholder board representation and socially conscious executive compensation for PBCs that IPO, get acquired, or exceed a certain size.[31] Multiple stakeholder board representation would require equal representation between shareholder-elected board members and social purpose-elected board members. The social purpose board members might consist of employees, nonprofit charity members, or academics, and would be elected by a third-party coalition of disinterested non-shareholders aligned with the company's social purpose objectives. Socially conscious executive compensation would link a substantial proportion of executive pay to achievement of certain

[29] For example, investors and lenders make significant financial investments in the firm and seek certainty and stability in doing so. Employees may select the firm because of its pursuit of multiple objectives. Customers may only pay a premium for products from a firm with objectives beyond profit. *See* Murray, *supra* note 28, at 364-5 (describing assurances investors need when investing in companies committed to pursuit of both social purpose and profit); Plerhoples, *Social Enterprise as Commitment*, *supra* note 13, at 99.

[30] *See Danone's Positive Incentive Financing Strategy*, BNP PARIBAS (Aug. 3, 2018), https://cib.bnpparibas.com/sustain/danone-s-positive-incentive-financing-strategy_a-3-2238.html [https://perma.cc/3K7R-QBZ2]. If these commitments could be systematized, it could help shift funding toward socially oriented businesses with a long-term perspective, rather than being an unusual, notable example. In addition to investors, employees also make costly firm-specific investments. For them, a company's pursuit of objectives beyond profit may be a material factor in employment. Many scholars have shown how employee knowledge, skills, and abilities at a certain firm have limited value outside of a given firm, and that this firm-specificity encumbers mobility. Employees therefore likely rely on the certainty and permanence of the pursuit of multiple objectives over time. *See* Russell W. Coff, *Human Assets and Management Dilemmas: Coping with Hazards on the Road to Resource-Based Theory*, 22 ACAD. MGMT. REV. 374, 380 (1997); Nile W. Hatch & Jeffrey H. Dyer, *Human Capital & Learning as a Source of Sustainable Competitive Advantage*, 25 STRATEGIC MGMT. J. 1155, 1156 (2004); Yasemin Y. Kor & Huseyin Leblebici, *How Do Interdependencies Among Human-Capital Deployment, Development, and Diversification Strategies Affect Firms' Financial Performance?*, 26 STRATEGIC MGMT. J. 967, 973 (2005); *see, e.g.*, Achor et al., *supra* note 15 (discussing employee desire for meaningful work); Hu & Hirsh, *supra* note 15, at 1649 (finding that employees are willing to accept lower salaries for more meaningful work); *see also* Gelles, *supra* note 1.

[31] That is, the commitment mechanism proposal would not be waivable or redeemable.

social impact metrics, such as employee satisfaction and environmental impact, rather than pegging compensation almost entirely to financial metrics, as it is currently. These metrics would all be verified according to third-party standards, rather than by the company itself.

The proposed commitment mechanism is well-suited to help address the problems associated with the loss of strategic (board) and managerial (day-to-day) control at scale. It addresses the loss of strategic control by targeting the board of directors and helping balance social purpose and profit in the key strategic decision-making at the board level. Socially conscious executive compensation addresses the loss of managerial control by targeting company executives and helping ensure better balance between social purpose goals and financial goals in their daily management of the firm. It would offer companies that wish to opt in a means to bind themselves to the pursuit of objectives beyond profit, without imposing any requirements on companies that do not wish to do so.

By enabling firms to more credibly bind themselves to their multiple objectives, these solutions would help make PBC law more meaningful and facilitate private ordering — a fundamental aim of business law that the current legal framework undermines. Perhaps most importantly, these proposals can also facilitate companies with a proven track record of achieving both social and economic impact to do so on an even larger scale — better enabling large-scale social impact, instead of just large-scale profit.

This Paper proceeds as follows. Part I defines and distinguishes companies that have articulated objectives beyond profit maximization. It describes their value and why they warrant preservation, and provides evidence for the scaling up problem. Part II describes how these companies currently attempt to privately order themselves to achieve their objectives through traditional incorporation, PBC incorporation, and private contracting, including B-Corp certification. Part III argues that when these companies scale up, they systematically struggle to retain their objectives beyond profit no matter how they scale, how they legally incorporate, or how they privately order themselves. Business law fails to provide them with a durable commitment mechanism. Part IV advocates addressing this problem by providing a voluntary commitment mechanism in corporate law. The proposed commitment mechanism would require multiple stakeholder board representation and socially conscious executive compensation for PBCs at scale.

I. COMPANIES WITH OBJECTIVES BEYOND PROFIT

This Part defines companies that have articulated objectives beyond profit maximization and distinguishes them from other socially conscious behavior in business. It also describes these companies' value and why they warrant preservation.

A. Defining and Distinguishing

Socially conscious behavior in business is on the rise. [32] Even for-profit firms that primarily pursue a single profit objective increasingly enumerate social or problem-solving goals alongside, and often in tension with, their profit goals.[33] It can be difficult to precisely define and categorize socially conscious firms.[34]

But recent years have seen an unprecedented surge in firms that articulate and explicitly commit to pursuing objectives beyond profit.[35]

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32 *See* Julie Battilana, Metin Sengul, Anne-Claire Pache & Jacob Model, *Harnessing Productive Tensions in Hybrid Organizations: The Case of Work Integration Social Enterprises*, 58 ACAD. MGMT. J. 1658, 1658 (2015) [hereinafter *Harnessing Productive Tensions*].

33 *See, e.g.*, Julie Battilana, Marya Besharov & Bjoern Mitzinneck, *On Hybrids and Hybrid Organizing: A Review and Roadmap for Future Research, in* THE SAGE HANDBOOK OF ORGANIZATIONAL INSTITUTIONALISM 128, 143-44 (Royston Greenwood et al. eds., 2d ed. 2017) [hereinafter *On Hybrids and Hybrid Organizing*].

34 *See* Elizabeth Pollman, *Social and Asocial Enterprise*, *in* THE CAMBRIDGE HANDBOOK OF SOCIAL ENTERPRISE LAW 1, 15 (Benjamin Means & Joseph W. Yockey eds., 2018).

35 Battilana et al., *Harnessing Productive Tensions*, *supra* note 32, at 1658 (documenting the unprecedented rise of organizations jointly pursuing social and commercial objectives in the past thirty years). Pursuing both social purpose and profit objectives under the same organizational roof is not a new phenomenon. Prior to the past thirty to forty years, social purpose has not been so disassociated from commercial pursuits, including in for-profit firms like corporations. In fact, in the nineteenth century, for-profit firms had to prove they were serving a social good in order to receive a charter from the state. Even in the past few decades, for-profit firms have consistently engaged in plenty of non-profit-related activities — such that firms should be understood as utility maximizers rather than strictly profit maximizers. But in recent years, there has been a sharp and unprecedented rise in for-profit firms that explicitly seek to pursue both social purpose and profit — companies like Etsy, Patagonia, Seventh Generation, Tom's Shoes, and Warby Parker. *See* Reuven S. Avi-Yonah, *The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility*, 30 DEL. J. CORP. L. 767, 767 (2005); Matthew G. Grimes, Trenton Alma Williams & Eric Yanfei Zhao, *Anchors Aweigh: The Sources, Variety, and Challenges of Mission Drift*, 44 ACAD. MGMT. REV. 819, 820 (2019) (arguing that claiming to have multiple objectives alongside profit is not new for corporations, and the fact that firms take time to formulate mission statements is proof that they are not meaningless); Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 209 (1986); David Millon, *Theories of the Corporation*, 1990 DUKE L.J.

These companies differ from other for-profits, including ones that may be socially conscious in some ways, in that they pursue both social purposes and profit as core organizational goals. Socially conscious behavior in for-profit firms does not fit neatly into pre-prescribed categories, but rather, should be visualized along a spectrum. The spectrum ranges from firms that make occasional pro-social decisions all the way down to firms that make social purpose and profit objectives core to their organization and consider their multiple objectives in all or nearly all of their decision-making. Designations such as "corporate philanthropy," "corporate social responsibility," "mission-driven business," and "purpose-driven" can be thought of as roughly corresponding to this spectrum of activity.

On one end of the spectrum, primarily profit-focused companies may still engage in some ad hoc pro-social acts, such as corporate philanthropy.[36] As the spectrum progresses, companies increasingly place equal weight on pro-social and pro-profit objectives. For example, in the middle of the spectrum, firms may engage in corporate social responsibility ("CSR") initiatives that are more pro-social than corporate philanthropy, but still on the fringes of their business model.[37] Further down the spectrum, some firms are mission-driven and link their business models intimately with social purpose.[38] But even for these companies, when social purpose comes into conflict with profit, they ultimately choose profit. Companies on the farthest end of the spectrum are those that explicitly articulate and pursue social purpose objectives co-equal with profit. These companies most equally weight social purpose and profit.[39]

201, 201; *see also* Christine Vallaster, Francois Maon, Adam Lindgreen & Joëlle Vanhamme, *Serving Multiple Masters: The Role of Micro-Foundations of Dynamic Capabilities in Addressing Tensions in For-Profit Hybrid Organizations*, ORG. STUD., June 2019, at 1, 2-3.

[36] These pro-social acts also come with significant tax breaks, moderating their pro-sociality.

[37] *See* Eldar, *Role of Social Enterprise*, supra note 3, at 159-63; Julie Battilana, Anne-Claire Pache, Metin Sengul & Marissa Kimsey, *The Dual-Purpose Playbook*, HARV. BUS. REV. (Mar.–Apr. 2019), https://hbr.org/2019/03/the-dual-purpose-playbook [https://perma.cc/PQ6R-4HWV].

[38] Mission-driven companies can be thought of a for-profit enterprise that incorporates a social purpose into its strategy and operations. CCM Staff, *What is a Conscious Company?* SOCAP DIGITAL (May 10, 2020), https://socapglobal.com/2020/05/what-is-a-conscious-company/ [https://perma.cc/3KPU-YFTE].

[39] For example, a C-Suite executive at a Fortune 500 single profit objective company described how two of the companies they had acquired "were a different animal altogether. . . . All in, 100% . . . . They were an army of real true believers in what they were doing, from a mission and B-Corp perspective. . . . [We] said [they]

In the hybrid organizations literature within the discipline of management, Professors Battilana, Sengul, and Pache substantiate this empirically informed notion of a socially conscious spectrum.[40] Hybrid organizations are those that combine organizational goals that are not usually thought to go together — such as social purpose and profit.[41] Battilana et al. show how hybrid organizing should be thought of as occurring as a matter of degree, rather than as a binary phenomenon, as it is commonly conceived.[42] This conception of hybrid organizing seems to better reflect the empirical reality, at least in the for-profit context, that firms frequently have multiple or nuanced objectives that incorporate some element of social purpose, and that they do so to varying degrees. Firms that explicitly articulate and commit to their multiple objectives prioritize social purpose objectives alongside profit to the greatest extent of all for-profit firms.

A key distinction, then, between firms that articulate multiple core organizational objectives and firms that may pursue ad hoc socially conscious behavior, seems to be that when firms with multiple objectives face zero-sum tradeoffs between social purpose and profit, they do not always choose the profit objective.[43] In addition, these

were going to try to learn from them. We left them alone . . . . But [our group] doesn't understand the B-Corp thing. . . . [The acquired company] was spending money on . . . food donations and nutritional education. They're trying to convince [us] that *that's* the brand, that's the marketing. . . . [The acquired company] hasn't grown. It is stagnant, stable. Most of it is [our] fault." Whereas the target company saw social purpose as intertwined with achieving financial goals, the parent company saw the two as mutually exclusive. Interview with Executive at pilot research company (Oct. 2018) (transcript on file with author). *See* Aguirre, *supra* note 12.

40 *See* Battilana et al., *Harnessing Productive Tensions*, *supra* note 32, at 1658-59.

41 *Id.*

42 *See id.* at 1664.

43 This definition draws from original empirical work on companies that articulate objectives beyond profit. *See* Aguirre, *supra* note 12. It consisted of fifty-five semi-structured interviews conducted at fourteen companies over nearly two years, ranging from interns at early-stage startups to C-Suite executives at Fortune 500 companies. The sample includes nine companies that either currently or previously identified as having multiple objectives, and five companies that never have. It includes eleven companies that have adopted a "traditional" corporate form such as a limited liability company or general corporation, and three incorporated as PBCs. All three PBCs are also certified B-Corps, and one of the traditional companies achieved certified B-Corp status. Companies are in the tech, finance, and food sectors. They include an early-stage startup, privately held scaled company, franchise, seven subsidiaries or separate business units, and four publicly traded companies. Six of the companies were also recently venture-backed growth-stage startups that were acquired or scaled up privately. The empirical work also included in-depth on-site research over ten months at two research sites: An early-stage tech startup and a large publicly traded multinational company and three of its subsidiaries or business units in the consumer packaged goods

companies seem to attempt to optimize along both social purpose and profit dimensions as much as possible in their decision-making processes.[44] Optimizing along both dimensions may take a few different forms depending on the company, or may even vary among teams and individuals within the same company.[45] But in this way, companies with multiple objectives attempt to get around zero-sum decisions, by trying to make these decisions *not* zero-sum to the extent possible. Instead, they consistently view decision-making as containing inherent tensions and simply requiring more creativity, consensus-building, and time to solve along both social purpose and profit dimensions.[46] In contrast,

and finance sectors. All research took place from October 2018 through February 2021. Empirical research in management supports this claim. *See* Battilana et al., *On Hybrids and Hybrid Organizing*, *supra* note 33, at 152-53; Vallaster et al., *supra* note 35, at 2-3; *see also* Battilana et al., *Harnessing Productive Tensions*, *supra* note 32, at 1674.

[44] For example, one early-stage startup has a senior leadership position devoted to sustainability, despite the fact that the company is pre-profitable and every dollar counts for survival. It does so because it is committed to its sustainability objective. *See* Aguirre, *supra* note 16. To take another example, several respondents at one multiple objective company described a decision-making framework in which they always examine both the financial and social implications of a proposed course of action. For example, one respondent said, "I think the first thing we look at is, does it make good business sense? And then the other thing we look at, . . . is it aligned with our global vision and mission? . . . I wouldn't say it's always originally a financial decision, but in most cases we're looking at, is it going to bring us a social impact? Or is it going to bring us a financial impact? Some cases, it doesn't bring us any financial impact, it could just be a social decision." *See* Aguirre, *supra* note 12.

[45] For example, one growth stage (i.e., later-stage) startup uses a process of radical transparency, publicly blogging about its decision-making processes to ensure accountability. It even previously made all internal emails available to everyone in the company. Although it always considers social and financial impact, decision-making in the large company varies by team and department. *See* Battilana et al., *Harnessing Productive Tensions*, *supra* note 32, at 1674-75; Battilana & Dorado, *supra* note 18, at 1420; Pache & Santos, *supra* note 18, at 995; Smith & Besharov, *supra* note 18, at 4.

[46] For example, the early-stage startup with the senior leadership position also folded customer education into the role in order to align sustainability with customer success. *See* Aguirre, *supra* note 16. Another company with multiple objectives beyond profit lamented the lack of efficiency associated with its creative and consensus-building decision-making framework, but highlighted how it resulted in outcomes that used creativity to maximize both social purpose and profit and to meet all of their organizational objectives. For example, a manager described all the creativity and organizational democracy his team brings to decision-making processes, then described how "letting any idea be explored can really, it can hurt efficiency at some point. And I think that's the other, you know, we've talked a lot about the good parts of this. There are a lot of bad parts of this such as, that it's hard to do both. It's really hard to say, 'I'm going to do both things [social purpose and profit] at the same time.' And, I'm an engineer by trade, so I think about efficiency a lot. It's all I think about all the time. And, when I see myself pinging from one thing to the other and the other I realize that I'm just not efficient with my time." *See* Aguirre, *supra* note 12.

traditional for-profit companies seem considerably more likely to perceive decisions as zero-sum.[47] Although these companies might pursue pro-social behavior in some contexts, when faced with a perceived zero-sum choice, they reliably make those decisions along a profit dimension.[48]

B. The Value of Companies with Objectives Beyond Profit

Companies that have articulated objectives beyond profit represent an important innovation in business with the potential to help improve overall social welfare.[49] Many of these companies are developing technologies, products, organizational structures, and business models to help solve some of the world's most serious problems, including systemic threats to sustainability and climate change; public health crises and alarming rates of noncommunicable disease; gender, racial, and ethnic inequalities; and untenable labor outcomes. In tandem with current approaches in government and the nonprofit charitable sector, these firms offer potential to help solve intractable social problems and address untenable externalities in effective and efficient ways. In doing so, they can serve as an important complement to current approaches

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[47] *See* Aguirre, *supra* note 12. For example, a C-Suite executive of one Fortune 500 single-objective company described how "leaders of publicly traded companies are all paid the same: based on shareholder returns, and every single one is incentivized to compete on share price." He went onto describe how his company culture is characterized by "growth growth growth." At his company, they "don't see a disconnect between growth and purpose" — until a brand stops growing, at which point he said they immediately cut costs associated with the social purpose. This respondent noted that all big companies in their sector had similarly focused on cutting costs over the past decade. Interview with Executive at pilot research company (Oct. 2018) (on file with author); *see* Aguirre, *supra* note 12.

[48] *See* Aguirre, *supra* note 12.

[49] *See* Eldar, *Role of Social Enterprise*, *supra* note 3, at 95. Although it is difficult to quantify the number of such companies in existence, to give a rough proxy sense, there are over 3500 certified B-Corps globally, over two-hundred PBCs incorporated in Delaware, and near four thousand PBCs incorporated in the United States. Charlie Kannel & May Samali, *Startups: Should You Incorporate as a Public Benefit Corporation?*, VENTURE BEAT (Apr. 30, 2017), https://venturebeat.com/2017/04/30/startups-should-you-incorporate-as-a-public-benefit-corporation/ [https://perma.cc/5LGB-QEJT]; *How Many Certified B Corps Are There Around the World?*, CERTIFIED B CORP., https://bcorporation.net/faq-item/how-many-certified-b-corps-are-there-around-world (last visited Dec. 19, 2020) [https://perma.cc/4JEL-GSMG]; *What You Need to Know About the Delaware Public Benefit Corporation*, INCNOW (Feb. 17, 2020), https://www.incnow.com/blog/2020/02/17/about-b-corps/ [https://perma.cc/Q3LG-A7MW].

by government and nonprofit charities, and as valuable routes to capital needed for large-scale impact.[50]

All companies implicate various social issues — such as labor inequality, environmental sustainability, public health, and gender, racial and ethnic justice — in nearly every business decision they make. For example, a company implicates racial, ethnic, and gender diversity in how it recruits and retains employees, including where and how it hires interns or entry-level employees; how it sets its standards for promotion; and its parental leave policies.[51] A company implicates the environment, human rights and labor practices when it chooses suppliers to procure its inputs, and sets required standards for its suppliers to follow.[52] A company frequently implicates population health and safety with its product lines or its developments in research and innovation.[53] And it implicates a range of social issues across its other business decisions — such as how it collects and uses data, markets products, selects customers, and secures capital.[54]

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[50] *See* Rachel Culley & Jill R. Horwitz, *Profits v. Purpose: Hybrid Companies and the Charitable Dollar* 5 (Law & Econ., Working Paper No. 48, 2014); *see also* Elizabeth Pollman & Jordan M. Barry, *Regulatory Entrepreneurship*, 90 S. CAL. L. REV. 383, 385 (2017) (noting a rising trend of companies for which changing the law is a significant part of their business plan, and acting as agents of legal change). Powerful arguments have been made for why legal rules are less efficient than using, for example, the income tax system to redistribute income directly. *See* Kaplow & Shavell, *supra* note 14, at 667. Companies with objectives beyond profit are attractive because they do not rely on legal rules to redistribute income, but can serve *multiple* objectives beyond just income redistribution. They provide another tenable solution that can help solve multiple intractable social problems at once, while also not reducing incentives to work, which Kaplow and Shavell argue is attractive about the income tax system. *See also* Alicia E. Plerhoples, *Nonprofit Displacement and the Pursuit of Charity Through Public Benefit Corporations*, 21 LEWIS & CLARK L. REV. 525, 545 (2017) [hereinafter *Nonprofit Displacement*].

