

# The Social Welfare-Maximizing Potential of the For-Profit Corporate Form

by

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## I. Introduction

The dynamism of the human spirit propels us ever forward, producing outcomes that are “inevitably complex” and “at points inescapably ambiguous” but “always becoming,” always “something new.”<sup>1</sup> From the consumer goods we purchase to the institutions we fashion, our outputs are “social product[s]” whose characteristics are defined and redefined by the collective needs and individual visions of societies, their citizens, and their respective eras. The automobile is one such product, different in form and attribute today than at any point in the past. So too the corporation has evolved over time; its emergent forms do not fully resemble the popular portrait of the traditional corporation.

The ‘dismal science’ of economics is subject to the same perpetual revision as are cars and corporations. Core assumptions of the neoclassical corporation – of humans as satisfaction-maximizing rational agents, of wealth as the sole barometer of satisfaction – have been challenged by behavioral economists and other social scientists with a different perspective.<sup>2</sup> The result is a growing body of research devoted to the limited role of rationality in human behavior. Not only in economics itself, but researchers in sociology, psychology, and even the natural sciences have reexamined economic assumptions and principles. This fusion of sciences has proven valuable in offering an explanation as to why individuals, as boundedly rational agents, sometimes act in a manner inconsistent with the tenets of strict rationality.<sup>3</sup>

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<sup>1</sup> William T. Allen, “Our Schizophrenic Conception of the Business Corporation,” 14 *Cardozo L. Rev.* 261

<sup>2</sup> See, among others, Jon Elster, “Social Norms and Economic Theory,” 3 *J. Econ. Perspectives* 99; James G. March, “Bounded Rationality, Ambiguity, and the Engineering of Choice,” 9 *Bell J. of Econ.* 587; Matthew Rabin, “Psychology and Economics,” 36 *J. Econ. Lit.* 11; Vivian Walsh, “Rationality as Self-Interest versus Rationality as Present Aims,” 84 *Amer. Econ. Rev.* 401

<sup>3</sup> *Id.*

Among the most challenging tendencies for the neoclassical economic view of human action is altruism. Exhibited by a multitude of individuals, altruism manifested in the form of service, philanthropy, and charitable giving is an enduring facet of human life. Neoclassical economics offer only the impoverished, tautological explanation that a person gains subjective utility from altruism. This explanation confuses altruism with egoism and is impoverished because it cannot distinguish between theft and charity. Theft is motivated purely by egoism and results in utility gains solely for the thief, whereas charity can be motivated by altruism, egoism, or a mixture of both, and results in utility gains for multiple parties. Neoclassical economics is thus unable to fully explain nuanced human behavior.

Despite recent interest in the modification of key assumptions, finance theory and, to some extent, corporation law are still based largely upon neoclassical ideas of economics. Consequently, the notion that rationality is consistent with greed coupled with the conjecture that wealth is tantamount to satisfaction has impacted the manner in which business and, specifically, its dominant corporate form are viewed and measured. It is taken for truth that the sole purpose of the for-profit corporation – any for-profit corporation – is the maximization of return to owners by any legal means available. This belief reflects a superficial reading of modern American history. It portrays one influential conception of the corporation, but fails to acknowledge a second conception that sees the purpose of the corporation more broadly as a means to advance general welfare.

Thus, one might say that there exist two paradigmatic conceptions of the for-profit corporation.<sup>4</sup> The first is a property conception that asserts profit maximization as the only legitimate aim of corporate activity, while the second is a social entity view that accepts expansive notions of corporate purpose. These seemingly opposed views acknowledge the varied opinions heretofore offered in reference to the nature of the corporation and classify them as representative of either conception. By recognizing these disparate views, we can see the inherent malleability of the corporate form. This acknowledgment of diverse opinions suggests possibilities beyond relentless profit maximization and equity holder superiority and, in doing so, provokes a deconstruction of the corporation to its most basic institutional purpose: risk-sharing.<sup>5</sup>