[51] *See, e.g.*, Robin J. Ely & Irene Padavic, *What's Really Holding Women Back?*, HARV. BUS. REV., Mar.–Apr. 2020, at 58, 60 (noting companies are seeking solution in retaining women and promoting them to senior ranks).

[52] Take, for example, Danone's RESPECT program with its suppliers, which explicitly recognizes the social and environmental impacts of supply chains. *Responsible Company Practices*, DANONE, https://www.danone.com/impact/health/responsible-company-practices.html (last visited Dec. 20, 2020) [https://perma.cc/RWA8-NLL9]. These implications are often compounded if the company has a global supply chain.

[53] For example, product lines in the food, beverage, agriculture, drug and pharmaceutical, tobacco, firearm, vitamin, cosmetics, health and beauty, infant products, technology, video game, automobile, mining, petrochemical, and transportation industries, among many others, all have significant effects on public health.

[54] How a company collects and uses big data can affect all of these social issues. How a company uses data to determine customer experience and marketing can either

Companies that pursue objectives beyond profit offer a unique opportunity because unlike traditional companies, they attempt to privately order themselves to account for social goals alongside their financial goals. Having these two core organizational objectives bleeds into every aspect of their company decision-making, which creates significant — and presently largely under-realized — potential for social impact across a variety of dimensions. For example, these companies can make procurement decisions using higher environmental standards,[55] develop product lines that prioritize human health,[56] or recruit and promote a more gender, racially, and ethnically diverse workforce.[57] They are well-situated to help address labor inequality and

reduce or reinforce socioeconomic and racial inequalities, environmental impact, public health outcomes, and so on. How a company geographically tracks and targets its customers with advertisements can reinforce socioeconomic and racial inequalities, or improve or exacerbate public health outcomes. In some industries, data collected can provide insight into environmental impacts that a company can either leverage or ignore. How a company markets product can also have significant social impacts, particularly if it markets to children or vulnerable populations. Similar to selecting suppliers, companies can also generate positive or negative social impact in how they select customers or develop a target demographic. Companies can develop business models to enable socially conscious access to their products. For example, a B2B company (that is, one with businesses as clients, rather than individual consumers), can prioritize socially conscious businesses — whether that is because they are environmentally conscious, prioritize gender or racial representation, improve population health outcomes, empower employees, or have some other positive social impact. Similarly, how a company capitalizes itself and who it chooses as an investor can have huge impact on its subsequent decision-making. A socially-minded investor could have much different influence than one focused solely on short-term profit, for example.

55 Take, for example, Chipotle and Patagonia, which have shifted entire supply chains with their decisions to source local, antibiotic-free meat and other ingredients, and organic cotton, respectively, and the incentives they provided suppliers and farmers to help them be able to transition to do so. REINHARDT ET AL., *supra* note 16, at 4; Erica Shaffer, *Chipotle Supply Chain Partners Form 'Virtual Farmers' Market*,' MEAT + POULTRY (June 30, 2020), https://www.meatpoultry.com/articles/23387-chipotle-supply-chain-partners-form-virtual-farmers-market [https://perma.cc/M2AP-E8MX].

56 For example, Plum Organic has focused on the health of its product line of organic baby foods. *Food Philosophy*, PLUM ORGANICS, https://www.plumorganics.com/resource_center/plum-organics-food-philosophy/ (last visited Dec. 20, 2020) [https://perma.cc/TC67-82KM]. Danone has increased its focus on health over the past few decades, divesting unhealthier product lines, reformulating existing products (such as reducing sugar in its yogurts), and acquiring and investing in future healthier product lines. CHRISTOPHER MARQUIS, HARV. KENNEDY SCH., DANONE NORTH AMERICA: THE WORLD'S LARGEST B CORPORATION (2018).

57 For example, Ben & Jerry's has acknowledged its shortcomings "as a mostly white company based in a mostly white state," and has taken actions to increase diversity in its recruiting and to financially support racial justice initiatives. It also publicly supported the Black Lives Matter movement in 2016, years before it was popularly

worker burnout and commodification through improved employee treatment and policies.[58] In addition, employees generally prefer to work at companies with objectives beyond profit, leading to better workplace fulfillment and labor outcomes.[59] These companies also have the benefit of tailoring their approaches to the unique needs of their own firms and industries, and the ability to more nimbly experiment and better respond to feedback in real time.[60] This experimentation can yield valuable data on which approaches prove more or less effective. Such fine-grained tailoring to individual circumstances can be difficult for external laws or programs to accomplish, but more readily achievable for companies.[61]

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accepted, and took what as probably the strongest company response to the killing of George Floyd in its statement, "We Must Dismantle White Supremacy." *See Ben & Jerry's: Educating Themselves and Others About Racial Equity*, B THE CHANGE (Feb. 14, 2019), https://bthechange.com/ben-jerrys-educating-themselves-and-others-about-racial-equity-929866bec474 [https://perma.cc/B5H8-6HJF]; *We Must Dismantle White Supremacy*, BEN & JERRY'S, https://www.benjerry.com/about-us/media-center/dismantle-white-supremacy (last visited Dec. 20, 2020) [https://perma.cc/46H7-7SRT].

[58] Of course, offering for-profit companies as part of a solution to labor inequality and worker commodification is not intended to replace robust labor and employment laws. For-profit socially conscious activity occurs above and beyond the floor these laws set.

[59] In fact, employees frequently trade lower salaries to engage in work with a sense of purpose. This preference is even more pronounced among Millennials and Generation Z, and will only increase as these generations increasingly comprise the workforce. *See* Hu & Hirsh, *supra* note 15, at 1; Achor et al., *supra* note 15; *see also* Michal Barzuza, Quinn Curtis & David Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 101, 102 (2020) (explaining millennial workers indicated that the primary purpose of businesses should be improving society, rather than generating profit); Gelles, *supra* note 1 (stating that employees took lower salaries to work at Etsy because it provided meaningful work).

[60] For example, Danone recently administered a company survey seeking employee feedback, to which it received an astounding eighty percent response rate. As a result of that feedback, it conferred voting rights on employees, giving every employee a share in the company, and it created twenty-six employee volunteer representatives to offer feedback and meet with the board each year. Cassie Werber, *What Happens When You Ask 100,000 Employees to Help Run a Multinational Company*, QUARTZ WORK (May 21, 2019), https://qz.com/work/1618038/danone-asked-100000-employees-to-help-run-a-multinational-company/ [https://perma.cc/6DUK-D692]. To take another example, one startup in the sample has one-on-one meetings between the founders and the employees to get honest feedback, and also administers various short surveys at periodic intervals to get employee feedback. It changes company policy in real time in response to the feedback received. *See* Aguirre, *supra* note 16.

[61] Multiple objective companies can achieve these outcomes by leveraging economies of scope. Economies of scope leverage efficiencies formed by variety, rather than by volume. *See* Panzar & Willig, *supra* note 14, at 268; *see also* Kaplow & Shavell,

Companies with objectives beyond profit are also particularly attractive because they can achieve these improved social outcomes without requiring much costly additional legislation to incentivize or penalize company action, for example through employment law, environmental law, or tax law.[62] Unlike many nonprofit charities or government initiatives, they also offer the benefit of being ultimately self-sustaining through revenue, rather than primarily reliant on donations, grants, or government support for long-term survival. This Paper does not aim to suggest that for-profit companies replace robust government or charitable activity to solve societal problems — even companies with objectives beyond profit.[63] Rather, it recognizes the powerful role these businesses can play to complement government and charitable activity to help solve critical and intractable social problems.

C. The Scaling Up Problem

Companies with social purpose objectives aim to maximize social impact alongside economic impact, just as traditional businesses aim to maximize profit.[64] To do so, many of these companies attempt to scale up, which can be defined as "spreading excellence within an organization as it grows."[65] Scaling up is a challenging prospect for any company, requiring it to maintain organizational excellence while growing substantially larger at a rapid pace.[66] It is an elusive topic that is ripe for further study in general.[67]

But for companies with objectives beyond profit, scaling up seems to present an even more acute challenge. Unlike traditional businesses,

supra note 14, at 667 (noting the inefficiency of legal regulations in achieving social outcomes).

62 *See* Kaplow & Shavell, *supra* note 14, at 667.

63 *See* Culley & Horwitz, *supra* note 50, at 1; Plerhoples, *Nonprofit Displacement*, *supra* note 50, at 528-29.

64 Filipe Santos, Anne-Claire Pache & Christoph Birkholz, *Making Hybrids Work: Aligning Business Models and Organizational Design for Social Enterprises*, 57 CAL. MGMT. REV. 36, 38 (2015).

65 Eldar, *Role of Social Enterprise*, *supra* note 3, at 182 ("Without scaling, firms cannot reach a large number of beneficiaries and have a substantial social impact"); Dean A. Shepherd & Holger Patzelt, *A Call for Research on the Scale of Organizations and the Scaling of Social Impact*, ENTREPRENEURSHIP THEORY AND PRACTICE 1, 9-11 (2020); *see also* ROBERT I. SUTTON & HUGGY RAO, SCALING UP EXCELLENCE – GETTING TO MORE WITHOUT SETTLING FOR LESS-CROWN BUSINESS 8 (2014).

66 *See* SUTTON & RAO, *supra* note 65 at 3-7; Shepherd & Patzelt, *supra* note 65, at 1-11.

67 *See* Shepherd & Patzelt, *supra* note 65, at 1-11. *See generally* SUTTON & RAO, *supra* note 65 (discussing the challenges and common mistakes associated with properly scaling a business).

companies with social purpose objectives face an additional challenge of achieving scale (and mobilizing the resources required to do so) in a context of weaker prospects of financial sustainability.[68] They face greater struggles accessing equity capital,[69] and grapple with an absence of managerial blueprints to inform their scaling up process. Indeed, scholars in a small but growing literature in scaling social entrepreneurship have found that while many for-profit ventures pursuing social and commercial objectives have been started, few have successfully scaled up, "making scaling one of the most important yet least understood topics in social entrepreneurship."[70] It is difficult to quantify the extent of this scaling up problem, in light of the nascent literature on the subject and difficulty in collecting systematic data.[71]

But preliminary field research conducted in this area over the past three years bears out these findings. This field research has consisted of fifty-six interviews with respondents from fourteen companies of various sizes, stages, and orientations to social purpose and profit.[72] All of the companies either pursue social purpose alongside profit, or have acquired such companies.[73] The dataset includes early-stage startups, late-stage startups, privately scaled companies, private equity, and large-scale publicly traded companies.[74]

Results from this field research underscore a perception among practitioners that successfully scaling up social ventures presents a significant problem. For example, one former General Counsel at a Fortune 500 company described the difficulty of acquiring small, purpose-driven companies.[75] Among other things, he referenced their under-capitalization, outsourced manufacturing, attempts to go "too far

[68] Santos et al., *supra* note 64, at 53.

[69] Eldar, *Role of Social Enterprise*, *supra* note 3, at 172.

[70] "In the social entrepreneurship literature, scholars have noted that while many social ventures have been started, few have successfully experienced scaling, thus making scaling one of the most important yet least understood topics in social entrepreneurship" Shepherd & Patzelt, *supra* note 65, at 8.

[71] Shepherd & Patzlet, *supra* note 65, at 1-11; *see e.g.*, Smith & Besharov, *supra* note 18 (describing their data methodology). For example, there is no central repository of IPOs or acquisitions of companies that pursue social purpose and profit objectives, nor a repository of formerly certified B-Corps. Additional research to ascertain the magnitude and contours of the problem is important, and is the subject of ongoing work and data collection I am conducting, both qualitatively and quantitatively.

[72] *See* Aguirre, *supra* note 12.

[73] *See id.*

[74] *See id.*

[75] *See id.*

too fast," and lack of staffing, resources, and technical expertise.[76] He underscored how these challenges are not carefully enough considered in acquisitions and post-merger integrations, complicating the process.[77]

Another C-Suite Executive at one well-known publicly traded food company explained his company's inability to successfully scale-up acquired startups with objectives beyond profit. He described the disappointing results from its three most recent acquisitions. In his opinion, the first startup lost its social purpose objectives post-acquisition and scale up, and would, he anticipated, lose its B-Corp certification when it came time for re-certification. The second startup stagnated financially, and was eventually sold at a loss. The third startup was flourishing at the present moment — in his view because the parent company left the acquired company alone as long as the brand remained financially lucrative. But he predicted that as soon as the relevant product category became more competitive, the parent company would strip the social purposes in an attempt to drive growth.[78]

To illustrate the phenomenon in another context, one privately scaled company described its unusual (and largely unprecedented) journey to buyout its venture capital investors in order to preserve its objectives beyond profit. Despite having selected socially conscious venture capital investors, the startup still struggled to scale while maintaining its objectives beyond profit, and perceived the only way to do so was to buyout the investors and pursue a path of slower, more sustainable growth (rather than an IPO or acquisition).[79] Similarly, another startup still in its early stages struggled to access capital from investors who aligned with its social purpose objectives alongside profit. So far, it has relied on downplaying its social purpose objectives in investor settings,

76 *See id.* ("Acquiring small healthy purposeful companies complicates the process. That's a big factor. These are small companies, they are under-capitalized, they are outsourcing manufacturing. They may be serving 100 different clients. What are the challenges in truly scaling up? These issues are not carefully considered. . . . They go too far too fast, they may not have the staffing, resources, technical expertise to really maintain what you have to maintain as far as food safety is concerned and that is a zero-tolerance oversight system. Even though FDA is historically reactive, FSMA gave it tools to apply proactively. Hazard-oriented food systems are in place. Startups usually have nothing but the bare minimum. But when they're acquired by a multinational, the stakes ratchet up.").

77 *Id.*

78 *Id.*

79 Joel Gascoigne, *We Spent $3.3M Buying Out Investors: Why and How We Did It*, BUFFER (Aug. 29, 2018), https://buffer.com/resources/buying-out-investors/ [https://perma.cc/4PUS-TB55].

but is realizing it must further confront how best to access capital to scale while maintaining its multiple objectives over the long-term.[80]

Although additional empirical research is needed, these examples from both the management literature and preliminary field research suggest the acute difficulty of scaling up a social venture, despite the corporate law and private ordering frameworks available to enable the existence of these firms in the first instance.

II. CURRENT OPTIONS IN BUSINESS LAW AND CONTRACT LAW

Companies that articulate purposes beyond profit may privately order themselves in a number of different ways to achieve their objectives, using both business law and contract law. A company can choose to incorporate in a traditional form, such as a general corporation, and memorialize its multiple objectives in its charter or through informal commitments. Or it can choose to incorporate as a PBC, a legal form that mandates the pursuit of social purpose and profit simultaneously. And regardless of how a company chooses to legally incorporate, it can also privately contract to achieve its multiple objectives, including with stakeholders or beneficiaries, or through third-party B-Corp certification.

A. The Traditional General Corporation

A company with objectives beyond profit may elect a traditional form such as a general corporation or limited liability company ("LLC") and pursue its multiple objectives by memorializing them in its charter or adopting certain organizational practices.[81] These organizational practices could include treatment of employees, customers, suppliers,

[80] *See* Aguirre, *supra* note 16.

[81] Delaware refers to the traditional corporate form as a "general corporation." Although there is variation in nomenclature across states, this paper uses the Delaware term of general corporation for simplicity. General corporations further elect a separate tax status — generally either C-Corporation or S-Corporation — which is not a legal entity but an IRS designation. In addition, multiple objective companies may also elect to form one of several other less common forms, such as a cooperative, partnership, low-profit limited liability company ("L3C") or one of several other for-profit forms that exist in addition to the more common general corporation or LLC, though these have had little uptake. *See* Dana Brakman Reiser, *Theorizing Forms of Social Enterprise*, 62 EMORY L.J. 681, 683 (2013); Dana Brakman Reiser & Steven A. Dean, *Hunting Stag with Fly Paper: A Hybrid Financial Instrument for Social Enterprise*, 54 B.C. L. REV. 1495, 1506-08 (2013); Plerhoples, *Social Enterprise as Commitment*, *supra* note 13, at 89; Culley & Horwitz, *supra* note 50, at 4.

or the environment.[82] For example, a company might have a deep commitment to employee welfare that it expresses through internal practices of organizational democracy or worker empowerment.[83] It may seek out ethical supply chains, or work to reduce its carbon footprint, or pursue racial and ethnic equity in its hiring or selling practices.[84] It might develop products to meet its social purpose standards, such as a food company with a portfolio that meets a baseline nutritional profile, or an environmental apparel company that develops product lines to source organic (environmentally friendly) cotton.[85] These organizational practices may not be legally enforceable, but can nonetheless reflect a robust underlying commitment to the pursuit of social purpose and profit as core organizational goals.

There is robust debate in corporate law scholarship over whether traditional corporate forms like the general corporation legally permit the pursuit of objectives beyond profit, or require the pursuit of the single profit objective.[86] Most standard views of corporate law today

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[82] Take, for example Danone's commitment to developing healthier products, or Patagonia's commitment to developing product lines with organic cotton. Both product lines require additional research and innovation, and frequently additional financial investment to achieve.

[83] *See* Julie Battilana, Julie Yen & Emilie Aguirre, *Placing Both Humans and the Planet at the Core of a Sustainable Economy: On the Need to Prioritize and Empower Workers in Companies*, *in* HANDBOOK ON THE BUSINESS OF SUSTAINABILITY: THE ORGANIZATION, IMPLEMENTATION, AND THE PRACTICE OF SUSTAINABLE GROWTH (forthcoming 2021).

[84] *See, e.g.*, MARQUIS ET AL., *supra* note 56 (describing Danone's business model); REINHARDT ET AL., *supra* note 55 (explaining Patagonia's prioritization of social and environmental goals).

[85] These examples all derive from real companies, such as Patagonia, Danone, Ben & Jerry's and several other companies. *See* MARQUIS ET AL., *supra* note 56 (referencing Danone); REINHARDT ET AL., *supra* note 55 (referencing Patagonia); *see also* James E. Austin & Herman B. "Dutch" Leonard, *Can the Virtuous Mouse and the Wealthy Elephant Live Happily Ever After?*, 51 CAL. MGMT. REV. 77, 81-84 (2008); David Marchese, *Ben & Jerry's Radical Ice Cream Dreams*, N.Y. TIMES (July 27, 2020), https://www.nytimes.com/interactive/2020/07/27/magazine/ben-jerry-interview.html [https://perma.cc/NYX7-2R7C].

[86] Theories of the firm have developed over the past two centuries in both economics and law to attempt to explain why for-profit firms exist and how they function. One strand represents the more widely held view today that for-profit firms exist to pursue a single profit objective and to maximize shareholder wealth. This camp derives from classical theories of the firm and their progeny. The second camp pushes back against the classical theories of the firm, asserting that for-profit firms exist to pursue social objectives alongside profit. These theoretical tensions perhaps unsurprisingly give way to doctrinal tensions in business law. *See* Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 777 (1972); Anthony Casey & M. Todd Henderson, *The Boundaries of 'Team' Production of Corporate Governance*, 38 SEATTLE U. L. REV. 365, 365 (2015); R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 387 (1937); Oliver Hart, *An*

adopt some version of a shareholder primacy and shareholder value model, maintaining that shareholders are the principals for whom corporate governance is organized, that they exercise ultimate control over the corporation, and that maximization of shareholder wealth is the only proper goal of the corporation.[87] But some more recent developments in economic and legal theories of the firm push back against this conception, departing from the classical view that for-profit firms exist solely to pursue a single profit objective.[88]

These underlying tensions in theories of the firm translate into doctrinal tensions in business law. These tensions create uncertainty over what corporate law permits and requires of traditionally incorporated firms that seek to pursue objectives beyond profit.[89]

Economist's Perspective on the Theory of the Firm, 89 COLUM. L. REV. 1757, 1758 (1989); Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976); Luigi Zingales, *In Search of New Foundations*, 55 J. FIN. 1623, 1624 (2000); Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970.

87 *See* Stephen Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 563, 565, 568 (2002); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1446 (1989); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440-41 (2001); *see also* Jill E. Fisch & Simone M. Sepe, *Shareholder Collaboration*, 98 TEX. L. REV. 863, 864 (2020).

88 *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 296, 303 n.138 (1999); Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, J.L. FIN. & ACCT. 247, 248 (2017); *see also* Robert P. Bartlett, III, *Venture Capital, Agency Costs, and the False Dichotomy of the Corporation*, 54 UCLA L. REV. 37, 107-114 (2006) [hereinafter *Venture Capital, Agency Costs*]; Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 734 (2005); Fisch & Sepe, *supra* note 87, at 863 (arguing that in practice, the corporate world has moved on from traditional confrontational models of the corporation, debating managerialism and shareholder power, to a collaboration model of the corporation, emphasizing insider-shareholder collaboration); Elizabeth Pollman, *Team Production Theory and Private Company Boards*, 38 SEATTLE U. L. REV. 619, 645 (2015) [hereinafter *Team Production Theory*].

89 Christopher M. Bruner, *Corporate Governance Reform in a Time of Crisis*, 36 J. CORP. L. 309, 324 (2011) (citing Delaware cases for the proposition that "U.S. boards generally . . . have explicit latitude to consider the interests of other stakeholders, such as employees and creditors, in deciding how to respond to a hostile bid"); Lyman Johnson, *Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405, 432 (2013) (arguing that Delaware law is unsettled on the question of whether corporations are required to advance the long-term interests of stockholders); *see also* Jill E. Fisch & Steven Davidoff Solomon, Centros*, California's "Women on Boards" Statute and the Scope of Regulatory Competition*, 20 EUR. BUS. ORG. L. REV. 493, 509 (2019) (arguing that California SB 826 requiring female representation on boards reflects a broader conception of corporate purpose and responsibilities beyond shareholder primacy, and citing further additional examples).

Several seminal cases in business law seem to suggest that it requires for-profit firms to pursue a single profit objective and therefore maximize shareholder wealth, while others stand for the opposite proposition.[90]

Business law is therefore muddled on the question of corporate purpose, and whether firms must pursue a single profit objective.[91] It is unclear for both scholars and practitioners whether and how companies may legally pursue objectives beyond profit if they adopt a traditional corporate form such as the general corporation.

B. The Public Benefit Corporation

In light of muddled understanding around traditional general corporations, business law attempts to provide an explicit solution for

[90] *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986); *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 34 (Del. Ch. 2010); Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919); Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 768, 771 (2015) (writing that "*Revlon* could not have been more clear that directors of a for-profit corporation must at all times pursue the best interest of the corporation's stockholders, and that the decision highlighted the instrumental nature of other constituencies and interests" and stating that "a clear-eyed look at the law of corporations in Delaware reveals that, within the limits of their discretion, directors must make stockholder welfare their sole end, and that other interests may be taken into consideration only as a means of promoting stockholder welfare"); *see also* Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163, 167 (2008). *But see* Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968); LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 30-31 (2012) (arguing that *Revlon* is the "exception that proves the rule" and "it is only when a public corporation is about to stop being a public corporation that directors lose the protection of the business judgment rule and must embrace shareholder wealth as their only goal"); Elhauge, *supra* note 88, at 772, 775 (explaining why profit maximization proponents' reliance on *Dodge v. Ford* is misplaced). An example from a case outside of business law is also informative. In *Burwell v. Hobby Lobby*, the Supreme Court held that a closely held for-profit company was exempt from complying with regulations to which its owners religiously object. The Court's recognition that a closely held for-profit firm could claim religious beliefs pushes back against the notion that for-profit firms are and must be strict profit maximizers. 573 U.S. 682 (2014); *see* John C. Coates IV, *Corporate Speech & The First Amendment: History, Data, and Implications* 30 CONST. COMMENT. 223, 263 (2015); Elizabeth Pollman, *Corporate Law and Theory in* Hobby Lobby, *in* THE RISE OF CORPORATE RELIGIOUS LIBERTY (Micah Schwartzman et al. eds., 2016); Margaret M. Blair & Elizabeth Pollman, *The Derivative Nature of Corporate Constitutional Rights*, 56 WM. & MARY L. REV. 1673, 1729-30 (2015).

[91] *See* Elizabeth Pollman, *Social and Asocial Enterprise*, *in* THE CAMBRIDGE HANDBOOK OF SOCIAL ENTERPRISE LAW (Benjamin Means & Joseph W. Yockey eds., 2018).

companies that wish to pursue social purpose and profit simultaneously: public benefit corporation law.[92] This legislation has been adopted in thirty-seven jurisdictions including Delaware.[93] It facially requires companies that opt in to pursue social purpose alongside profit, though provides few enforcement mechanisms.

Public benefit corporation legislation imposes several stated requirements on firms that elect to incorporate as PBCs. First, it requires firms to pursue a "general public benefit," meaning they must pursue social purposes beyond profit, and take account of stakeholders beyond shareholders.[94] In addition, Delaware PBCs are required to enumerate a "specific public benefit" in their charters. Specific public benefit is defined as "a positive effect (or reduction of negative effects) on one or more categories of persons, entities, communities, or interests (other than stockholders in their capacities as stockholders) including, but not limited to, effects of an artistic, charitable, culture, economic, educational, environmental, literary, medical, religious, scientific, or technological nature."[95] Most jurisdictions mandate an annual report detailing the corporation's efforts to pursue the public benefit. The report must be made publicly available and use a third-party standard of the company's choosing to track its progress.[96] In Delaware, PBCs are only required to publish a report every two years, and only to

[92] *See id.* In most states, this law is referred to as "benefit corporation law." Because Delaware uses the term "public benefit corporation," for the sake of simplicity, this paper will use the term PBC to refer to any company legally incorporated in any jurisdiction as a benefit corporation. Most jurisdictions have substantially similar benefit corporation laws, drawn from the Model Benefit Corporation Law, though Delaware PBC law has some notable divergence, which will be noted.

[93] *See State by State Status of Legislation*, BENEFIT CORP., https://benefitcorp.net/policymakers/state-by-state-status?state=wisconsin (last visited Dec. 25, 2020) [https://perma.cc/F5S4-9LKY] [hereinafter *State by State Status*]. Definitive figures are difficult to tabulate, because each state's Secretary of State tracks data on incorporation differently, but best estimates suggest that there are over 5000 benefit corporations in the United States today. This number is high in absolute terms, but quite low in relative terms compared to the number of total businesses in the US today. *See Find a Benefit Corp*, BENEFIT CORP., https://benefitcorp.net/businesses/find-a-benefit-corp?field_bcorp_certified_value=&state=&title=&submit2=Go&sort_by=title&sort_order=ASC&op=Go (last visited Dec. 25, 2020) [https://perma.cc/W6Y4-BGQV].

[94] Reiser, *supra* note 22, at 597-98; *see* REISER & DEAN, *supra* note 22, at 53. The thirty-seven states with benefit corporation statutes includes the District of Columbia. *See State by State Status*, *supra* note 93.

[95] DEL. CODE ANN. tit. 8, § 362 (a), (b) (2020); *see also* MODEL BENEFIT CORP. LEGIS. § 102 (2014).

[96] *See* MODEL BENEFIT CORP. LEGIS. §§ 401(a), 402(b).

shareholders and not the general public.[97] PBCs are not required to use a third-party standard as part of their self-evaluation.[98]

PBC legislation provides companies that opt in with some important benefits, but it lacks meaningful enforcement mechanisms, undermining its utility as a solution for companies that articulate objectives beyond profit.[99] Enforcement mechanisms in PBC legislation are both narrow and weak. They are narrow because they only grant shareholders — and not third-party stakeholders — a private right of action to enforce the social purpose.[100] Despite imposing a duty to consider stakeholder interests, PBC legislation does not afford stakeholders an accompanying enforcement right.[101] They are weak because they provide an extremely low standard for both disclosure and liability. PBCs are only required to publish an annual report that uses a self-chosen third-party standard to assess performance.[102] In Delaware, the bar is even lower. Reports are only required every *two* years, are not required to be made publicly available, and are not required to use even a self-chosen third-party standard for assessment.[103] Early data suggested an extremely low compliance rate with the reporting

[97] tit. 8, § 366(b) (2020).

[98] *Id.* § 366(c).

[99] The benefit corporation legal form does serve several important purposes. It helps confer legitimacy to these organizations, helping attract investors, employees, and customers, and thus enabling their survival. The penalties for defying socially legitimate categories are high, creating high barriers for firms outside mainstream social conventions. This new form and its uptake helps bolster the success of individual multi-objective firms and the multiple objective social movement generally. *See* Ezra W. Zuckerman, *The Categorical Imperative: Securities Analysts and the Illegitimacy Discount*, 104 AM. J. SOC. 1398, 1400-01 (1999). Occupying this new category may even help propel these firms to even greater success. Organizations that can successfully navigate hybridity and occupy multiple categories can ultimately garner even more social and material support through their ability to leverage both of their "institutional logics" (social purpose and profit). But they can only do so when their perceived legitimacy in both worlds is secure. *See* Julie Battilana & Matthew Lee, *Advancing Research on Hybrid Organizing – Insights from the Study of Social Enterprises*, 8 ACAD. MGMT. ANNALS 397, 410 (2014); Battilana et al., *On Hybrids and Hybrid Organizing*, *supra* note 33, at 128-62; Matthew S. Kraatz & Emily S. Block, *Organizational Implications of Institutional Pluralism*, *in* THE SAGE HANDBOOK OF ORGANIZATIONAL INSTITUTIONALISM, 243-75; Pache & Santos, *supra* note 18, at 972.

[100] In Delaware, shareholders must hold at least two percent of the PBC's shares to bring a lawsuit, meaning the requirement is not nominal. If the PBC is publicly traded, shareholders must hold at least $2 million in market value to bring a lawsuit. At present, there is only one publicly traded PBC, making this requirement largely moot to date.

[101] *See* BRAKEMAN REISER & DEAN, *supra* note 22; Brakeman Reiser, *supra* note 22, at 604-06.

[102] *See* MODEL BENEFIT CORP. LEGIS. § 401(a) (2014).

[103] *See* DEL. CODE ANN. tit. 8, § 366(b) (2020).

requirement, and for those that do comply, the reports are frequently so skimpy as to be of little use.[104]

PBC legislation also does not prescribe a hierarchy of purposes or stakeholders in defining directors' duties. Instead, Delaware PBC law explicitly provides that directors will be considered to have met their duties if they acted in a way that is "informed and disinterested and not such that no person of ordinary, sound judgment would approve."[105] It is likely that courts in other jurisdictions that have not explicitly provided a legislative standard for liability would apply the business judgment rule and largely defer to managerial discretion. PBC legislation may therefore serve to widen managerial discretion even further and insulate managerial decision-making, rather than enforce the pursuit of multiple objectives beyond profit.[106]

C. Private Contracting and the Certified B-Corp

Regardless of how they legally incorporate, companies that articulate objectives beyond profit may also privately contract to achieve their multiple objectives, including with stakeholders or beneficiaries, or through attaining third-party certification such as a B-Corp. For example, a company with both social purpose and profit objectives might voluntarily contract with employees to provide them with pro-social benefits or higher wages.[107] It might contract with suppliers to meet higher environmental or social standards.[108] And it might contract with investors or creditors to meet certain environmental, social, or

[104] *See* J. Haskell Murray, *An Early Report on Benefit Reports*, 118 W. VA. L. REV. 25, 34 (2015) (finding an eight percent compliance rate among benefit corporations in Hawaii, California, New York and Virginia from 2014 and prior).

[105] tit. 8, § 365(b).

[106] There is also concern that by carving out a special status for firms that pursue social purpose, this legislation harmfully perpetuates the notion that standard for-profit firms cannot or should not pursue social purpose alongside profit. *See* BRAKMAN REISER & DEAN, *supra* note 22, at 23; Brakeman Reiser, *supra* note 22, at 599-600.

[107] For example, one startup in the sample allows equity options not only to its employees but even to its contractors, including those overseas — a very unusual move, but one that signals to its employees that they are valued and respected. *See* Aguirre, *supra* note 16.

[108] For example, in Danone's RESPECT program, "all the direct suppliers of certain categories, such as raw ingredients, and bigger suppliers in other categories, such as Services & Goods, undergo a rigorous process of assessment of their social, environmental and ethical performance that increases reliability of the supply chain, conserves our planet's natural resources, and protects the people who work for and with us." *Responsible Company Practices*, DANONE, https://www.danone.com/impact/health/responsible-company-practices.html (last visited Dec. 26, 2020) [https://perma.cc/4SSQ-Q59V].

governance ("ESG") terms in exchange for capital.[109] These contractual arrangements attempt to create enforceable commitments to the pursuit of objectives beyond profit, which can help memorialize internal organizational practices and organizational goals.

Companies with objectives beyond profit can also elect to certify as B-Corps — considered the highest current third-party standard for the pursuit of social purpose in business.[110] This certification — is administered by a third-party nonprofit organization called B-Lab — and subjects companies to voluntary, rigorous standards of conduct that attempt to assess a company's "entire social and environmental performance."[111] This assessment spans several dimensions, including a company's impact on workers, suppliers, customers, community, and environment, as well as its governance and transparency.[112] To achieve B-Corp certification, a company must score at least eighty points out of two-hundred on a comprehensive assessment.[113] It includes periodic company auditing and requires recertification every two years.[114]

B-Corp certification provides many important benefits, including subjecting companies to in-depth and rigorous third-party verification. Certification requires mobilizing significant company resources to achieve, both in terms of financial investment and employee time. This process helps ensure that certified companies meaningfully commit to the pursuit of social purpose alongside profit. But because it is voluntary and rigorous, and requires sustained effort and resources to maintain, the B-Corp certification is also easily lost.[115]

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[109] For example, Danone contracted for a €2 billion Positive Incentive Loan that provided favorable loan terms in reliance on its commitment to ESG goals. *Danone's Positive Incentive Financing Strategy*, BNP PARIBAS (Aug. 3, 2018), https://cib.bnpparibas.com/sustain/danone-s-positive-incentive-financing-strategy_a-3-2238.html [https://perma.cc/V86B-URLK].

[110] *See Certification*, CERTIFIED B CORP., https://bcorporation.net/certification (last visited Dec. 26, 2020) [https://perma.cc/C4NH-XEKF].

[111] *See id.*

[112] B-Lab has tailored the assessment process according to both company industry and company size. *Id.*; *see also The B Impact Score, Frequently Asked Questions*, B IMPACT ASSESSMENT, https://bimpactassessment.net/how-it-works/frequently-asked-questions/the-b-impact-score (last visited Dec. 26, 2020) [https://perma.cc/PP62-SQVJ] [hereinafter *B Impact Score*].

[113] *Certification Requirements*, CERTIFIED B CORP., https://bcorporation.net/certification/meet-the-requirements (last visited Dec. 26, 2020) [https://perma.cc/9SU3-G48S]; *see also B Impact Score*, *supra* note 112.

[114] *Certification Requirements*, *supra* note 113; *see also B Impact Score*, *supra* note 112.

[115] *See, e.g.*, Marc Gunther, *B Corps: Sustainability Will Be Shaped by the Market, Not Corporate Law*, GUARDIAN (Aug. 12, 2013), https://www.theguardian.com/sustainable-

All of these private ordering frameworks provide some means for companies to pursue their objectives beyond profit. But these means are limited and prove particularly unsatisfactory when these companies with objectives beyond profit seek to scale up.

III. THREE AVENUES TO SCALING UP AND THE LOSS OF OBJECTIVES BEYOND PROFIT

Companies with objectives beyond profit can pursue several avenues to scale up, including most commonly going public, getting acquired, or private growth. Each of these avenues to scaling up is associated with losses of both strategic and managerial control, which consistently lead to the loss of the multiple objectives. The loss of strategic control is a problem of dispersed equity that reduces high-level strategic oversight. The loss of managerial control is a size problem that reduces day-to-day managerial oversight. Business law fails to provide a meaningful commitment mechanism to counter these losses.

A. *Scaling Up with Outside Equity: IPO and Acquisition*

This subpart describes the two most common avenues to scaling up: going public and getting acquired. It explains why both avenues often result in a loss of strategic and managerial control no matter how the company is incorporated or privately ordered. It argues that these losses lead in turn to a loss of the pursuit of multiple objectives post-scale.

Both an IPO and an acquisition entail accessing outside equity capital — meaning the company exchanges ownership shares essentially in return for cash.[116] If a company pursues an IPO, it will generally offer its shares on a public exchange, making them available to most any individual or institutional investor.[117] If the company pursues an acquisition, it will be purchased by another company or a private equity firm.[118] Particularly given a declining IPO landscape, an increasing

business/b-corps-markets-corporate-law [https://perma.cc/QFN7-8XZA] (discussing the role benefit corporations play in sustainable business practices).

[116] *See* Jason Fernando, *Initial Public Offering (IPO)*, INVESTOPEDIA, investopedia.com/terms/i/ipo.asp (last updated Nov. 24, 2020) [https://perma.cc/39WQ-HMYN]; *see also* John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* 4 (HARV. PUB. L., Working Paper No. 19-07 4, Sept. 20, 2018).

[117] *See* Fernando, *supra* note 116. A company's securities may also be traded over-the-counter, rather than listed on a formal exchange, but this distinction is beyond the scope of this paper.

[118] *See* Will Kenton, *Acquisition*, INVESTOPEDIA, investopedia.com/terms/a/acquisition.asp (last updated Jun. 14, 2020) [https://perma.cc/SX82-MFQC]. The IPO is usually a riskier approach with both greater potential financial upside and downside.

number of firms, including firms that articulate objectives beyond profit, now choose to pursue the acquisition route.[119]

Scaling is an extremely difficult task for any company, and there are several advantages to seeking outside equity capital when doing so.[120] First, it provides the considerable infusion of capital necessary to rapidly operate the business on a much larger scale, resulting in greater social and economic impact.[121] Companies usually cannot generate anywhere near the amount of capital necessary to scale up through revenue alone.[122] It also has the advantage of providing liquidity for founders and early investors.[123] Finally, equity capital also usually brings an infusion of expertise on how to operate a business on a larger scale, either from those who help take the company public or from the acquiring company. This expertise includes, for example, guidance on how to scale up production rapidly, access to extended distribution channels and suppliers, and legal support.

But outside equity capital also generally results in dispersed ownership and dilution of founder equity, frequently leading to a loss of voting control and therefore loss of control over electing the board.[124]

An acquisition has less potential financial upside, but also carries less risk. The dispersed equity problem can also occur even earlier for start-ups, for example, when they give up equity in the company to attain venture capital funding. For firms without private sources of capital — say from family, friends, or an angel investor — this choice can feel particularly acute at earlier stages, highlighting that social equity concerns also arise through the current system.