As the two preeminent risk-sharing entities in Western society, the for-profit corporation and government have historically been considered in contrast to one another, owing to the fact that government possesses coercive power and engages in non-profit activities while for-profit corporations are voluntary and profit-seeking in nature. When observed as entities with a shared institutional function, however, they are revealed to have important similarities. This observation suggests that the for-profit corporation need not be confined to its current limited societal role. Government and certain for-profit corporations may in fact share the same, or a similar, ultimate purpose: to be vehicles for an attempt to maximize social welfare. Beyond the fact that it is the social welfare-maximizing state that grants corporate charters, the for-profit corporate form possesses attributes remarkably conducive to this aim. It offers the risk-sharing characteristics vital

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<sup>4</sup> Allen, *supra* note 1

<sup>5</sup> Todd R. Zenger and C.R. Marshall, "Determinants of Incentive Intensity in Group-Based Rewards," 43 *Academy of Mgmt. J.* 149 in which the authors state that "a broad range of empirical research supports the assumption that performance-contingent rewards enhance employee effort... lure talented employees... and deliver higher organizational performance."

to activity of scale and extends limited liability to those willing to invest and share risk. Through direct monitoring enabled by its governance structure and, especially, its ownership by residual claimants in the form of shareholders, it discourages performance and accountability problems as well as perverse incentives to “maximize...private rewards rather than social return.”<sup>6</sup> These performance, accountability, and incentive problems arise due to “bureaucratic discretion,”<sup>7</sup> a “lack of well-defined goals,”<sup>8</sup> and obscured monitoring arrangements and too often plague government and even non-profit corporations. Finally, the fact that the for-profit corporation must generate profit if it is to remain operational forces it to maintain baseline levels of performance and efficiency and provides it with a renewable stream of internal funding over which it enjoys free rein. Consequently, the for-profit corporation’s unique combination of monitoring, incentives for efficient and effective performance, and profit-generating ability suggests that it may be well-equipped to maximize social welfare by addressing particular cost-intensive social concerns or achieving levels of scale that non-profits find difficult to attain, among other possibilities.

Prompted by increased public awareness of social problems and influenced by the actions of visionary but oft-constrained predecessors, a growing number of ‘social entrepreneurs’ are poised to leverage the for-profit corporate form’s unique features in pursuit of their vision of societal improvement by creating and developing social welfare-maximizing corporations. The social welfare-maximizing corporation may generally be defined as a corporation that engages in for-profit activity but, above all, operates in

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<sup>6</sup> Pascal Courty and Gerald Marschke, “Measuring Government Job Performance: Lessons from a Federal Job-Training Program,” 87 *Amer. Econ. Rev.* 383

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

pursuit of the maximization of some view of social welfare. Such a corporation's economic profits are freely utilized in the manner that most effectively addresses a specific social concern or set of concerns in the long-run. This particular type of corporation is thus largely dependent on sources of equity capital that are willing to accept less monetary return than a risk-adjusted market return for political, personal, or moral reasons. Due to the nascent nature of this form, it would be intellectually stifling to limit the real, inspiring potential for diversity of method by attempting to formulate any definitive list of ways in which this purpose may be accomplished. Certain extant examples of the social welfare-maximizing, for-profit corporation, including the U.S.-based Greyston Bakery, choose to do so by engaging in social welfare-minded production of conventional goods or services and channeling their residual profits to trusts or foundations charged with the betterment of society. Others aim to maximize a particular vision of social welfare primarily through profit-sacrificing production of certain socially responsible or eco-friendly goods and subsequently use most residual profits in pursuit of scale. Still others may explore a combination of these models, or even develop drastically different methods. Irrespective of individual method, the key trait that defines this social welfare-maximizing form of the for-profit corporation is that which it does not possess: the tendency to subordinate the collective social welfare to the maximization of profit or return to owners.