119 *See* Elisabeth De Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 471-72 (2017); Xiaohui Gao, Jay R. Ritter & Zhongyan Zhu, *Where Have All the IPOs Gone?*, 49 J. FIN. & QUANTITATIVE ANALYSIS 1663, 1663 (2013) (noting that the average was 311 US IPOs per year from 1980–2000, whereas the average was 102 US IPOs per year for 2001–2009).

120 *See* Joan MacLeod Heminway, *To Be or Not to Be (A Security): Funding For-Profit Social Enterprises*, 25 REGENT U. L. REV. 299, 308-09 (2013).

121 *See* Fernando, *supra* note 116.

122 This process of growing on earned income alone is also known as "bootstrapping." *See* MALENE ALLEYNE, CAMILLE CANON, AMELIA EVANS, YICHEN FENG, NATHAN SCHNEIDER & MARA ZEPEDA, MEDIA ENTER. DESIGN LAB & ZEBRAS UNITE, EXIT TO COMMUNITY: A COMMUNITY PRIMER 14 (2020), https://www.colorado.edu/lab/medlab/sites/default/files/attached-files/exittocommunityprimer-web.pdf [https://perma.cc/44VC-P77S].

123 For more on debt financing, see *infra* Part IV.1 and see also Fernando, *supra* note 116.

124 *See* Robert P. Bartlett, *Shareholder Wealth Maximization as Means to an End*, 38 SEATTLE U. L. REV. 255, 268-69 (2015); Coates, *supra* note 116, at 4; *infra* Part IV.A.1. A company can use blunt private ordering instruments like multi- or dual-class shares to attempt to retain strategic control over the company after securing outside equity capital. Many companies, such as Facebook and Snap, increasingly use this approach to protect their founders' idiosyncratic strategic desires. This approach of broadly stripping shareholders of rights is not well-tailored to the aim of retaining a company's

Because the board sets overall company strategy, including hiring officers such as the CEO, the loss of control over the board translates into a loss of high-level strategic control over the company. Whether a company retains its multiple objectives is then left to the discretion of its outside investors.[125]

This loss of strategic control makes it relatively easy to undo ex ante private ordering attempts to protect the pursuit of objectives beyond profit. Multiple objectives memorialized in the charter are easily removed or ignored; the PBC legislative mandate is largely unenforceable in practice; contracts to do social good can easily be undone; and B-Corp certification is easy to let expire.[126] For example, Etsy took special measures to safeguard its social purpose after going public.[127] It marketed shares to smaller investors and Etsy sellers and sought to concentrate ownership in a smaller than usual number of institutional investors to protect against short-termism it saw as antithetical to its pursuit of social purpose and profit.[128] Yet activist investors still targeted Etsy and used their newfound strategic influence to elect new board members who redirected the company toward pursuit of profit.[129] Parallel examples abound for acquired companies

multiple objectives, broadly removing shareholder rights that extend well beyond protecting the pursuit of multiple objectives. In addition, there is increasing push back — including from the SEC — about using this approach in publicly traded companies. *See* Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 596-99 (2017); Jill Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. L. Rev. 1057, 1060 (2019); Andrew Winden & Andrew Baker, *Dual-Class Index Exclusion* 11 (Rock Center for Corp. Governance, Working Paper Series No. 233, 2018).

125 *See, e.g.*, Coates, *supra* note 116, at 3-4 (describing how outside investors such as VCs traditionally have selected boards that become self-replacing for firms that go public, even though boards are nominally elected by shareholders, and how modern trends have given way to increased concentration of ownership among institutional investors such as index funds that now wield considerable influence).

126 Corporate law, including in Delaware, grants significant freedom to directors to amend corporate bylaws (the core governing documents of the company) unilaterally as part of their authority to manage the business and affairs of the corporation. *See infra* Part IV.A.2. Companies that scale using outside equity capital and lose their controlling stake in the company therefore often lose control over charter amendments, which must be approved by shareholders. *See* DEL. CODE ANN. tit. 8, § 141(a) (2020); Albert H. Choi & Geeyoung Min, *Contractarian Theory and Unilateral Bylaw Amendments*, 104 IOWA L. REV. 1, 15 (2018).

127 *See* Gelles, *supra* note 1; *see also* Mitchell, *supra* note 1; Peters, *supra* note 1.

128 Gelles, *supra* note 1; Mitchell, *supra* note 1; Peters, *supra* note 1.

129 *See* Gelles, *supra* note 1; Mitchell, *supra* note 1; Peters, *supra* note 1. See *infra* Part IV.A.1 for a more in-depth discussion of the limitations of dual-class stock in solving this problem.

that attempted to protect their social purposes after being purchased, but fell short.[130]

In addition, any scaling — whether through outside equity capital or otherwise — is also associated with a loss of managerial control. The increased size of the company means founders or early officers lose the ability to make day-to-day decisions for every aspect of the business, complicating retention of the objectives beyond profit. For example, they no longer personally select employees, outside investors, suppliers, distributors, and customers. They lose close ties and personal relationships with all of these stakeholders. Scaled companies must put into place distributed infrastructure systems to accommodate the exponential increases in production. They must transition from a world where they frequently know and trust their suppliers personally, to establishing robust and reliable global supply chains with suppliers they will never meet. They must shift from familiar and tested regional distribution channels to unknown national and international distribution channels for their products. They must comply with a host of new laws, both domestically and globally, and contend with much greater exposure to legal liability on a global forum. And they must delegate the hiring of a significant number of new employees to accomplish this work, while trying to maintain the underlying processes that led to their smaller-scale success.

[130] Take, for example, the Kashi example after it was acquired by Kellogg's, and a number of other similar examples. *See* Kesmodel & Gasparro, *supra* note 11. Even the acquisition examples touted as successes experience mixed results. For example, Ben & Jerry's attempted to memorialize its social purpose in contract in its acquisition negotiations with Unilever. It achieved varying degrees of success in doing so, including for example its independent social purpose advisory board, though within five years of the acquisition, many of the terms had sunsetted. It was also only upon new leadership at Unilever that there was renewed interest in reigniting Ben & Jerry's social purposes. Lastly, it is also critical to note that this example occurred with an acquirer — Unilever — known to be socially conscious and, as a European company, thought to be more amenable to combining social purpose and profit in business. *See* David Marchese, *supra* note 85. In general, it is well-established that these acquisitions are extremely difficult to get right. *See* Austin & Leonard, *supra* note 85 ("It is precisely because [these social icons] are different that they are appealing. These small innovators have mastered what we call a 'social technology' — a special know-how — that embeds social values into their missions, production processes, product characteristics, organizational cultures, and relationships with their employees, their suppliers, and their consumers. This constellation has created distinctive value propositions and powerful brand integrity. The social icons have cultivated new, high-growth market segments. The big companies that acquire them are betting on products with high social content becoming a salient component of the future marketplace. . . While these special attributes make the social icons attractive and valuable, they are also likely to be fragile and easy to disrupt or destroy.").

Companies that scale with outside equity capital thus highly risk the loss of the multiple objectives due to the losses of strategic and managerial control that occur at scale. Business law fails to provide a meaningful commitment mechanism to counter these losses, limiting these firms' potential for social and economic impact, and hindering their abilities to privately order themselves as they wish. It also undermines their abilities to contract with key third-party stakeholders such as employees and investors. Employees make significant firm-specific investments of their human capital, and the pursuit of objectives beyond profit is often a critical factor in employees' decisions to join a company.[131] It creates a costly employment decision for them if they cannot rely on the retention of the multiple objectives.[132] Whether the company is durably committed to objectives beyond profit over the long-term is also of critical importance to investors and lenders — who make significant financial investments in the firm. In fact, there is even evidence that some investors and lenders will give favorable financing terms to companies that can credibly commit to social purpose objectives alongside profit objectives, due to lower long-term risk assessments.[133] The lack of a durable commitment mechanism undermines a company's ability to assure prospective investors and employees that it will adhere to its multiple objectives over time, hindering its attractiveness as a contractual partner.[134]

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[131] *See* Hu & Hirsh, *supra* note 15, at 8; Achor et al., *supra* note 15; *see also* Gelles, *supra* note 1 (stating that employees took lower salaries to work at Etsy because it provided meaningful work).

[132] *See* Russell W. Coff, *Human Assets and Management Dilemmas: Coping with Hazards on the Road to Resource-Based Theory*, 22 ACAD. MGMT. REV. 374, 374 (1997); Nile W. Hatch & Jeffrey H. Dyer, *Human Capital and Learning as a Source of Sustainable Competitive Advantage*, 25 STRATEGIC MGMT. J. 1155, 1155 (2004); Yasemin Y. Kor & Huseyin Leblebici, *How Do Interdependencies Among Human-Capital Deployment, Development, and Diversification Strategies Affect Firms' Financial Performance?*, 26 STRATEGIC MGMT. J. 967, 967 (2005).

[133] *See* BNP PARIBAS, *supra* note 30.

[134] DANA BRAKMAN REISER & STEVEN DEAN, SOCIAL ENTERPRISE LAW: TRUST, PUBLIC BENEFIT AND CAPITAL MARKETS 23 (2017). Consumers and the general public often accuse businesses that claim to pursue social purposes of engaging in mere "greenwashing" in an effort to increase profits. When 181 CEOs of the world's largest companies issued a statement redefining the purpose of the corporation and stating that profit should represent but one goal of the business alongside consideration of other stakeholders, they were accused of attempting to avoid regulation and negative press. Shortly after Larry Fink, CEO of BlackRock, the world's largest fund manager, publicly urged CEOs to redefine the purpose of business to include social goals and especially sustainability, and announced the decision to prioritize sustainability in BlackRock's investment decisions, BlackRock rebuked the company Siemens over its environmental record but then voted to approve all management resolutions at its annual meeting,

B. *Scaling Up Through Private Growth*

This subpart describes a third option to scale up: private growth. A company that chooses to scale privately forgoes outside equity capital and remains a closely held company — meaning the founders generally retain a controlling stake.[135] This option has both benefits and drawbacks.

Perhaps most notably, because founders retain controlling stakes in the company, they retain voting control, helping mitigate the loss of strategic control associated with attaining outside equity capital. The founders more reliably retain control over the board and therefore high-level strategic oversight over the company.[136] Retaining this strategic control makes it perhaps more likely for the founders to continue balancing their social purpose and profit objectives. For example, it is perhaps not surprising that one of the most prominent large-scale examples of a company that articulates objectives beyond profit, Patagonia, is privately held.

But scaling privately also has several drawbacks: namely, it does not entirely mitigate the loss of strategic control, is still associated with a loss of managerial control, limits potential large-scale impact, and presents several barriers to widespread uptake.[137] First, scaling privately may only partly mitigate the loss of strategic control. For example, if a company scales up using debt financing, although it retains voting rights, it can give up serious control rights over the company due to terms attached to creditors' restrictive debt covenants.[138] If it experiences cash flow problems, as is common for scaling companies, it

Greenpeace Germany accused the firm of engaging in "blunt greenwashing." *See* Attracta Mooney, Joe Miller & Peter Smith, *BlackRock Rebukes Siemens on Its Environmental Record*, FIN. TIMES (Feb. 6, 2020, 8:06 AM), https://www.ft.com/content/92512bcc-48b3-11ea-aee2-9ddbdc86190d [https://perma.cc/5TA7-5N3X]; *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans*,' BUS. ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/2W3K-LPL9].

135 *See* James Chen, *Private Company*, INVESTOPEDIA, https://www.investopedia.com/terms/p/privatecompany.asp (last updated Aug. 8, 2020) [https://perma.cc/8472-BDJQ] [hereinafter *Private Company*].

136 *See id.*

137 *See* Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 161-62 (2019).

138 See *infra* Part IV.B.1, for more in-depth discussion of the restrictive debt covenants. *See also* Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1216-17 (2006); Bartlett, *Shareholder Wealth*, *supra* note 27, at 257.

may experience even greater losses of control.[139] In addition, scaling up privately is still often associated with a loss of managerial control because the company still grows in size, limiting managers' ability to oversee its now distributed operations. And by forgoing outside equity capital, the company also forgoes the significant outside expertise that usually accompanies it, further hindering the scaling process. Staying private also makes it more difficult to raise the necessary capital to scale, which the company must do through other means, such as debt or revenue.[140] Both of these financing alternatives present significant challenges, and because they are generally a smaller capital infusion, also limit a company's potential scale of impact.[141]

In addition, there are several barriers to widespread uptake of scaling privately. As a result, scaling privately may not be a viable option for most companies even if they wish to pursue it. First, companies may not be able to fully finance a scale with debt, and most will never be able to accrue the needed capital to scale through revenue alone at their earlier stages.[142] In addition, most startups that seek to scale are venture-backed, meaning a venture capital ("VC") firm has invested financially in the company and taken a non-controlling equity stake in return.[143] Although a VC firm usually does not have majority (board) control over the company, it can exert significant influence with its minority stake through significant monitoring and control rights that are disproportionate to its stock ownership, and which are negotiated as part of the financing agreement.[144]

139 For example, creditors might use the threat of accelerating debt to exercise significant control over the company. *See* Sudheer Chava & Michael R. Roberts, *How Does Financing Impact Investment? The Role of Debt Covenant Violations*, 63 J. FIN. 2085, 2085 (2008); Baird & Rasmussen, *supra* note 138, at 1217.

140 *See* Chen, *Private Company*, supra note 135.

141 Debt financing has several drawbacks, including losses of control, lack of liquidity, and restricting ability to attain future capital. See *infra* Part IV.B.1, for more in-depth discussion of the drawbacks of using debt financing to scale. In terms of growth through revenue, or bootstrapping, it is extremely difficult and often impossible to scale up through revenue alone. *See* ALLEYNE ET AL., *supra* note 122, at 122; Bartlett, *Shareholder Wealth*, *supra* note 27, at 256.

142 For companies that do not wish to scale up, using debt or revenue to finance can present a viable option. But these companies then have to forgo the option to scale up, limiting their social and economic impact.

143 *See* SHAI BERNSTEIN, RAMANA NANDA & ALLISON CIECHANOVER, HARV. BUS. SCH., NEWVIEW CAPITAL AND VENTURE CAPITAL SECONDARIES 2-3 (2019); Bartlett, *Shareholder Wealth*, *supra* note 27, at 263; Pollman, *Team Production Theory*, *supra* note 88, at 627-28.

144 Syndication of investments also increases the likelihood that VC investors will enjoy *collective* control over the startup. *See* Bartlett, *Venture Capital*, *supra* note 88, at

VCs generally follow a high-risk, high-reward portfolio investment strategy in which they actively invest in a number of startups but plan for a very small number to generate outsize returns through an IPO or acquisition.[145] Under the VC model, analysis has shown that only about 6% of startups, representing about 4.5% of dollars invested, generate about sixty percent of total returns.[146] The VC model relies on the most promising companies going public or getting acquired and doing so within a relatively short timeframe, so that VCs can achieve a liquidated return within the lifetime of the fund — usually around seven to ten years.[147]

As a result, the VC model often places distinct pressure on venture-backed startups to pursue an IPO or acquisition, and to do so quickly.[148] These startups face serious disincentives from scaling privately — and in fact are frequently actively discouraged or barred from doing so by investors who may collectively control the board or exercise control disproportionate to their level of stock ownership. This funding structure often eliminates or significantly undermines long-term private sustainable growth as an option. For a variety of reasons, then, private growth on its own is not a viable solution for companies with objectives beyond profit that seek to scale or that seek to have large-scale impact.

C. *The Lacking Commitment Mechanism*

When a company with objectives beyond profit seeks to scale, it thus faces three unappealing options: IPO, get acquired, or go it alone privately. And if the company is venture-backed, the pressure to pursue one of the first two options — which are most highly associated with losses of strategic and managerial control — is frequently quite strong. No matter which avenues a multiple-objective company pursues, it is difficult to reliably tie itself to the mast of its social purpose and profit objectives through private ordering.

Companies with objectives beyond profit encounter this problem whether they traditionally incorporate, incorporate as a PBC, or

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55; *see also* BERNSTEIN ET AL., *supra* note 143, at 8-11; Bartlett, *Shareholder Wealth*, *supra* note 27, at 263-66; Pollman, *Team Production Theory*, *supra* note 88, at 619.

145 *See* BERNSTEIN ET AL., *supra* note 143, at 2.

146 *Id.*

147 *Id.* Firms that pursue private equity financing also face this similar problem.

148 *See* Bartlett, *Shareholder Wealth*, *supra* note 27, at 263-65 (explaining the bargaining control VC investors can exert over company decisions for liquidity-constrained founders). This is even the case for many, if not most, socially conscious investment firms, which still need a return on their investment and favor exit as the means of doing so. *See infra* Part IV.B.2.

privately contract, including B-Corp certification. For companies that pursue traditional incorporation, their charter commitments and internal organizational practices have little staying power. The loss of strategic control associated with an IPO or acquisition means these measures are easily removed, ignored, or eliminated. Even for the small number of companies with multiple objectives that are able to scale up privately, they may still experience a loss of strategic control, particularly if they finance through debt. In addition, the loss of managerial control can make it difficult to maintain the internal organizational practices that once preserved the objectives beyond profit.

For PBCs, the legal incorporation form proves largely toothless. Narrow and weak enforcement mechanisms, as identified in Part II, result in little accountability for managers and directors of PBCs at any stage. The losses of strategic and managerial control at scale compounds this lack of accountability: those with newfound strategic and managerial control can simply redirect the company however they desire, which frequently results in a loss of the objectives beyond profit. On its own, then, the PBC form does not provide a meaningful commitment mechanism at scale.

Finally, private contracting and B-Corp certification also lack commitment mechanisms to help companies pursue objectives beyond profit at scale. New managers and directors can easily change the terms of their contracts with stakeholders such as employees, customers, and suppliers. They can also easily let the B-Corp certification expire. B-Corp certification requires significant sustained company resources to achieve and maintain. This rigor is both a blessing and a curse: it provides the highest third-party standard available, but it also makes it easy to abandon the certification. Private growth combined with B-Corp certification is perhaps the best strategy for a company with multiple objectives seeking to scale because it helps reduce problems associated with the loss of strategic control. But to pursue this route requires largely forgoing most sources of available capital, including outside equity capital (and possibly debt), in order to retain strategic control. Because of the significant VC pressure to IPO or sell on a short timeline, it may also mean forgoing VC capital earlier in the lifecycle of the company. Forgoing VC capital can threaten early-stage and growth-stage company survival — as well as company long-term potential impact — by eliminating a significant potential source of capital for liquidity-constrained founders.[149] Private contracting and B-Corp certification thus prove largely insufficient to protect the pursuit of multiple objectives at scale.

No matter which way these companies privately order themselves — no matter how they incorporate or privately contract — they cannot reliably commit to their pursuit of objectives beyond profit. Under existing private ordering frameworks, when companies with objectives beyond profit scale up, they can easily renege on whatever promises they made at the outset to pursue social purpose alongside profit. In other words, the existing options lack a durable commitment mechanism that enables the company to bind itself to objectives beyond profit in the future.

The lacking commitment mechanism is problematic because it limits these companies' potential social impact. It is problematic because it prevents these companies from assuring prospective investors and employees, who make significant firm-specific investments, that the company will abide by its social purposes over the long-run. And it is problematic because it hinders these companies from privately ordering as they wish. As a result, most companies with multiple objectives either raise outside equity capital to scale and lose their social purpose objectives in the process, or they forgo outside equity, remain small or fail, and have limited social and economic impact.[150] Despite the promise of the PBC form, business law does not currently provide a viable commitment mechanism to help address this problem.

149 Because founders are generally liquidity-constrained and lack the ability to secure traditional bank financing, VC finance is a significant source of capital to overcome these financing challenges. *See* Bartlett, *Shareholder Wealth*, *supra* note 27, at 263.

150 Some notable examples diverge. Patagonia has famously remained a privately held company that continues to pursue social objectives alongside profit. Several publicly traded companies also seek to pursue dual objectives, though opinions differ on their degree of success. Examples include Danone and its subsidiary Danone North America, which is the largest certified B-Corp in the world, and Unilever, which engages frequently in socially conscious acquisitions. Danone and Unilever are headquartered in Europe, to which many attribute a different underlying cultural approach to the pursuit of social good in business. There is also Laureate, the first ever publicly traded public benefit corporation, though may question the true social impact of the company. The insurance company Lemonade, which is both a PBC and a certified B-Corp, went public in July 2020 in the year's best IPO debut to date. Vital Farms, a Delaware PBC and certified B-Corp known for its pasture-raised egg production, went public in an extremely successful IPO on July 31, 2020. *See* Chloe Sorvino, *Vital Farms' Blockbuster IPO Proves Wall Street Has an Appetite for Sustainable Farming*, FORBES (Aug. 1, 2020, 6:00 AM ET), https://www.forbes.com/sites/chloesorvino/2020/08/01/vital-farms-blockbuster-ipo-proves-wall-street-has-an-appetite-for-sustainable-farming/#2ac8194a345b [https://perma.cc/ME5G-NCJS].

IV. PROPOSING SOLUTIONS

To help address the lacking commitment mechanism, this Part proposes providing a voluntary commitment mechanism in business law. This proposal would require multiple stakeholder board representation and socially conscious executive compensation for PBCs that go public, get acquired, or exceed a certain size. This Part also discusses the merits and critiques of this proposal compared to several other potential solutions in corporate governance and corporate finance.

A. *Providing a Commitment Mechanism in Business Law*

This subpart proposes providing a voluntary commitment mechanism in business law by enacting a two-pronged amendment to PBC law that would apply to PBCs that go public, get acquired, or exceed a certain size.[151] This proposal would require first, multiple stakeholder board representation, and second, socially conscious executive compensation for these PBCs.[152]

1. Multiple Stakeholder Board Representation

The first prong of the proposal would trigger multiple stakeholder board representation for scaled PBCs.[153] This prong would require equal numbers of shareholder-elected representatives and social purpose-

[151] In other words, for these companies — which have voluntarily opted into the PBC form — the commitment mechanism would not be waivable or redeemable, but rather, would provide a tighter framework on how the firm operates in order to provide a meaningful commitment device.

[152] The proposal focuses on Delaware because it is the most significant United States jurisdiction from a business law perspective. *See, e.g.*, *In re* Prudential Ins. Co. Derivative Litig., 659 A.2d 961, 969 (N.J. Super. Ct. Ch. Div. 1995) ("Delaware is recognized as a pacesetter in the area of corporate law."); Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661, 678 ("The corporation leader in the United States is now Delaware."); Omari Scott Simmons, *Branding the Small Wonder: Delaware's Dominance and the Market for Corporate Law*, 42 U. RICH. L. REV. 1129, 1172 (2008) ("Delaware is viewed as a pioneer and perennial leader in the market for corporate law.").

[153] For wholly acquired PBCs, it could require a separate, balanced board for the subsidiary, as for example Ben & Jerry's negotiated with Unilever. Indeed, it is quite common for subsidiaries in general to have separate boards from their parent companies. *See* DELOITTE, GOVERNANCE OF SUBSIDIARIES: A SURVEY OF GLOBAL COMPANIES 4 (Sept. 2013), https://www2.deloitte.com/content/dam/Deloitte/in/Documents/risk/Corporate%20Governance/in-gc-governance-of-subsidiaries-a-survey-of-global-companies-noexp.pdf [https://perma.cc/5YDC-CVRB].

elected representatives on the board.[154] The social purpose board members could consist of employee-elected employee representatives; nonprofit representatives from charities related to the company's social purposes; or academic representatives. They could also include a representative who does currently or has recently served as an executive or board member of another PBC or B-Corp. And they could include representatives with a long-term association with the company and knowledge of its founders, history, multiple objectives, and organizational identity — although in keeping with good governance practices, the number of long-term insider representatives should not exceed the number of outside social purpose representatives.[155]

Relatedly, it may be beneficial to retain the company's founder or current CEO on the board, past his or her tenure in management. Management research has shown the critical and long-lasting effects of founders' and early officers' imprints on their companies.[156] These imprints can last long past the founders' tenures or even lifetimes — even for large-scale publicly traded companies.[157] Several examples illustrate the importance of founder or early CEO visionary leadership to the success of companies with multiple objectives. Patagonia's founder Yvon Chouinard, Danone's CEO Emmanuel Faber, Ben & Jerry's founders Ben Cohen and Jerry Greenfield, and Beyond Meat's Ethan Brown are all widely believed to have outsize and ongoing impact on their companies' successful pursuit of objectives beyond profit, including at scale, and for many of them beyond their tenure in management.[158] Including these representatives on the board, if they are no longer serving in a management capacity at the company, could have significant impact on retaining multiple objectives post-IPO or post-acquisition.[159]

[154] Elements of this proposal have been adapted from two real-world examples. First, Ben & Jerry's moderately successful external social purpose board, and second, from a large multinational company in the sample, which uses outside advisory boards to help it push forward its commitments to social purpose. *See* Austin & Leonard, *supra* note 85, at 94; Aguirre, *supra* note 12.

[155] *See* Lucian Bebchuk & Michael Weisbach, *The State of Corporate Governance Research*, 23 REV. FIN. STUD. 939, 944 (2010). The presence of these independent directors on the PBC board would ostensibly provide them an informational advantage over outsiders that would enable them to add value to the company.

[156] *See* Battilana et al., *supra* note 32, at 1659; Vallaster et al., *supra* note 35 at 22-23; *see also* REINHARDT ET AL., *supra* note 16.

[157] *See* Battilana et al., *supra* note 32, at 1659; Vallaster et al., *supra* note 35, at 22-23.

[158] *See, e.g.*, REINHARDT ET AL., *supra* note 16, at 1; Austin & Leonard, *supra* note 85.

[159] And, including the founders, a former CEO, or another long-term company representative can help preserve the objectives beyond profit without requiring the

However, this proposal is not without downsides. Including insiders on boards runs counter to the growing consensus around an increased role for independent board members as good corporate governance practice.[160] Trading off the importance of imprinting and a visionary founder or CEO with the downsides of insider entrenchment must be considered carefully, and should be mitigated by ensuring the number of total insider social purpose board members does not exceed the number of independent social purpose board members. In addition, the number of insider board members across both shareholder-elected members and social purpose board members should not exceed the number of total independent board members. This proposal seeks to address this concern by limiting long-term insider spots on the board to just one or two — the founders or most recent CEO.

This Paper derives several details of the multiple stakeholder board proposal from real-world businesses' experiences. To take a specific example, Ben & Jerry's negotiated an outside social purpose board — an unusual term in an acquisition — which has helped retain pursuit of objectives other than profit after its acquisition by Unilever.[161] The external social purpose board helped protect the company's social purposes, albeit not perfectly, during a time period when the parent company did not have leadership that particularly valued Ben & Jerry's social purpose orientation.[162]

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blunt approach of dual-class shares. For greater discussion of dual-class shares, see *infra* Part IV.A.1.

160 *See, e.g.*, Bebchuk & Weisbach, *supra* note 155, at 943-44. *But see* James D. Cox, *Fair Pay for Chief Executive Officers*, *in* LAW AND CLASS IN AMERICA: TRENDS SINCE THE COLD WAR, ch. 6 (P.D. Carrington & T. Jones, eds., 2006) (noting that independent directors can suffer from the same agency problems as the managers they are charged with monitoring, particularly because of the importance of the CEO in selecting independent directors). It should also be noted that a provision that ensures longevity may also be at odds with efforts to improve the racial and gender diversity on boards. Because founders and long-term insiders in these industries tend to be white and male, a provision that ensures their retention is a provision that undermines diversity efforts. For example, following this process of retaining insiders has previously gotten the tech industry in trouble. *See, e.g.*, Lisa Fairfax, *Board Diversity Revisited: New Rationale, Same Old Story*, 89 N.C. L. REV. 856, 880-83 (2011).

161 *See* Austin & Leonard, *supra* note 85, at 94; Marchese, *supra* note 85.

162 *See* Austin & Leonard, *supra* note 85, at 94; Marchese, *supra* note 85. To take another example, one large company uses outside advisory boards comprised of nonprofit managers and academics to help reinforce and advance its commitments to social purpose. Notably, this company is an unusual example in that it is a wholly owned subsidiary; its parent company is also committed to both social and financial goals and helps drive the subsidiary's social goals. This arrangement perhaps helps explain why the subsidiary successfully relies on more informal advisory boards, rather than having an external social purpose board. And yet, even with a parent company that

Empirical research in management has also shown the importance of implementing this kind of "organizational guardrail" in organizations that articulate objectives beyond profit.[163] Organizational guardrails refer to "formal structures, leadership expertise, and stakeholder relationships" associated with each of the organization's multiple objectives, which facilitate ongoing adherence to both core organizational goals, and thereby help sustain both over time.[164] The multiple stakeholder board represents one such guardrail.[165] For example, evidence has shown that including multiple stakeholders on the board enables better fulfillment of objectives beyond profit.[166] In addition, research on employee representation has shown that worker representation on corporate boards can help result in greater worker fulfillment and better treatment of employees, without negatively impacting capital formation.[167] This additional representation from outside directors is also in concert with the mounting movement toward increasingly independent boards as good corporate governance.[168]

The process of board selection is also an important component of this proposal. Relying on consistent and sustained outside third-party perspectives to select the board helps support robust pursuit of social purposes while avoiding entrenchment and following good governance practices.[169] It provides an ongoing system of checks and balances to

drives its commitment to objectives beyond profit, this subsidiary still enacts organizational guardrails consisting of outside social purpose advocates. This example underscores the importance of outside social purpose representatives on these companies' boards to help retain the pursuit of multiple objectives at scale. Empowering these boards with more than simply advisory capacity seems particularly important when, as in most cases, the company does not have an especially socially conscious parent company reinforcing its pursuit of multiple objectives. *See* Aguirre, *supra* note 12.

[163] *See, e.g.*, Smith & Besharov, *supra* note 18, at 1; *see also* Battilana & Dorado, *supra* note 18, at 1431; Pache & Santos, *supra* note 18, at 995; Vallaster et al., *supra* note 35, at 20.

[164] *See* Smith & Besharov, *supra* note 18, at 1.

[165] *See* Austin & Leonard, *supra* note 85, at 96; Vallaster et al., *supra* note 35, at 20.

[166] *See* Austin & Leonard, *supra* note 85; Vallaster et al., *supra* note 35, at 20.

[167] *See* Julie Yen, Julie Battilana, and Emilie Aguirre, *Worker Well-Being, Workplace Democracy, and the Pursuit of Multiple Objectives*, *in* HANDBOOK ON THE BUSINESS OF SUSTAINABILITY (forthcoming 2021); Simon Jäger, Benjamin Schoefer & Jorg Heining, *Labor in the Boardroom* 23 (Nat'l Bureau of Econ. Research, Working Paper No. 26519, 2019).

[168] *See supra* note 155 and accompanying text.

[169] *See, e.g.*, Cox, *supra* note 160 (pointing out the potential perils of CEOs having a large role in selecting independent directors). Removing the selection of the social purpose board members from the CEO's ambit would help address these problems — though raises the corollary question of who would comprise the coalition that elects the social purpose board members.

better ensure informed and diverse perspectives on social purpose as the company evolves.[170] Non-shareholder third parties that select the social purpose board members could include nonprofit organizations such as B-Lab, the third-party certifier of B-Corps; or the Sustainability Accounting Standards Board ("SASB"), an organization that sets financial reporting standards; or other charitable organizations related to the company's specific social purpose.[171] It could also include academics or the founders themselves, if they are not on the board. In addition, the employee representative will be employee-elected. Ensuring that outside, disinterested parties — and not board members or senior management — select the social purpose members will help ensure social purpose board members are robust advocates for the objectives beyond profit, can help avoid managerial entrenchment, and can help address board independence concerns.[172]

In addition to the mandatory rule for acquired or public PBCs, this proposal would also establish a default rule — that is, an opt-out rule — of multiple stakeholder board representation for privately held PBCs upon twenty percent founder equity dilution. This level of dilution often occurs when a startup secures Series A venture capital funding. Series A funding can be a key inflection point for companies with objectives beyond profit because of shifting power dynamics and incentives that occur with the introduction of an outside VC investor.[173] Supplying a default rule at this critical inflection point provides companies that pursue objectives beyond profit with a framework to help them pursue multiple objectives at a critical juncture. Doing so can not only help preserve the objectives beyond profit, it can do so without requiring founders or managers to become experts in the academic corporate governance and management literatures, reducing transaction and information costs. But if these firms do not want to

[170] For example, ensuring outside involvement in board selection can also help address current efforts to diversify boards. Because founders and long-term insiders tend to be white and male, a provision that maintains their involvement undermines diversity efforts. This reliance on third-party nonprofit involvement can help provide a check against this status quo and broaden out pursuits of social purposes.

[171] *See, e.g.*, SUSTAINABILITY ACCOUNTING STANDARDS BOARD, https://www.sasb.org/ (last visited Dec. 19, 2020) [https://perma.cc/V9LX-CAKJ] ("[The Sustainability Accounting Standards Board] connects businesses and investors on the financial impacts of sustainability.").

[172] Ensuring third-party selection of social purpose board members finds support in the literature on what constitutes good corporate governance and board independence. Fairfax *supra* note 160.

[173] *See, e.g.*, *infra* Part IV.C.2 (explaining how the Buffer Company ultimately bought out its VC investors).

enact the multiple stakeholder board, the default rule also enables opt-out, preserving the value placed on private ordering in business law.

This proposal suggests broadening board representation to include social purpose board members. If this approach is not considered to go far enough, a further step could even consider creating a new liability rule for social purpose board members. This rule — which would admittedly be quite a controversial proposal — would, for example, subject all board members to standard duties of care and loyalty, but the duties could run to the constituency that elected the individual board member rather than automatically to shareholders. For example, the employee representative would be liable to employees, and the other social purpose board members would be liable to the third parties involved in their election, such as B-Lab, SASB, or another charitable organization, and traditional board members would of course be liable to shareholders.[174] A new liability rule would raise a host of issues, but could be considered to further distinguish the PBC form from traditional corporate forms if desired.[175]

The multiple stakeholder board has several upsides. First, because it is required of those companies that opt in, it helps specifically address the lacking commitment mechanism in business law. In addition, it is well-suited to address the loss of strategic control at scale because it targets the composition of the board. As described previously, outside equity financing generally results in a dispersal of ownership and dilution of founder equity.[176] Founders or current management, who have led the company to success thus far, lose their ability to elect the board. As a result, they lose high-level strategic control over the company. Multiple stakeholder board representation presents a structural solution to help address this loss of strategic control by requiring representation of the social purpose on the board, *but only* for those who voluntarily opt in. Introducing social purpose board members helps better match board representation to the company's

[174] In this case, remedies for breach should only include injunctive relief or economic damages that would go toward curing the neglected social purpose, and no economic damages should be awarded to the suing stakeholders personally. This rule would mirror current rules in PBC law and Model Benefit Corporation legislation.

[175] In addition to being likely politically intractable, this new liability rule would raise a host of other issues. For example, would it would better align directors' incentives, or would it actually entrench directors in pursuit of a narrow set of interests? Would any directors even be willing to serve under these terms? How would individual liability would actually work and would it be effective in practice? Would D&O insurance undercut the utility of such a rule? Alternatively, would D&O insurance become prohibitively expensive?

[176] *See supra* Part III.A.

objectives, ensuring both social purpose and profit are represented and better balanced at the board level. In doing so, it helps mitigate pressures to diverge from the pursuit of the multiple objectives, especially in the presence of an increasing number of outside investors who may not value social purpose as highly.[177] Boards will be better equipped to balance social purpose and profit objectives in their critical high-level decision-making — such as setting overall company strategy and hiring officers including the CEO.

There are also several potential critiques to this proposal. First, this proposal is offered as an empirically informed starting point, and not as a fully worked out solution, to help solve the lacking commitment mechanism in business law for companies with objectives beyond profit. It will be critical going forward to optimize the details of the proposal to ensure it best achieves its aims. Another potential critique may argue that other countries engage in multiple stakeholder board representation to negative effect. Relatedly, detractors of this multiple stakeholder board proposal may argue that putting different stakeholders on the board does not mean they will adequately represent the broader interests of the company or their constituents once elected. A third related critique might argue that increasing the board or introducing representatives with such different constituencies may result in intractable decision-making or irreparably upset internal board dynamics. For example, influential arguments have posited that worker representation in Germany undesirably blocks company decision-making or results in disinvestment in the company.[178]

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[177] For companies that pursue social purpose and profit objectives, stakeholder-inclusive governance and the "design of formal, structured, and ongoing connections with complex stakeholder networks" that are inherent to these companies have been shown to be particularly important to retain the multiple objectives. These pressures can go both ways: As outside equity investors increase, the company may experience additional pressure to pursue the profit objective. But it may also experience pressure to pursue the social purpose objective at the expense of achieving profitability or even viability — for example from customers, employees, or even third-party certifiers. Ensuring balance on the board helps chart a middle course between the two objectives. *See, e.g.*, Vallaster et al., *supra* note 35, at 20 (noting a balance between decision makers "allows for-profit hybrids to acknowledge and strategically address evolving expectations in distinct economic and socio-environmental ecosystems").

[178] *See, e.g.*, Paul A. Grout, *Investment and Wages in the Absence of Binding Contracts: A Nash Bargaining Approach*, 52 ECONOMETRICA 449, 449 (1984) (positing that "in the absence of binding contracts inputs will not be employed efficiently if the union has any power"); Michael C. Jensen & William H. Meckling, *Rights and Production Functions: An Application to Labor-Managed Firms and Codetermination*, 52 J. BUS. 469, 473-75 (1979) (arguing "codetermination or industrial democracy is less efficient than the alternatives which grow up and survive in a competitive environment").

Yet proponents of the German model point to the success of German businesses and relative superior well-being of German workers compared to the United States. For example, one empirical study of German firms found that codetermination — that is, including workers on boards — actually resulted in positive effects on capital formation and long-term investment in the firm, rather than disinvestment, as feared.[179] In addition, nonprofit boards are usually much larger in size than for-profit boards, and contain members representing a range of social purpose and financial objectives, yet they function successfully on the whole. These examples suggest a counterpoint to concerns about intractability or ineffectiveness of larger boards that represent a wider range of constituencies.

2. Socially Conscious Executive Compensation

The second prong of the proposal would require socially conscious executive compensation in PBCs that go public, are acquired, or exceed a certain size. For most major companies, executive pay is linked heavily to financial performance-based metrics, which currently account for an average of 90–95% or more of executive compensation.[180] Executive compensation is generally tied to stock price, achieving quarterly targets, and measures of profitability.[181] For PBCs that pursue both social purpose and profit, this method of compensation ignores a significant proportion of their objectives. It creates lopsided incentive structures toward the profit objective at the expense of the social purpose objectives.[182]

Instead, this prong of the proposal would link a significant proportion of executive pay in these PBCs to certain social impact metrics. These

179 Jäger et al., *supra* note 167, at 3. *But see* Jens Dammann & Horst Eidenmueller, *Codetermination: A Poor Fit for U.S. Corporations* 44 (European Corp. Governance Inst., Law Working Paper No. 509, 2020) (arguing against mandatory codetermination in the U.S. and pointing out the inconclusive evidence on codetermination in Germany). It should be noted, however, that Dammann and Eidenmueller refer to codetermination that would elect around half of a company's board, rather than one seat, as this proposal would require.