Of course, the potential for such entities to have an effect will largely depend on whether those who comprise the social environment – consumers, investors or sources of capital, workers – decide that a particular corporation's vision of social welfare-maximization is something that they too are able and willing to invest in. Currently, the

U.S. has the capacity to support and nurture the development of these corporations in a unique manner because key components of the social environment are present to a greater degree than elsewhere. Specifically, it is home to a large base of philanthropic individuals who presumably may be able and willing to take a haircut on monetary returns in order to support desired social effects, “socially conscious”<sup>9</sup> and “ecologically concerned”<sup>10</sup> consumers in the form of individuals and corporations<sup>11</sup>, and workers already supplying “labor...at lower than market wages in return for the opportunity to provide goods with positive social externalities,”<sup>12</sup> though it is not expected that firms committed to paying above-market wages as part of their particular vision of social welfare-maximization would require this last component. Furthermore, the United States possesses other factors that have proven vital to the emergence and sustenance of efficient, effective markets and “clusters”<sup>13</sup> of corporations. Among those present are Internet-enabled search networks or ‘e-channels’, availability of information, and well-defined property and corporation laws.<sup>14</sup> Cognizant of the fact that available technologies and capital availability dictate the efficient size and form of the corporation, it follows that a place with the greatest availability of technology and the greatest aggregations of capital might be the place where the social welfare-maximizing corporation might first evolve.

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<sup>9</sup> W. Thomas Anderson Jr. and William H. Cunningham, “The Socially Conscious Consumer,” 36 J. Marketing 23, 30

<sup>10</sup> Thomas C. Kinnear, James R. Taylor and Sadrudin A. Ahmed, “Ecologically Concerned Consumers: Who Are They?” 38 J. Marketing 20

<sup>11</sup> Minette E. Drumwright, “Socially Responsible Organizational Buying: Environmental Concern as a Noneconomic Buying Criterion,” 58 J. Marketing 1

<sup>12</sup> Anne E. Preston, “The Nonprofit Worker in a For-Profit World,” 7 J. Labor Econ. 438

<sup>13</sup> Paul Krugman, *Pop Internationalism* (1997)

<sup>14</sup> See, among others, E. Brynjolfsson, Y. Hu and M. Smith, “Consumer Surplus in the Digital Economy: Estimating the Value of Increased Product Variety,” 49 Management Science 1580; Hernando de Soto, *The Mystery of Capital* (2000)

Although such factors as indicated above can be strong drivers of social welfare-maximizing corporation development, several potential difficulties exist. First, individual social welfare-maximizing corporations must decide which particular visions of societal betterment they wish to pursue. This will dictate the manner in which they sacrifice profits and the extent to which they can gain scale. Second, scaling using resources beyond those provided by philanthropic individuals requires turning to standard financial market participants who will not accept haircuts on risk-adjusted market returns. Since profits cannot be freely sacrificed on their funds, social welfare-maximizing corporations must fully or partially compromise their mission if they wish to achieve scale to this degree. Third, the willingness of employees and consumers to, respectively, supply their human capital and purchase goods at higher cost or lower quality may wane if the corporation fails to remain faithful to its purpose or attempts to do so inefficiently or ineffectively. Fourth, there currently exists no comprehensive measure of success that can be applied with equal effectiveness to all conceivable types of social welfare-maximizing corporations. Finally, equity holders may develop unrealistic expectations regarding return if social welfare-maximizing corporations fail to honestly and effectively communicate specific goals and the extent to which profits will be sacrificed from their time of incorporation. In order to remain viable, these corporations must address such potential difficulties at some time in the future.

## **II. The For-Profit Corporate Form in Modern American History**

For the better part of nearly two decades, academics and lay citizens alike



have been engaged in a contentious debate regarding the nature of the for-profit corporation. Though opinions and theories are as varied as they have been numerous, they may nevertheless be classified or grouped according to certain overarching principles to which they ascribe. The most informative, comprehensive method of doing so entails labeling such opinions as indicative of either a property or social entity conception. Such classification produces a symbiotic relationship: particular opinions and the conception associated with them equally describe and define one another. Thus, the conceptions stand as summations of their detailed, varied parts. To understand them – their respective meanings, development, and prevalence at different periods – is to understand the history and potential future of the for-profit corporate form in the United States.