180 *See* Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 149-50 (2020); Cox, *supra* note 160, at 102.

181 For example, financial metrics are generally the sole metrics used when determining executive compensation, valuating the company, and so on. Stock price and quarterly targets are two examples of financial metrics used to assess performance. Bebchuk & Tallarita, *supra* note 180, at 139-40, 153.

182 *See* Ofer Eldar, *Designing Business Forms to Pursue Social Goals*, 106 VA. L. REV. 937, 941-42 (2020) ("Ideally, the firm should have a financial stake in the accomplishment of the social mission.") [hereinafter *Designing Business*].

social impact metrics could include employee satisfaction, environmental impact, and B-Corp score. For example, this proposal could require linking ten percent of executive compensation to employee satisfaction, ten percent to environmental impact, and ten percent to achievement of a certain B-Corp score, for a total of thirty percent of executive compensation linked to social impact.[183] Recognizing that PBCs frequently experience a loss of managerial control at scale whether they are publicly traded, acquired, or privately held, this proposal would apply not only to acquired and public PBCs, but also to PBCs above a certain size.

Employee satisfaction could be measured by a survey administered at regular intervals to all employees and contractors.[184] The survey could be as simple as a standard net promoter score ("NPS"), in which employees are asked to answer on a scale of one to ten how satisfied they are with their employer. Environmental impact could be measured via a third-party standard such as the metrics put forth by SASB, the nonprofit third-party organization that sets financial reporting standards.[185] The B-Corp score could be assessed by performance on B-Lab's certification scheme. Companies need to score a minimum of eighty points to achieve certification, but can score a maximum of two hundred, leaving ample room for improvement across a range of categories even for certified B-Corps, particularly since no company has, to date, achieved a perfect score of two hundred.

For all of these measures, executive compensation could be linked in several ways. It could follow a sliding scale, such that the higher the score, the higher the compensation. Or it could be linked in a binary way, with that proportion of the CEO's compensation triggered only if a certain minimum score is achieved. It could also be structured to reward executives for improving their scores in the different categories by a certain percent, or for achieving or maintaining a certain score. Alternatively, the board could set certain social impact goals, with executives compensated only if they meet those goals. For example, one multinational company links employee and executive bonuses to the achievement of certain measurable social impact goals that the employees set themselves each year in conjunction with their

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[183] Not all PBCs are certified B-Corps. If a PBC did not want to certify as a B-Corp, it could assess its score using B-Lab's publicly available assessment tool.

[184] Both of the in-depth field sites in the research sample — both the early-stage startup and the large-scale publicly traded company — engage in this practice of surveying employee satisfaction. *See* Aguirre, *supra* note 12.

[185] SUSTAINABILITY ACCOUNTING STANDARDS BOARD, *supra* note 171.

managers.[186] One option would be for this proposal for socially conscious executive compensation to also follow that framework. In addition, this proposal would require that the company's multiple stakeholder board approve the socially conscious executive compensation scheme, to help better ensure arms' length dealing and accountability. This element of the proposal also underscores how these two prongs would work together in tandem and mutually reinforce each other.

As with multiple stakeholder board representation, socially conscious executive compensation could take several forms, and of course the devil is in the details. It will be critical to identify the right social impact metrics to properly incentivize desired outcomes. When designing socially conscious executive compensation provisions, it will also be key to strike the right balance between standardization and flexibility. On the one hand, the scheme must consist of standardized legal rules that cannot be gamed. On the other, it must also have the flexibility to enable companies to tailor to their individual circumstances and to accommodate inevitable evolutions in social purposes over time. As with multiple stakeholder board representation, this Paper does not claim to have optimized the proposal for socially conscious executive compensation in PBCs, and much can be critiqued about the specific details offered.[187] But it does claim to offer an empirically informed starting point and basic framework to help address the lacking commitment mechanism in business law for companies with objectives beyond profit.

Socially conscious executive compensation has several upsides. First, it is well-suited to address the loss of managerial control at scale by incentivizing managers to take social purpose objectives into account alongside profit. Linking a substantial percentage of executive compensation to social impact metrics would elevate social purpose to a more balanced position alongside profit, and better ensure executives take the social purpose objectives into account in their daily management of the company. In addition, the use of metrics

[186] *See* Aguirre, *supra* note 12. It should be noted that arms' length negotiation has been shown to be an important factor linked to good governance in determining executive pay. It will be important to ensure striking a balance between calibrating incentives that are best linked to their intended social impact metrics, and avoiding executives coopting their own payment structures. *See* Lucian Bebchuk & Jesse Fried, *Executive Compensation as an Agency Problem*, 17 J. ECON. PERSP. 71, 71-72 (2003) [hereinafter *Executive Compensation*]; LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE ix (Harvard Univ. Press 2004) [hereinafter PAY WITHOUT PERFORMANCE].

[187] Defining the specifics of these metrics is the ongoing subject of future empirical work.

documenting the company's social impact would further strengthen the credibility of its commitment by providing quantifiable and auditable assurances to investors and employees, who invest their financial and human capital in the firm, that it will not stray from the pursuit of multiple objectives.[188] Socially conscious executive compensation would provide an additional organizational guardrail to protect the objectives beyond profit as these companies scale up.

There are also several critiques to this proposal. A primary critique is that linking executive compensation to achieving certain *financial* metrics has led to negative unintended consequences.[189] Performance-based compensation in the financial context has frequently been shown not to solve the agency problems it intends to address, or to properly incentivize executive behavior to achieve intended outcomes.[190] It is not clear, then, why it should be extended to the socially conscious context when it has not been proven to work well in the financial context.

However, the failure to properly align incentives in other contexts does not mean performance-based compensation should be eliminated wholesale. Rather, it suggests a need for greater emphasis on correctly

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188 *See* BRAKMAN REISER & DEAN, *supra* note 22, at 124-26; Eldar, *Designing Business*, *supra* note 182, at 940 ("[I]t is extremely difficult to verify companies' social impact. Existing measures of social impact tend to be vague, include metrics that are difficult to quantify, and even mix shareholder protection metrics with environmental or societal ones.").

189 *See* BEBCHUK & FRIED, PAY WITHOUT PERFORMANCE, *supra* note 186, at ix (arguing that "[f]lawed compensation arrangements have been widespread, persistent, and systemic, and they have stemmed from defects in the underlying governance structure that enable executives to exert considerable influence over their boards. Given executives' power, directors could not have been expected to engage in arm's-length bargaining with executives over their compensation"); JEFFREY PFEFFER, WHAT WERE THEY THINKING?: UNCONVENTIONAL WISDOM ABOUT MANAGEMENT 75 (Harvard Bus. Sch. Press, 2007) (finding that incentives that are too large begin to drive, and thereby distort, behavior, leading them to backfire, whereas rewards that are large enough to be noticed, and provide an occasion for celebration and recognition, can help better generate successful and intended outcomes); Bebchuk & Fried, *Executive Compensation*, *supra* note 186, at 72; Robert Daines, Vinay B. Nair, & Lewis Kornhauser, *The Good, the Bad and the Lucky: CEO Pay and Skill* 7 (NYU Working Paper No. CLB-06-005, 2005) (finding that the effect of incentive-based executive compensation is highly context-dependent and varies depending on various characteristics of firms); Kevin J. Murphy & Michael C. Jensen, *The Politics of Pay: The Unintended Consequences of Regulating Executive Compensation*, 1-3 (Univ. of S. Cal. Gould Sch. of Law, Ctr. For Law & Soc. Sci. Research Paper Series No. 18-8, 2018).

190 *See* BEBCHUK & FRIED, PAY WITHOUT PERFORMANCE, *supra* note 186, at 4; PFEFFER, *supra* note 189, at 78; Iman Anabtawi, *Explaining Pay Without Performance: The Tournament Alternative*, 54 EMORY L.J. 1557, 1558 (2005); Bebchuk & Fried, *Executive Compensation*, *supra* note 186, at 72-73; Daines et al., *supra* note 189, at 6-7; Murphy & Jensen, *supra* note 189, at 49-51.

calibrating incentives to the desired outcomes, and adjusting accordingly if a set of incentives results in unintended consequences.[191] Research showing the context-dependency of successful incentive-based executive pay suggests that incentives can indeed help drive desired managerial behavior — but to do so successfully requires certain characteristics be met, such as properly calibrating the incentives, spending adequate time devising the incentives, and arriving at them through arms' length negotiation.[192] The successful experience of one large multinational company that links bonuses to the achievement of social impact metrics also provides an important counter-example to address this critique.[193] It suggests that with the right metrics, socially conscious compensation could be implemented successfully in practice. The presence of a multiple stakeholder board can also help by increasing independent (and socially conscious) director involvement in executive compensation, and de-emphasizing reliance on financial metrics that may have previously been distortive.[194]

[191] *See, e.g.*, Sanjai Bhagat, Brian Bolton & Roberta Romano, *Getting Incentives Right: Is Deferred Bank Executive Compensation Sufficient?*, 31 YALE J. ON REG. 523, 523 (2014) (on recalibrating incentives in the banking context to better incentivize desired executive behavior); Cox, *supra* note 160 (describing the harmful features of poorly designed financially-based executive compensation).

[192] *See* BEBCHUK & FRIED, PAY WITHOUT PERFORMANCE, *supra* note 186, at ix; PFEFFER, *supra* note 189, at 80; Bebchuk & Fried, *Executive Compensation*, *supra* note 186, at 89; Sanjai Bhagat & Roberta Romano, *Reforming Executive Compensation: Focusing and Committing to the Long-term*, 26 YALE J. ON REG. 359, 361 (2009); Daines et al., *supra* note 189, at 18; *see also* Anabtawi, *supra* note 190, at 1599 (asserting an alternative tournament theory explanation of executive pay that explains the disconnect between performance and pay, and arguing that reallocating decision-making authority away from boards and toward shareholders in response would be misguided); Cox, *supra* note 160, at 106, 109 (explaining the little amount of time boards (or compensation committees) devote to devising executive compensation packages, and the insularity of the process).

[193] *See* Aguirre, *supra* note 12.

[194] To the extent that socially conscious executive compensation reduces managers' say over their own pay and increases arms' length negotiations over executive pay, and to the extent it creates less distortive incentives by diversifying the metrics by which executives are compensated, this proposal would help address and mitigate some of the serious shortcomings plaguing current executive compensation arrangements as identified not only in the business law literature, but also the finance and management literatures. *See* BEBCHUK & FRIED, PAY WITHOUT PERFORMANCE, *supra* note 186, at x; PFEFFER, *supra* note 189, at 80; George Baker, Robert Gibbons & Kevin J. Murphy, *Subjective Performance Measures in Optimal Incentive Contracts*, 109 Q.J. ECON. 1125, 31-33 (1994) (arguing that compensation contracts based solely on objective performance measures create distorted incentives); Bebchuk & Fried, *Executive Compensation*, *supra* note 186, at 71, 74; Daines et al., *supra* note 189, at 27.

Another critique asks why companies cannot engage in socially conscious executive compensation on their own and need a change in the law to implement this measure. Of course, companies can adopt socially conscious executive compensation on their own, and in fact some do. But the problem identified in this Paper is that they cannot adequately *commit* themselves to doing so over the long-term. Creating a voluntary commitment device in business law by requiring socially conscious executive compensation in PBCs helps address this problem. The required element of the proposal — again, for companies that have voluntarily elected to opt in — is critical to its effectiveness as a commitment device.

In addition, for this proposal to succeed, it will require development of more robust social impact metrics in order to assess whether these firms are succeeding in achieving their social aims.[195] Over the last several decades, the for-profit sector has developed in-depth financial metrics that are now taken for granted as the only significant way to assess company performance.[196] These financial metrics include, for example, profit, revenue, stock price, valuation, and quarterly targets. The unidimensional accounting practices that underlie this system also rely solely on financial metrics. Equivalently robust social impact metrics lag behind.[197] They lag in robustness, uniformity, and social acceptance as an important performance indicator for a for-profit company — even one that explicitly and overtly pursues both social purpose and profit objectives. And they lag in particular outside of the sustainability context.

Some accounts claim that the lack of robust social impact metrics is because it is too difficult to quantify social impact. But progress in sustainability metrics provides a counter-example. For example, SASB has developed robust, largely generalizable metrics that are gaining traction as the gold standard in assessing company performance in sustainability. In his most recent annual letter to CEOs, BlackRock Chairman and CEO Larry Fink called for firms to make standardized

[195] Improved social impact metrics would also facilitate the success of the voluntary commitment mechanism proposal by enabling better, more holistic assessment of board activity, and particularly of the social purpose activity of boards.

[196] *See* Frank Dobbin & Dirk Zorn, *Corporate Malfeasance and the Myth of Shareholder Value*, 17 POL. POWER & SOC. THEORY 179, 179-80 (2005); *see also* Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L.J. 923, 934-40 (2019) (showing how the SEC has long considered sustainability not properly part of financial disclosure); Philip Selznick, *Institutionalism "Old" and "New*,*"* 41 ADMIN. SCI. Q. 270, 272 (1996).

[197] *See* Eldar, *Designing Business*, *supra* note 182, at 940 ("The problem is that it is extremely difficult to verify companies' social impact.").

sustainability disclosures and promoted the use of SASB and other environmental metrics, suggesting that they are gaining both robustness and social acceptability.[198] In addition, companies often individually track non-financial metrics, and even use some of them as key performance indicators ("KPIs") internally, which could also give greater insight into development of other social impact metrics.[199] These successful examples suggest potential for further developing and standardizing social impact metrics in other critical areas, such as employee well-being, population health outcomes, community impact, and racial and gender diversity. At present, the under-development of social impact metrics impairs holistic and accurate assessment of companies with objectives beyond profit.[200] For the socially conscious executive compensation proposal to succeed, it is necessary to further develop social metrics in order to generate well-calibrated incentives and to measure whether a company meets its social goals.

B. Corporate Governance Solutions

There are also several other potential solutions to the commitment mechanism problem, including in corporate governance. This subpart describes two ways in which companies might attempt to structure their corporate governance to commit to their pursuit of objectives beyond profit after scaling, through dual-class shares and charter and bylaw commitments. It also discusses merits and critiques of each of these options.

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198 BlackRock has stated it will use its considerable influence by increasingly voting against management and directors that do not make sufficient progress on sustainability-related disclosures. Whether BlackRock follow through on this threat or not, this example underscores the growth occurring in developing social metrics. It also highlights considerable gains in public support that increasingly treat social metrics as legitimate indicators of company performance, at least in the area of sustainability. Larry Fink, *A Fundamental Reshaping of Finance*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter (last visited Feb. 27, 2021) [https://perma.cc/7PPE-RTAB].

199 For example, one company in the sample tracks its B2B customers' stress levels through administered surveys, generating data on its impact on mental health in the industry it serves. *See* Aguirre, *supra* note 16.

200 *See, e.g.*, Fisch, *supra* note 196, at 923 (arguing for the need for improved standardization to improve comparability and reliability of sustainability disclosures in financial reporting).

1. Dual-Class Shares

Enacting dual-class shares refers to the practice of offering two different shares of stock: one reserved for founders or insiders, and the other offered publicly on an exchange but with limited or no voting rights, and therefore little to no say over corporate governance.[201] Several high-profile companies like Facebook and Snap use dual-class share structures, as well as the New York Times.[202] Publicly traded companies using dual-class shares appear to get the best of both worlds by securing outside equity capital without giving up strategic (voting) control of the company.[203] Usually these companies use dual-class shares as a private ordering instrument to protect founders' or early management's control and preserve their idiosyncratic desires for running the company.[204] Companies that articulate objectives beyond profit have some parallels, in that they also seek to protect the founders' or early management's idiosyncratic desires at scale — though in this case the idiosyncratic desires also have social value.

Although they seem to address the commitment mechanism problem, dual-class shares have several key drawbacks. First, they are a blunt instrument that broadly strips shareholders of all or most of their rights over corporate governance, further entrenching managers.[205] It is an overly broad solution that is not well-tailored to the narrower goal of retaining the pursuit of multiple objectives post-scale.[206] In addition, because some shareholders may be socially conscious, stripping all shareholders of all or nearly all voting power could actually be detrimental to pursuing multiple objectives beyond profit. Dual-class

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[201] *See* Bebchuk & Kastiel, *supra* note 124, at 585; Dhruv Aggarwal, Ofer Eldar, Yael V. Hochberg & Lubomir P. Litov, *The Rise of Dual-Class Stock IPOs* 1-5 (Duke Law Sch. Pub. Law & Legal Theory Series No. 2020-78, 2020); James Chen, *Dual Class Stock,* INVESTOPEDIA, https://www.investopedia.com/terms/d/dualclassstock.asp (last updated Apr. 26, 2019) [https://perma.cc/PC8R-BXD3]; *see also* Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. 687, 701-02 (2019); Dave Michaels, *Facebook, Snap and Other Firms Targeted by SEC Regulator's Attack on Dual-Class Shares*, WALL ST. J. (Feb. 15, 2018, 4:30 PM ET), https://www.wsj.com/articles/facebook-to-viacom-targeted-by-sec-regulators-attack-on-dual-class-shares-1518730229 [https://perma.cc/M5TM-LU7L].

[202] Michaels, *supra* note 201.

[203] Lund, *supra* note 201, at 691; Chen, *supra* note 201.

[204] Lund, *supra* note 201, at 715-16; Chen, *supra* note 201. Although the nature of controllers in dual-class shares now varies significantly across firms adopting this structure. Aggarwal et al., *supra* note 201, at 1-5.

[205] *See* Bebchuk & Kastiel, *supra* note 124, at 602-03. *But see* Lund, *supra* note 201, at 744.

[206] *See generally* Winden & Baker, *supra* note 124 (discussing the complexities of multi-class stock structures).

shares have also been shown to generate large agency costs, decrease firm value, and increase tunneling, a practice where insiders direct company assets to themselves for personal gain.[207] The dual-class shares solution also ignores that the primary problem facing companies with multiple objectives has to do with *scaling up* generally, and not with IPOs *per se*. This solution therefore only addresses one part of the problem and largely ignores acquisitions.[208]

Using dual-class shares also exacerbates risk, both in capital markets and from a regulatory perspective.[209] For example, dual-class shares would likely severely curtail financing opportunities for a large number of companies with objectives beyond profit — namely, for those that are not extremely highly valuated at the time of their IPO or do not have "unicorn" status, such as Facebook or Snap.[210] Companies that pursue multiple objectives beyond profit already often struggle to access outside capital because of their unique organizational practices and structures.[211] A dual-class share structure would likely exacerbate this problem, sending an unattractive and risky signal to investors or potential buyers. In addition, there has been significant and mounting pushback against dual-class shares, including from the SEC and several

207 *See* Marianne Bertrand, Paras Mehta & Sendhil Mullainathan, *Ferreting Out Tunneling: An Application to Indian Business Groups*, 117 Q.J. ECON. 121, 121-22 (2002) (finding increased risks of tunneling for firms with dual-class shares); Bebchuk & Kastiel, *supra* note 124, at 603; Lucian A. Bebchuk, Reinier Kraakman & George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control From Cash-Flow Rights*, *in* CONCENTRATED CORPORATE OWNERSHIP 445, 445 (R. Morck ed., 2000); Paul A. Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, REV. FIN. STUD. 1, 36 (2007) (finding increased agency costs and decreases in firm value for firms with dual-class shares). *But see* Lund, *supra* note 201, at 744 (arguing that issuing voting and nonvoting shares can reduce inefficiencies associated with voting).

208 It is conceivable that a company could use a dual-class share in an acquisition, but it is highly unlikely that an acquirer would be interested in purchasing a company over which it would have no strategic or managerial control.

209 *Cf.* Alicia E. Plerhoples, *Risks, Goals, and Pictographs: Lawyering to the Social Entrepreneur*, 19 LEWIS & CLARK L. REV. 301, 302 (2015) [hereinafter *Risks, Goals and Pictographs*] (describing risk evaluations applied to start-up social entrepreneurs).

210 Unicorn startups are those valued at $1 billion or more. James Chen, *Unicorn*, INVESTOPEDIA (last updated Mar. 31, 2020), https://www.investopedia.com/terms/u/unicorn.asp [https://perma.cc/CD3U-PKAX]; *see* Bebchuk & Kastiel, *supra* note 124, at 626; Bebchuk et al., *supra* note 207, at 28-30; Bertrand et al., *supra* note 207, at 122; Gompers et al., *supra* note 207, at 15.

211 *See* Heminway, *supra* note 120, at 308-09; Plerhoples, *Risks, Goals and Pictographs*, *supra* note 209, at 317.

leading index funds.[212] The SEC recently stated opposition to allowing dual-class companies to go public.[213] The three largest index providers recently changed eligibility requirements for their benchmark equity indexes to exclude, limit, or underweight companies with multi-class stock structures.[214] Dual-class shares thus present a significant set of downsides that undermine their attractiveness as a systematic solution to the commitment mechanism problem.

2. Charter and Bylaw Commitments

Companies could also structure their corporate governance to include commitments to the objectives beyond profit in their charters or bylaws. A charter, also known as a certificate of incorporation, is a short legal document that formally establishes a corporate entity.[215] It outlines the company's basic components, such as its name, headquarters, and any restrictions on business activity or stock issuance.[216] Bylaws are the core governing documents of a corporation. They are longer than the charter and generally contain detailed provisions about the business and affairs of the corporation.[217]

Corporations use charters and bylaws to tailor corporate governance arrangements to their individual company needs.[218] A corporation that wants to commit to pursuit of objectives beyond profit could include such provisions in its charters or bylaws. For example, it could include a requirement that the corporation always remain a certified B-Corp, absent a one-hundred percent shareholder approval to the contrary. Charter and bylaw commitments offer the benefit of leveraging private ordering and not requiring any additional legislation to effect.

But they also have several downsides. First, extreme charter commitments that seek to irrevocably constrain the company risk binding it to certain objectives that an original set of shareholders desired, but that future shareholders may not wish to maintain for any number of reasons.

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212 *See* Fisch & Solomon, *supra* note 203, at 1060; Winden & Baker, *supra* note 124, at 3.

213 *See* Lund, *supra* note 201, at 746.

214 *See* Lund, *supra* note 201, at 708-11; Winden & Baker, *supra* note 124, at 4.

215 Will Kenton, *Charter*, INVESTOPEDIA, https://www.investopedia.com/terms/c/charter.asp (last updated Sept. 11, 2019) [https://perma.cc/T5X9-LEX9].

216 *Id.*

217 *See* Choi & Min, *supra* note 126, at 15; *see also* DEL. CODE ANN. tit. 8, § 144(a) (2020).

218 Choi & Min, *supra* note 126, at 3; *see* Fisch, *Governance by Contract*, *supra* note 3, at 378-80; *see also* tit. 8, § 144(a).

On the other hand, even extreme charter or bylaw commitments may also be relatively easy to undo or ignore. In the case of bylaws, corporate law, including in Delaware, grants significant freedom to directors to amend bylaws unilaterally as part of their authority to manage the business and affairs of the corporation.[219] Once a company is scaled, whether through IPO or acquisition, and founders have lost control over the board, any commitments in the bylaws would likely be easy to undo, undermining their utility as a commitment mechanism.[220] Charter commitments present a few additional obstacles to amend, but they too may be too easy to change or ignore to function as a useful commitment device. For companies that have been acquired and are wholly owned, the acquirer owns one-hundred percent of the target, giving it the power to amend the charter unilaterally.

For publicly traded companies, too, it may be difficult for the charter provision to function as a meaningful commitment device. Although charter amendments typically require both board and shareholder approval, in practice, it is often not overly burdensome for publicly traded companies to opt out of their initial charter commitments.[221] First, only directors can propose charter amendments — not shareholders. This power gives directors a wide degree of control over setting the ballot and determining the issues over which shareholders ultimately vote.[222] In addition, dispersed shareholders (as exist in publicly traded companies) have both a collective action and a rational apathy (or ignorance) problem.[223] Because they are entitled to one vote

[219] *See* Choi & Min, *supra* note 126, at 1; Fisch, *Governance by Contract*, *supra* note 3, at 379 (stating that the vast majority of Delaware corporate charters vest directors with the authority to unilaterally adopt, amend, and repeal bylaws). It should be noted that for Delaware corporations, unlike most other jurisdictions, the board enjoys the power to amend the bylaws only if granted that authority in the articles of incorporation. James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 258 (2015).

[220] *See* Cox, *supra* note 219, at 263 (stating that when a "shareholder acquires shares with only the awareness that the board of directors can unilaterally amend the bylaws to accomplish a constellation of objectives. Even the most efficient market cannot be prescient; thus, serious information deficiencies eviscerate the likelihood of pricing the impact of the board's power over the bylaws"); Fisch, *Governance by Contract*, supra note 3, at 373.

[221] *See, e.g.*, Lucian Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820 (1989) (explaining opting out after a company's initial charter has been set) [hereinafter *Limiting Contractual Freedom*].

[222] *See* DEL. CODE ANN. tit. 8, § 242 (2020); Choi & Min, *supra* note 126, at 13.

[223] *See, e.g.*, Bebchuk, *supra* note 221, at 1837 (referencing the nature of shareholders in voting).

per share, it is not rational for shareholders with small stakes to expend significant energy voting, given their small impact on the outcome. In practice, this system affords particular power to shareholders with larger stakes, who *de facto* control the board and therefore charter amendment proposals and outcomes.[224] Even extreme charter commitments may therefore not be safe from amendment for companies that scale by going public and that lose control over the board.[225]

C. Corporate Finance Solutions

Companies can also attempt to solve the commitment mechanism problem in how they structure their corporate financing. This subpart describes potential debt financing mechanisms, such as restrictive debt covenants and poison puts, and securing socially conscious capital. It also articulates merits and downsides for each.

1. Debt Covenants and Poison Puts

There are various ways to attempt to memorialize objectives beyond profit through debt financing, including entering into restrictive debt covenants and implementing so-called "poison puts," also known as "proxy puts."[226] Debt covenants are restrictions that lenders put into place to ensure borrowers engage in or refrain from certain behaviors.[227]

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[224] *See, e.g.*, John C. Coates, *Thirty Years of Evolution in the Roles of Institutional Investors in Corporate Governance*, *in* RESEARCH HANDBOOK ON SHAREHOLDER POWER 84-87 (Jennifer G. Hill & Randall S. Thomas eds., 2015) (highlighting the power of activist investors of various types — both individually and collectively — to influence company behavior even when holding relatively small stakes in a company that are well short of full control).

[225] *See* Bebchuk, *supra* note 221, at 1830-31; Choi & Min, *supra* note 126, at 8-9; *see also* Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1260-61 (2008) (arguing that minority shareholders have more power than ever before, and activist investors are using this power to influence managers' behavior); Stephen J. Choi, Jill E. Fisch, Marcel Kahan & Edward B. Rock, *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. 1119, 1124-25 (2016) (showing shareholder inability to cast an effective vote against director candidates); Plerhoples, *Social Enterprise as Commitment*, *supra* note 13, at 91 (noting the lack of accountability for companies that seek to pursue social purpose goals alongside profit goals).

[226] *See, e.g.*, David A. Katz, *Delaware Court Raises Bar for Use of "Poison Put" Provisions*, HARVARD LAW SCH. FORUM ON CORP. GOVERNANCE (Mar. 15, 2013), https://corpgov.law.harvard.edu/2013/03/15/delaware-court-raises-bar-for-use-of-poison-put-provisions/ [https://perma.cc/CGH6-CQKD].

[227] *What Are Debt Covenants?*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/finance/debt-covenants/ (last visited, Jan. 10, 2021) [https://perma.cc/FNF5-AGNQ]; *see also* Bartlett, *supra* note 27, at 257-58; Baird & Rasmussen, *supra* note 138, at 1212.

Usually these restrictive debt covenants are financially oriented — such as restricting payout of dividends, or requiring yearly audited financial statements.[228] But companies could also enter into debt covenants as commitment devices to their objectives beyond profit — for example, to achieve a certain B-Corp score or meet another social metric. The lender could then accelerate the debt if the company violated a covenant.

Poison puts are a type of takeover defense strategy in which target company debt is accelerated in the event of a takeover.[229] When a company has a poison put covenant in a bond, an acquiring company must pay the full cost of the bond if it wants to acquire the target.[230] A company could issue a bond with a social poison put covenant that would trigger upon certain events it considers antithetical to its pursuit of objectives beyond profit, such as a takeover or an activist investor acquiring a meaningful stake.

Using these corporate financing mechanisms have some compelling upsides. For example, they may provide a strong commitment mechanism due to the catastrophic consequences, including a risk of company liquidation, if triggered. The overwhelming effectiveness of the poison pill as a parallel example is instructive: in the almost forty years since its invention, the poison pill has been triggered only once.[231] It has never failed in keeping the commitment promised. In addition, pursuing debt financing usually ensures founders retain voting control over the company, as they do not dilute their equity in exchange for capital. Retaining voting control can help preserve the pursuit of multiple objectives by helping prevent a loss of strategic control. For companies looking to tie themselves to the mast of their pursuit of

[228] *See* Bartlett, *supra* note 27, at 257-58.

[229] Will Kenton, *Poison Put*, INVESTOPEDIA, https://www.investopedia.com/terms/p/poison-put.asp (last updated Mar. 11, 2020) [https://perma.cc/7FX4-XKV7].

[230] *Id.*

[231] There have been two to three other, smaller, triggers that have occurred over the forty years, but just one notable instance. *See* Matt Levine, Opinion, *Don't Eat the Poison Pill by Mistake*, BLOOMBERG (July 25, 2018, 8:02 AM PDT) (citing LATHAM & WATKINS LLP, LESSONS FROM THE FIRST TRIGGERING OF A MODERN POISON PILL: *SELECTICA, INC. V. VERSATA ENTERPRISES, INC.* (Mar. 2009), https://www.lw.com/upload/pubContent/_pdf/pub2563_1.pdf [https://perma.cc/F7J4-92ZV]), https://www.bloomberg.com/opinion/articles/2018-07-25/don-t-eat-the-poison-pill-by-mistake [https://perma.cc/K87H-2LXH]. Whether the poison pill is preclusive or offers a meaningful opportunity of success to a hostile bidder could raise potential issues under Delaware law (preclusivity) and the Williams Act (meaningful opportunity of success). These are live and consequential debates in corporate law, which are beyond the scope of this paper.

objectives beyond profit, doing so through debt financing mechanisms may appear attractive.

But there are several countervailing downsides to using debt financing instruments as commitment mechanisms. First, in general, there are several general disadvantages to using debt financing rather than equity financing to scale.[232] Most importantly, using debt generally limits capital infusion, restricting companies' potential impact and speed of growth. In addition, although founders may retain voting control, they frequently give up significant control over the operation of the company through debt covenants, which can be even more restrictive on company action than loss of strategic control through equity dilution.[233] In addition, debt may also be an unattractive prospect for a company with uncertain cash flow, as is the case for many companies poised to scale up. And it limits the ability to attain future financing, making the company a riskier lending prospect.

Debt financing is also generally undesirable for scaling up because, unlike an IPO or acquisition, it does not naturally provide founders, early employees, and early investors with liquidity — meaning they do not receive a cash out for some or all of their early investments in the company. Liquidity is often a critical factor in the scale up. Early employees or founders, who have taken on a lot of risk forming or joining the startup, eventually need some form of liquidity in their investment, even if just partial. And early outside investors also need a liquidated return on their investment. Although there are ways to creatively structure debt financing to provide some intermediate liquidity, it is not a natural feature of this form of financing.[234]

There are also significant downsides associated specifically with restrictive covenants, poison puts, and other similar mechanisms in debt financing. First, committing to social purpose objectives through restrictive debt covenants or accelerating debt repayment is sub-optimal because it places enforcement of the social purpose objectives in the hands of lenders. Mainstream lenders' incentives are not generally aligned with achievement of a borrower's social purpose objectives. Achieving social purpose objectives is also not generally lenders'

[232] In a world without taxes or government regulation, bankruptcy costs, agency costs, and with perfect information and an efficient market, in theory there would be no difference between financing through debt or equity financing. Clearly those caveats do not apply in this case. *See* Franco Modigliani & Merton H. Miller, *The Cost of Capital, Corporation Finance and the Theory of Investment*, 48 AM. ECON. REV. 261, 262 (1958).

[233] *See* Bartlett, *supra* note 27, at 257-58; *What Are Debt Covenants?*, *supra* note 227.

[234] *See* ALLEYNE ET AL., *supra* note 122, at 14.

expertise.[235] The lender may not care enough or have the capacity to actively monitor the social purpose covenants. In addition, even if (or perhaps especially if) the lender were aligned with the firm's social purpose objectives, it may be unwilling to actually enforce the debt acceleration terms if doing so destroys the firm. Managers could anticipate and exploit lenders' hesitation to enforce social purpose terms, undermining the potential effectiveness of this solution. Placing enforcement power with lenders thus may not lead to effective and consistent enforcement of borrowers' social purpose objectives.[236]

In addition, debt covenants and poison puts — and indeed, contract provisions generally — may not be specific, anticipatory, or flexible enough to effectively address all the potential eventualities that may arise in the course of running a business. Instead of relying on specific contract terms to enforce social purpose, it may be important to specify a process or a framework to guide board and managerial action in this context.[237] These debt financing terms may also turn out to be relatively weak commitment devices — if, for example, the borrower could simply refinance the debt to make the restrictive covenant or poison put go away.

Because these measures are new and largely untested, they may also expose companies to significant potential risk. It is not clear whether courts will enforce these mechanisms. For example, the poison pill is a famous and effective commitment mechanism and its legality is now largely taken for granted. But at its inception, it was a risky experiment in private ordering and took years to validate in the courts.[238] In addition, recent litigation suggests courts may apply heightened scrutiny to poison puts or other financing mechanisms that affect shareholder voting rights or serve as anti-takeover devices, threatening their potential enforcement.[239] This uncertainty underscores the

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235 Though some lenders, such as social impact or ESG lenders, may be so aligned.

236 Socially conscious lenders that use third-party standards for accountability may help mitigate this concern, but would also come with the downside of limiting the amount of capital available for these types of loans.

237 As an analogy, take for example, the incomplete contract explanation for why fiduciary duties are necessary. It is not possible to write a contract specifying every possible eventuality in the course of managing a business or financial relationship. Creating a duty helps provide a framework of behavior for managers or trustees to make properly oriented decisions. *See* Bartlett, *Venture Capital, Agency Costs*, *supra* note 88, at 107 (discussing incomplete contracting theory); Bartlett, *Shareholder Wealth*, *supra* note 27, at 265-66 (discussing fiduciary duties and contract renegotiation).

238 *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356-57 (Del. 1985).

239 Courts have expressed wariness about upholding lending measures that are not really about lending. If a poison put is used as a takeover defense, the court will apply

riskiness, potential costliness and, if not upheld, possible ineffectiveness of these measures.[240]

2. Socially Conscious Capital

Another potential solution is for companies with objectives beyond profit to secure capital from socially conscious investors, often known as impact or ESG investors. It is estimated that the size of the impact investing market now exceeds $715 billion globally, and as of 2014, $6.57 trillion in total assets under professional management in the United States used at least one socially responsible investment strategy.[241] These investors span both debt and equity, and even include a growing number of venture capital firms.[242] The major upside to this approach is that the investor ostensibly supports the company's pursuit of multiple objectives, better aligning incentives between the two parties.[243]

But there are also significant downsides.[244] First, although the total amount of impact investment capital is numerically large, it still represents a tiny fraction of total assets under management globally — less than one percent.[245] This solution requires locating an outside

Unocal scrutiny, which could also apply here. *See* Kallick v. SandRidge Energy, Inc., 68 A.3d 242, 258-59 (Del. Ch. Mar. 8, 2013); *see also* Katz, *supra* note 226.

240 *See generally* Plerhoples, *Risks, Goals and Pictographs*, *supra* note 209 (discussing lawyers' risk aversion in adopting new terms and forms).

241 DEAN HAND, HANNAH DITHRICH, SOPHIA SUNDERJI & NOSHIN NOVA, GLOB. IMPACT INVESTING NETWORK, 2020 ANNUAL IMPACT INVESTOR SURVEY xiii (2020), https://thegiin.org/assets/GIIN%20Annual%20Impact%20Investor%20Survey%202020.pdf [https://perma.cc/JM35-J3B3]; Ofer Eldar, *supra* note 3, at 163.

242 *See* Mary Ann Azevedo, *Growth with an Impact*, CRUNCHBASE NEWS (Feb. 2, 2018), https://news.crunchbase.com/news/growth-impact-rise-vcs-looking-fund-profitable-cause [https://perma.cc/RQ95-R4HN]; *see also* HAND ET AL., *supra* note 241, at 20.

243 *See* Eldar, *supra* note 3, at 183 ("[A] great deal of untapped capital is potentially available for investments in firms that promote social purposes at below-market returns . . . ."); Dorothy Lund, *Corporate Finance for Social Good*, 121 COLUM. L. REV. (forthcoming 2021).

244 *See, e.g.*, Eldar, *Role of Social Enterprise*, *supra* note 3, at 163 (arguing that "to view [socially responsible investing] and social enterprise as synonymous is misguided").

245 It is estimated that total assets under management (AUM) globally reached $111.2 trillion in 2020, which would put impact investment capital at just 0.64% of total capital. *Compare* Anne Field, *With $715B in AUM, Impact Investors Stay the Course, Despite the Pandemic, Says The GIIN*, FORBES (June 16, 2020, 12:17 PM EDT), https://www.forbes.com/sites/annefield/2020/06/16/with-715b-in-aum-impact-investors-stay-the-course-despite-the-pandemic-says-the-giin/?sh=3a903476d3c7 [https://perma.cc/8RRW-WRTT] (reporting that total AUM for impact investors reached $715 billion despite the pandemic), *with Global Assets under Management Set to Rise to $145.4 Trillion*

investor who exactly matches the company's balance between profit and social purpose objectives, and then ceding control rights to that investor and hoping it will keep the company accountable over time. But it may be difficult to find the exact right outside investor to match the company's objectives, particularly because impact investing is still a relatively small space. And even with a perfect match, it simply pushes the commitment mechanism problem out one degree, creating the issue of who will monitor the impact investor.[246]

There are also specific downsides depending on whether a company seeks impact investment in the form of debt or equity. Impact investment in the form of debt still presents nearly all of the identified concerns above about debt financing, including especially, more limited potential growth and impact.[247] Impact investment in the form of equity, such as socially conscious VC funding, presents different concerns. Notwithstanding their commitment to social goals, socially conscious VC firms still adhere to the general VC model. They will still generally require an exit, whether in the form of an IPO or acquisition, to generate a liquid return in the life of the VC fund. This pressure to exit can be at odds with a venture-backed company's objectives beyond profit.[248]

The real-world example of the company Buffer helps illustrate the concern. When Buffer raised Series A funding in 2014, it specifically sought a non-traditional VC that would support its objectives beyond profit.[249] Buffer and its like-minded VC structured the terms of their deal differently than most traditional Series A funding, adding special provisions to reflect Buffer's objectives beyond profit.[250] And yet Buffer still found it was losing some of its core values while it grew. In response, it decided to pivot more deliberately toward long-term

by 2025, PwC, https://www.pwc.com/ng/en/press-room/global-assets-under-management-set-to-rise.html [https://perma.cc/J8GZ-KRKN] (last visited Feb. 27, 2021) (reporting that global AUM is set to double to US$145.4 trillion by 2025).