### *The 'Pure' Property Conception*

The property, or stockholder primacy, conception is the natural extension of the belief that, at its core, the corporation may be considered “a relatively stable corner of the market in which autonomous property owners freely contract.”<sup>15</sup> Corporations, or “firms,” are said to arise due to the “cost of using the price mechanism” to allocate resources. They are, in this case, created for the principal purpose of “minimising...contract costs,” and thereby serve to facilitate the operation of a given market economy. This view is consistent with the nineteenth century conception of the corporation in the United States. Rather than the institution it has become, the corporation was regarded as a direct extension of its equity holders. Neoclassical economists have historically clung to this understanding as the correct, or ideal, one. On

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<sup>15</sup> Allen, *supra* note 1 citing R.H. Coase, “The Nature of the Firm,” 4 *Economica* 386

the whole, they have fundamentally rejected the notion that the corporation should be run for any purpose other than the maximization of return to shareholders. Consistent with assumptions of strict rationality, most have characterized this return as solely monetary. Several have provided justifications of varying significance for their restrictive view of corporate purpose.

In his seminal work on the subject, Milton Friedman asserts that “the corporate executive is an employee of the owners” who “has direct responsibility...to conduct business in accordance with their desires.”<sup>16</sup> Interestingly, Friedman acknowledges the possibility that “in some cases...employers may have a different objective” than personal wealth creation yet fails to fully explore its implications. This is an important observation, however, as it implicitly recognizes the limits to strict rationality that exist in reality and legitimates certain emergent forms of the corporation discussed in later sections. This observation does not inform the rest of Friedman’s writing, however, as he associates owner desires with “money” and contends that managers can only fulfill their duties by acting as “agent[s] of the stockholders” and increasing profits. According to this reasoning, any attempt by management to explore ambiguous “social responsibility” or, more broadly, to allocate a corporation’s “money in a different way than [stockholders’] would have spent it” is akin to taxation by unelected officials and thus poses political problems. Friedrich Hayek clearly articulated this long-held sentiment of Friedman’s in his “Corporation in a Democratic Society” essay, writing that encouraging corporate managers to “employ...the capital of their stockholders...in the service of some

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<sup>16</sup> Milton Friedman, “The Social Responsibility of Business is to Increase its Profits,” New York Times Magazine, Sept. 13, 1970

‘public interest’” will “in the short run...increase an irresponsible power” and eventually invite “control of corporations by the power of the state.”<sup>17</sup>

Cognizant of the positive aspects of wealth maximization described by economists, prominent legal theorists have formulated a body of thought that supports the property conception on economic grounds and endorses a legal paradigm that closely aligns the duties of directors with the interests of shareholders. A.A. Berle emerged as one of the earliest supporters of this model when he pointedly stated that “all powers granted to a corporation...are necessarily and at all times exercisable only for the ratable benefit of all the stockholders as their interest appears.”<sup>18</sup> Though he would later allegedly reconsider this view, this statement provided a basis upon which others would come to elaborate.

Eugene Rostow attempted to legitimize Berle’s contention by examining it in light of other, more expansive views of corporate purpose, managerial power, and director responsibility. He unequivocally rejected these alternate visions on the grounds that “managerialism” and “corporate responsibility” would inevitably produce “two general classes of difficulties...one economic, the other legal and political.”<sup>19</sup> Indeed, Rostow settled upon “the voting powers of the common stock” as the only “classically legitimate base for the power of the directorate.”<sup>20</sup> Richard Posner’s work similarly served to promote the property conception. His writings on ‘law and economics’ transcend the corporate purpose debate by exploring a broad “efficiency or ‘wealth

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<sup>17</sup> Friedrich Hayek, “The Corporation in a Democratic Society,” *Management and Corporations 1985* (Melvin Anshen and George Leland Bach eds., 1960) at 99, 116

<sup>18</sup> A.A. Berle, “Corporate Powers as Powers In Trust,” 44 *Harv. L. Rev.* 1049

<sup>19</sup> Eugene V. Rostow, “To Whom and For What Ends is Corporate Management Responsible?” *The Corporation in Modern Society* (Edward S. Mason ed., 1959) at 46, 63-64

<sup>20</sup> *Id.* at 53

maximization' theory of justice," but nevertheless articulate a mode of legal thought that considers both market and non-market activities through the lens of neoclassical economic theory and is thus most amenable to a property conception of the corporation that equates shareholder return with profit.<sup>21</sup>

The work of economists such as Hayek and legal theorists like Rostow present a frightening vision of the consequences should managers embrace responsibilities or purposes aside from the fulfillment of shareholder interests through profit maximization. Expressed by Hayek and Friedman, the aforementioned "political authority" critique is one of the most convincing justifications for the 'pure' property conception.<sup>22</sup> It is made all the more powerful when coupled with the contention that "corporate morality may result in prices and wages which sabotage the market mechanism and systematically distort the allocation of resources."<sup>23</sup> Together, these sentiments suggest that the widespread acceptance of an expansive view of corporate purpose produces only an inefficient economy plagued by unemployment, inflation, and hindered implementation of policy.

While the idea that corporate social concern might realistically "destroy our free society" is a persuasive argument against moving beyond a highly restrictive view of corporate purpose, even the early proponents of the property view acknowledge that such a move occurred well before this critique was even espoused.<sup>24</sup> 1886 is regularly cited as the inception point, with the Supreme Court's decision in *Santa Clara Co. v. Southern*

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<sup>21</sup> Richard A. Posner, *The Economics of Justice* (1981)

<sup>22</sup> I cite a phrase used by Hayek in attempting to describe this argument/critique

<sup>23</sup> Rostow, *supra* note 19 at 64

<sup>24</sup> Hayek, *supra* note at 117 citing Friedman from "The Three Major Factors in Business Management: Leadership, Decision Making, and Social Responsibility," Summary by Walter A. Diehm, *Social Science Reporter Eighth Science Seminar*, Mar. 19, 1958; Hayek and Rostow, among others, lamented what they saw as the widespread acceptance of an expanded view of corporate purpose

*Pacific Railroad* labeled the impetus for change.<sup>25</sup> A traditional interpretation of the case is that it expresses “a new theory of the corporation,” that “of corporate personality.”<sup>26</sup> An alternate theory contends that the legal “personification” of the corporation coincided not with the *Santa Clara* decision but rather the rise of “a natural entity theory” that gained attention after the “turn of the century.”<sup>27</sup> This view ascribes development of this “natural entity theory” to “philosophical debates” regarding “corporate personality” that occurred in Western Europe and North America and played an integral role in “legitimizing big business.”<sup>28</sup> Only after the rise of this theory did the Supreme Court cease “to reduce the constitutional claim of the corporation to the constitutional rights of the shareholders” and begin to recognize the distinct rights of the corporation.

Though the *Santa Clara* decision and “natural entity theory” indicate a corporate form that had achieved a large measure of distinction from other forms of partnership and some separation from its owners, the property conception of its purpose remained dominant in the early years of the 20<sup>th</sup> century. The “basic model of the corporation... put forth in *Santa Clara*” is notable for “emphasizing the property rights of shareholders” and a decidedly “bottom up” view of corporate power. This model was steadfastly adhered to in the case law that followed, producing decisions that bound both corporate directors and the managers they appointed to the service of shareholder interests alone. It was during this time that U.S. social and legal views of the corporation began to diverge, however.