246 *See* Eldar, *Role of Social Enterprise*, *supra* note 3, 164 (stating that "it is noteworthy that commitment devices may be weak in some [socially responsible investment] funds. While some funds can change their social criteria only with a shareholder vote, other funds can alter investing policy without consulting the shareholders. Hence, there is some risk that capital raised under one set of ESG issues will be applied to advance a weaker or stronger set of issues").

247 *See supra* Part IV.C.1. *But see* Lund, *Corporate Finance for Social Good*, *supra* note 243, at 18 (presenting an alternative CSR bond proposal to help address many of the concerns in this subpart).

248 *See generally* Bartlett, *Venture Capital, Agency Costs*, *supra* note 88, at 71-77 (discussing general pressure and conflicts over exit events).

249 Gascoigne, *supra* note 79.

250 *Id.*

sustainable growth. As a result, as its founder described, Buffer was no longer "on a traditional venture-funded path."[251] To satisfy its VC investors' need for a liquid return while also enabling pursuit objectives beyond profit, Buffer decided to take the extremely unusual route of buying out its VC investors.[252] Buffer was able to pursue this largely unprecedented route because it had unusually achieved profitability after Series A funding and was able to build up enough cash reserves to buy out its investors — a rare feat. Additionally, and also unusually, it had not given up control of the company in raising its Series A funding, and so, relatedly, it only needed to buy its investors out of a relatively small amount ($3.3 million).[253] Buffer's solution is highly creative and was ultimately effective, but is essentially unprecedented and largely unavailable to the vast majority of venture-backed startups in the current financing landscape.[254]

The Buffer example provides a cautionary tale about socially conscious venture-backed investment. Even with Buffer's tailored terms, like-minded investors, and unusual early profitability providing investors with a steady return, it *still* was not aligned with the VC model. It helps illustrate the challenges facing companies that articulate objectives beyond profit and still want to access mainstream capital markets to achieve large-scale impact — both socially and economically.[255]

D. Advocating a Solution in Business Law

This subpart addresses potential general critiques of the commitment mechanism proposal and compares it to the solutions identified in corporate governance and corporate finance. Ultimately, it advocates for this proposal providing a voluntary commitment device in business

[251] *Id.*

[252] Doing so enabled the founder to better pursue his own vision for the company. *Id.*

[253] *Id.*

[254] This example highlights that if there were a greater variety of funding options for earlier-stage startups, it could help mitigate the scaling problem identified in this paper, by better avoiding VC pressure to go public or get acquired. This solution would require a complete change in the corporate finance and VC finance landscape. It also would not alleviate all of the losses of strategic and managerial control that occur at scale. *See* Bartlett, *Shareholder Wealth*, *supra* note 27, at 268.

[255] *See* Anabtawi & Stout, *supra* note 225, at 1292 (expressing skepticism over corporate governance measures designed to further empower shareholders, even where they might have private interests that diverge from shareholder wealth maximization, due to substantial potential danger of inducing influential shareholders to engage in harmful rent-seeking behavior).

law.[256] By targeting socially conscious executive compensation and multiple stakeholder board representation, this proposal both provides incentives for managers to simultaneously pursue the social and financial goals of the company, and helps ensure they have the competence to succeed in doing so.[257]

One potential critique of this proposal disfavors mandatory rules in business law. Instead, proponents of this view prefer a corporate law that provides a set of optional standard-form contracts that enable private ordering.[258] But this proposal is not inconsistent with this view: it would provide a *voluntary* commitment mechanism for companies that wish to opt in to bind themselves to the pursuit of objectives beyond profit. It would not require anything of companies that do not wish to opt in. Instead, it simply widens the menu of options available to companies in their private ordering by providing them with greater accountability through a voluntary commitment device in business law.[259]

In fact, the mandatory nature of the rule for those who voluntarily opt in is critical to enabling private ordering for these firms. Eliminating the mandatory element would not provide an effective commitment device, and would therefore fail to solve the underlying problem.[260] For business law to enable private ordering for companies with objectives beyond profit — and for PBC law to have substantive meaning — it must provide companies with a way to meaningfully commit to their

[256] *See* Eldar, *Role of Social Enterprise*, *supra* note 3, at 183 ("Gaining access to [socially responsible] capital is a particular problem for for-profit social enterprises because they lack a standardized commitment device (such as the non-distribution constraint) to assure their investors, customers, and the government that they utilize subsidies effectively. . . .").

[257] *See* Eldar, *Designing Business*, *supra* note 182, at 941-42 ("[Current legal] forms are simply not structured in a way that makes companies more likely to pursue social goals effectively. . . . An effective legal form must meet two conditions. First, the form must give firms *incentives* to pursue social missions effectively. . . . Second, the firm should have the *competence* to pursue such missions.").

[258] *See, e.g.*, Bebchuk, *Limiting Contractual Freedom*, *supra* note 221, at 1821 (discussing the role contractual alternatives could play in the corporate law setting).

[259] *See* Eldar, *Role of Social Enterprise*, *supra* note 3, at 174 (arguing that socially conscious investors seek assurance that their funds are well used but lack efficient means of monitoring the companies in which they invest and that currently, "no institutional mechanisms exist to signal a credible commitment to such passive investors").

[260] Nor is business law without mandatory rules — to the contrary, it contains a large body of mandatory rules, especially for scaled companies. The difference with those rules is that companies cannot opt out, unlike with PBC law and the proposal voluntary commitment mechanism. *See* Bebchuk, *Limiting Contractual Freedom*, *supra* note 221, at 1822-23; *see also* Plerhoples, *Social Enterprise as Commitment*, *supra* note 13, at 93.

objectives beyond profit when they scale up. It is precisely the point of corporate law to provide such tools and templates, reducing information and transaction costs and enabling companies to privately order themselves as they wish.[261]

Another related critique of this proposal prefers to rely on private ordering rather than legislation in business law. Indeed, private ordering and experimentation in management offer many benefits and lead to important innovations. But they can also come with several risks and costs. For example, novel governance and financing arrangements risk costly and time-consuming legal challenges. In some cases — for example, with the poison pill — it can take years for courts to uphold (or invalidate) the provision. Several of the options identified as potential corporate governance and corporate finance solutions have not yet been tested or upheld in courts, increasing the risk and cost associated with their implementation. In contrast, this proposal would provide a pre-approved, standardized, and reliable off-the-rack solution in corporate governance for companies with objectives beyond profit.[262] It would not require specialized lawyering and would avoid legal uncertainty, including costly and time-consuming risks of litigation and judicial invalidation.[263] Providing a standardized and pre-approved commitment mechanism also better enables third parties to draw clearer, more consistent inferences about these companies, because these scaled PBCs would share a basic common framework and corporate governance. By helping to hold companies to the corporate governance arrangements for which they originally bargained, this

[261] *See* Choi & Min, *supra* note 126, at 12; Cox, *supra* note 219, at 260 (stating that under a nexus of contracts view, corporate law is meant to be facilitative of private bargaining and that "the default rule is tailored toward what the legislature believes most, but not all, of an organization's stakeholders would agree to if contracting were efficient"); Brett H. McDonnell, *Committing to Doing Good and Doing Well: Fiduciary Duty in Benefit Corporations*, 20 FORDHAM J. CORP. & FIN. L. 19, 22 (2014); Plerhoples, *Risks, Goals, and Pictographs*, *supra* note 209, at 302.

[262] *See* Cox, *supra* note 219, at 264 ("[A]n over-arching feature of a contract is the requirement of definiteness. . . . Moreover, definiteness cannot be expected to be provided by 'wealth maximization' serving as the North Star by which to measure whether expectations are being fulfilled; wealth maximization as a norm is too incomplete to serve as a meaningful reference point of the parties' likely intent. Thus, contract provisions do not provide the desired adaptive feature of corporate organizations, whereas corporate governance does.").

[263] *See id.* at 282; McDonnell, *supra* note 261, at 22; *see also* Plerhoples, *Risks, Goals, and Pictographs*, *supra* note 209, at 302. Again, the poison pill was a risky private ordering experiment at its inception, and had to undergo a costly validation process in the courts over the course of a few years. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1348 (Del. 1985).

approach would also better facilitate reliable third-party contracting and help minimize marketplace risks associated with implementing untested experimentations in private ordering.[264]

Relatedly, it is important to remember the tension between restrictive corporate governance and financing arrangements, and access to capital. Particularly when accessing capital markets (that is, when securing funding for the company), there is a cost to businesses of engaging in governance and financing arrangements that deviate from the norm.[265] For example, a company could conceivably combine a dual-class shares arrangement with a charter commitment to retain B-Corp certification absent one-hundred percent shareholder approval to the contrary. But this company would likely struggle to secure capital to scale: investors and acquirers would be reluctant to buy stock in a company with such extreme corporate governance, where they attain no voting rights, in an environment where companies adopt notoriously mimetic structures to optimize their access to capital.[266]

In contrast, a ready-made bundled option for firms with objectives beyond profit may present a more attractive means of accessing capital markets because it preserves shareholder voting rights — unlike, for example, dual-class shares. This proposal would not strip shareholders of their voting rights wholesale. Instead, it would distribute power differently, retaining voting rights for shareholders so they would be able to elect their board representatives, while also ensuring these shareholders that there will also be board representation to protect the social purpose. It is important to remember that these shareholders buy into the firm with the goal of receiving a blended social and financial return. In this way, shareholders get to participate in the governance of the firm, while also providing guardrails to help ensure they receive the blended social and financial return for which they bargained. This proposal would help the PBC form to more faithfully reflects a PBC's prescribed legal duties to balance both social purpose *and* profit objectives. This rebalance of power reinforces the PBC legal entity as distinct from other for-profit legal entities, and the fact that its structure should meaningfully reflect this distinctiveness.

264 *See* McDonnell, *supra* note 261, at 19.

265 *See* Paul J. DiMaggio & Walter M. Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, 48 AM. SOC. REV. 147, 151 (1983); Plerhoples, *Risks, Goals, and Pictographs*, *supra* note 209, at 302; Ezra W. Zuckerman, *The Categorical Imperative: Securities Analysts and the Illegitimacy Discount*, 104 AM. J. SOC. 1398, 1399 (1999).

266 *See* DiMaggio & Powell, *supra* note 265, at 151; *see also* Zuckerman, *supra* note 265, at 1398-99.

Another common concern about creating lasting commitment mechanisms is the so-called "dead hand objection." This concern relates to a fear of binding companies to certain objectives that they may value at Time One, but which turn out to be undesirable at Time Two, whether because the firm naturally evolves its objectives in response to changing societal norms, or the original objectives prove inefficient, intolerable, or otherwise obsolete. This critique underscores the critical importance of devising the details of the proposal to adequately strike a balance between bright line rule and flexible standard. Ultimately, the details of the law must be reliable, consistent, and minimize susceptibility to gaming, while also providing sufficient flexibility to enable individual tailoring and accommodate natural and expected evolutions in firms' social purpose objectives over time.

But it is also likely that the proposal addresses the dead hand concern better than any of the identified options in corporate governance or corporate finance. This proposal creates a commitment that is sticky but not irreversible,[267] unlike some of the extreme corporate governance and corporate finance solutions, which are either relatively easily undone or ignored (not sticky) or impossible to undo or lead to catastrophic consequences if triggered (not reversible).

Again, because companies voluntarily elect to incorporate as PBCs, if this proposal makes the PBC form undesirable, companies can simply opt to incorporate in a different form. In addition, recent amendments to Delaware corporate law will lower the vote requirement to adopt or discard the PBC status from two-thirds to one-half of shareholders.[268] This new requirement will make it easier for companies to sidestep the two-pronged commitment mechanism by reincorporating out of the PBC form if they desire, again making the commitment sticky but not irreversible. It should be noted that this reduction in the vote requirement could also weaken the credibility of the commitment mechanism, to the detriment of this proposal. But by the same token, it will also make it easier for traditionally incorporated companies to reincorporate to *opt in* to the PBC form if they desire a more credible commitment mechanism prior to scaling up.

[267] The proposed commitment mechanism is sticky but not irreversible because it applies to all companies that choose to incorporate as PBCs, but can be reversed by reincorporating out of the PBC form (requiring two-thirds shareholder vote, or soon to be fifty percent shareholder vote). *See* Cox, *supra* note 261, at 263 ("There appears nothing inconsistent with a body of rules that allow change through deliberation and ultimately consent as opposed to unilateral action.").

[268] *See* DEL. CODE ANN. tit. 8, § 353 (2020).

This response, however, raises another objection that this voluntary commitment mechanism proposal may simply deter firms from incorporating as PBCs, or drive firms to reincorporate away from the PBC upon acquisition, IPO, or Series A funding. Lowering the threshold required for reincorporation further underscores the reincorporation concern.[269] The proposed voluntary commitment mechanism shares some of the same critiques of the charter commitments discussed in Part IV.B — namely, that acquirers of PBCs and directors of publicly traded PBCs could, without much difficulty, simply reincorporate the company into a new form, undermining the utility of the commitment mechanism.

It is true that the proposed commitment mechanism cannot fully solve for wholly acquired PBCs whose new parent companies wish to reincorporate out of the PBC form. For these companies, the proposed commitment mechanism may struggle to be adequately sticky because of the absolute control rights the parent company gains. In this case, however, the proposed solution can serve to provide a better matching mechanism to enable targets to identify acquirers with whom their values may align, and who may contract to maintain the PBC form. Providing a standardized commitment mechanism through the PBC form can better facilitate these relationships by enabling the parties to draw clear, more consistent references about the target companies.

For publicly traded PBCs, the proposed solution can better help to solve for the lacking commitment mechanism problem than many of the identified private ordering solutions in corporate governance and corporate finance. Upon going public, these companies would enact a multiple stakeholder represented board. The presence of a balanced board with social purpose and shareholder representatives would make reincorporation out of the PBC form more difficult, but not impossible. This proposal thus seemingly strikes a balance between stickiness and reversibility that, for example, the charter commitments discussed in Part IV.B may struggle to achieve.

In addition, keeping the PBC form toothless for the sake of driving up the numbers of incorporations undermines the purpose of the statute. Making the PBC form more meaningful will help enable those companies that wish to use the available legal incorporation status to successfully pursue their objectives beyond profit. Better empowering these companies to succeed can have knock-on effects that bolster their perceived legitimacy as organizations. At the same time, it will not penalize those who opt out, leaving them to pursue objectives beyond

[269] *See id.* § 122.

profit in their own way, using traditional incorporation and private contracting. It may also help filter those companies with a meaningful commitment to objectives beyond profit from those that may be engaging in greenwashing.[270] The voluntary commitment mechanism proposal may also better enable matching between companies with social purpose and profit objectives and third-party stakeholders who wish to contract with a genuinely multi-objective company.

Finally, this Paper also acknowledges the critique that the details of the commitment mechanism proposal could take many forms not fully articulated in this Paper, and that these details matter deeply to assessing the merits of the proposal. It recognizes that although this proposal is empirically grounded and draws from real-world examples, it provides a basic framework and empirically informed starting point, but not a fully fleshed out legislative proposal, and that it must grapple further with these critical details in the future.

Notwithstanding the potential downsides or need for future refinement of the proposal, this Paper argues for the proposal providing a voluntary commitment device in business law to help solve the identified commitment mechanism problem. For PBC law to have any meaningful effect, it must do more than mandate a standard without providing practical enforcement mechanisms. Unlike blunt instruments like dual-class shares, this proposal is well-tailored to address the losses of both strategic and managerial control at scale. It addresses organizational competence and the loss of strategic control by requiring more balanced board representation between the social purpose and financial objectives, and it addresses organizational incentives and the loss of managerial control by better aligning managerial incentives to account for the social purpose objectives in the day-to-day running of the company.

It is important to remember that when founders incorporate as a PBC, they do so by and large because they *want* to successfully pursue social purpose and profit objectives simultaneously. They turn to the PBC legal form, often in spite of significant perceived social or financial penalties for doing so, because they believe in the importance of

[270] Some businesses claim to pursue social purposes but are accused of engaging in mere "greenwashing" — trying to receive the benefits of the halo effect of claiming to pursue social and environmental goals without actually doing so, in an effort to actually just increase profits. *See* Mooney et al., *supra* note 134; *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans*,' BUS. ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/MYX7-2BNM] (discussing avoiding Elizabeth Warren legislation).

pursuing objectives beyond profit and seek guidance and protection from business law to achieve these aims.[271] Companies that genuinely want to pursue objectives beyond profit are in need of a legal framework and commitment mechanism to help them translate their visions into practice, particularly at key inflection points such as scaling up. This proposal is well-suited to address the lacking commitment mechanism problem, contributing to a more meaningful and impactful PBC law.

CONCLUSION

Recent years have seen an unprecedented surge in firms that explicitly commit to pursuing core organizational objectives beyond profit. Many of these companies are developing technologies, products, organizational structures, and business models to help solve some of the world's most serious problems — including systemic threats to sustainability and climate change; public health crises and alarming rates of noncommunicable disease; gender, racial, and ethnic inequalities; and untenable labor outcomes. In tandem with current approaches in government and the nonprofit charitable sector, these firms offer potential to help address serious social problems even more effectively *and* efficiently. Many of these companies have a proven track record of success on a smaller scale.

Yet when it comes time to scale up, they face significant challenges that often lead to the loss of the objectives beyond profit. Standard accounts blame market forces for this problem, citing lack of demand, poor underlying business models, greedy investors, capitalism, short-termism, or the impossibility of businesses pursuing multiple objectives at scale.

This Paper identifies a more fundamental problem. It argues that business law is not designed to enable companies with objectives beyond profit to scale up. Most importantly, business law lacks a durable commitment mechanism to enable long-term pursuit of multiple objectives. This problem is particularly acute when scaling up because of a dual-pronged loss of strategic and managerial control that founders experience at this stage.

Companies that articulate objectives beyond profit may privately order themselves in an attempt to achieve their objectives beyond profit. They might incorporate as a traditional general corporation, incorporate as a PBC, or privately contract for social good, including through B-Corp certification. They can also scale up in a number of ways, including going public, getting acquired, or pursuing private growth.

[271] *See* Aguirre, *supra* note 12.

This Paper argues that no matter how these companies choose to legally incorporate, privately order themselves, or scale up, business law fails to provide them with a durable commitment mechanism to help counter the losses of strategic and managerial control at scale. This inability to reliably scale up effectively bars companies with objectives beyond profit from substantial potential impact, both social and economic, to the detriment of overall social welfare.

This Paper proposes situating the solution in business law by enacting a voluntary commitment mechanism in PBC law. This proposal would require multiple stakeholder board representation and socially conscious executive compensation for PBCs that go public, get acquired, or exceed a certain size. It would offer companies that wish to bind themselves to the pursuit of objectives beyond profit a means to do so, without imposing any requirements on companies that do not wish to opt in to the PBC form. The Paper argues that this business law proposal is well-suited to help address the losses of strategic and managerial control that occur at scale, by targeting both board representation and managerial incentives.

At present, business law perpetuates a system in which companies with objectives beyond profit must either stay small or seriously risk losing their social purpose objectives after scaling up. Providing a commitment mechanism in business law can facilitate more innovative, effective, and self-sustaining solutions to some of society's most pressing problems, better enabling large-scale social impact — instead of just large-scale profit.