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<sup>25</sup> Morton J. Horwitz, “*Santa Clara* Revisited: The Development of Corporate Theory,” 88 W. Va. L. Rev. 173

<sup>26</sup> *Id.* at 174

<sup>27</sup> *Id.* at a174, 179

<sup>28</sup> Horwitz cites, among others, Ernest Freund, *The Legal Nature of Corporations* (1897); Otto Gierke, *Political Theories of the Middle Age* (F.W. Maitland ed., 1900); F.W. Maitland, *Collected Papers* (H.A.L. Fisher ed., 1911)

Close to 1920, Henry Ford challenged the conventional view of corporate purpose when he seemingly espoused a view that would come to be associated with the social entity conception of corporate purpose.<sup>29</sup> In asserting his “ambition...to employ more men” and “help them build up their lives and their homes” by investing the majority of Ford’s profits in its own operations rather than shareholder dividends, the influential founder put voice to a vision of corporate purpose that implicitly diminished the strictly monetary interests of his company’s stockholders.<sup>30</sup> Ford went so far as to explicitly state that “stockholders would have no right to complain” about this usage of profit.

Since Ford’s vision and subsequent statement directly contradicted the established property conception and its tenets, he incurred the wrath of a particular group of minority shareholders in the form of a lawsuit. Operating on the premises that the maximization of profit for shareholders is the express purpose of a for-profit corporation and that “it is not within the lawful powers of a board of directors to shape and conduct [its] affairs...for the merely incidental benefit of shareholders and for the primary purpose of benefiting others,” the Supreme Court of Michigan ruled against Ford’s vision and compelled the disbursement of dividends.<sup>31</sup> In effect, the court reaffirmed the property view’s dominance in the eyes of the law. Ford’s vision was not without merit or social appeal, however. Rooted in the “legal personification” of the corporation that began with the “new entity theory,” it and related others would begin to gain traction as the new century progressed.

### *The Social Entity Conception*

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<sup>29</sup> Allen, *supra* note 1 citing Allan Nevins and Frank E. Hill, *Ford: Expansion and Challenge 1915-1933* (1957)

<sup>30</sup> Dodge v. Ford Motor Co. (170 N.W. 668)

<sup>31</sup> Dodge v. Ford Motor Co. (170 N.W. 668)

In the years that followed 1920, the social redefinition of corporate purpose accelerated at such a rate that legal institutions could only remain steadfast in their unequivocal support of the shareholder wealth-focused property conception for so long. Like Ford, several influential stewards of American industry recognized a sense of civic and social duty inherent in their work.<sup>32</sup> Comments such as Standard Oil Company Chairman Frank Abrams' acknowledgment that his management sought to "maintain an equitable and working balance among the claims of the various directly interested groups – stockholders, employees, customers, and the public at large," confirmed that a fundamental shift was occurring in regard to corporations' view of themselves.<sup>33</sup>

Directors like Abrams were seemingly embracing a view of their duty consistent with the one introduced by legal theorist E. Merrick Dodd around the same period. Dodd advocated that directors serve as "trustees not merely for shareholders but for the entire community."<sup>34</sup> He offered this in response to Berle's aforementioned endorsement of the strict property conception, unknowingly providing a glimpse of the manner in which legal attitudes would soon evolve.

As many corporate directors began to accept an expanded view of their duty and purpose, so too did the public-at-large begin to accept and, eventually, expect this. Elected officials propagated the notion that U.S. industry played an indelible role in the nation's World War II triumph and, as a result, its national and social character.<sup>35</sup> The

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<sup>32</sup> See, among others, Allen, *supra* note 1 citing GE President Owen Young's comments as documented in E. Merrick Dodd, "For Whom Are Corporate Managers Trustees?" 45 Harv. L. Rev. 1145, 1154

<sup>33</sup> Rostow, *supra* note 19 at citing Edward S. Mason, "The Apologetics of Managerialism," 31 J. of Bus. 1, 3

<sup>34</sup> A.A. Berle, "Foreword," *The Corporation in Modern Society* (Edward S. Mason ed, 1959) citing citing Dodd's position put forth in "For Whom are Corporate Managers Trustees?" 45 Harv. L. Rev. 1145

<sup>35</sup> See President Dwight D. Eisenhower's comments about "American industrial fabric, ingenuity and skills," "the miracle of American war production," and General Marshall's willingness to "pay this high tribute to American industry" from his "Notes for Address to Industrial Associations, Chicago, Illinois,

20<sup>th</sup> century corporation, “transformed beyond all recognition” from the comparatively “puny institutions” of earlier centuries, was fast becoming the “accepted instrument of social [re: economic] policy” that it seems to have developed into.<sup>36</sup>

Likely influenced by the evolution of social thought occurring in reference to the corporation, U.S. courts rendered two noteworthy decisions that signaled a move away from the restrictive view adhered to in *Dodge*. The first of these was the Supreme Court of New Jersey’s ruling in *AP Smith Mfg. Co. v. Barlow*. In its decision, the court elected to “sustain...the validity” of corporate charitable donations and applaud the willingness of certain corporations to “insure and strengthen the society which gives them existence and the means of aiding themselves and their fellow citizens.”<sup>37</sup> Though it made certain to justify its ruling on the grounds that charitable donations can be considered necessary to the long-term success of the corporation and, by extension, its owners, the court explicitly endorsed an expansive view of corporate purpose. Justice Jacobs’ opinion cites the testimony of Standard Oil Chairman Abrams and U.S. Steel Chairman Irving Olds as indicative of a burgeoning sense of corporate responsibility. Furthermore, it calls attention to historical notions of civic awareness and concern on the part of corporations and asserts that “calls upon the corporations for reasonable philanthropic donations have come to be made with increased public support” due to corporations’ increasing size and power.

If 1953’s *Barlow* indicated U.S. courts’ willingness to recognize the idea of corporate citizenship, the outcome of *Shlensky v. Wrigley* confirmed it. The *Shlensky*

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January 17, 1947”; also Rostow, *supra* note 19 citing President Eisenhower’s “Economic Report of the President,” January 1959

<sup>36</sup> Rostow, *supra* note 19 at 50-51

<sup>37</sup> *AP Smith Mfg. Co. v. Barlow* (98 A.2d 581)



decision came nearly fifteen years after *Barlow* and validated a director's right to consider the interest of the community when making corporate decisions.<sup>38</sup> This outcome reflected a heightened level of respect for the business judgment of directors. In doing so, it confirmed their right to conduct corporate policy in pursuit of the long-term success of the corporation despite instances of complaint from profit-seeking, time-constrained stockholders.

The courts involved in *Barlow* and *Wrigley* clearly recognized the long-term interests of stockholders as legitimate drivers of director decisions, but did so in the context of opinions that reflect a social entity view of the corporation. This social entity conception encompasses a range of views of corporate purpose. Unlike the property conception, it is broad, malleable, and reflective of the range of demands and interests that modern public corporations certainly consider in the process of conducting business. It acknowledges the aforementioned social and legal evolution of thought that has occurred in regard to the for-profit corporation as it has grown in stature and significance. As a result, it accepts and sometimes endorses the fact that “management sees itself as responsible to stockholders, employees, customers, the general public, and, perhaps most important, the firm itself as an institution.”<sup>39</sup> Justifications for ‘managerialism’ are both economic and overtly philosophical. Some proponents predicate their support of the entity conception upon the fact that “the fundamental interests of all social groups”<sup>40</sup>

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<sup>38</sup> *Shlensky v. Wrigley* (237 N.E.2d 776)

<sup>39</sup> Carl Kaysen, “The Social Significance of the Modern Corporation,” 47 *Amer. Econ. Rev.* 311; See also David Vogel, “The Market for Virtue: The Potential and Limits of Corporate Responsibility,” ed. 1 at 18 in which the author cites the 60s-era “emergence of a ‘5 percent club,’ so named because its members [corporations] donated at least 5 percent of their pretax earnings” to philanthropic ventures.

<sup>40</sup> Rostow, *supra* note 19 in which he cites William O. Douglas, *Democracy and Finance* (1940)

inevitably converge, while others go so far as to claim that “corporations have ‘souls’ and ‘consciences.’”<sup>41</sup>

### *A Constant Debate*

Despite widespread acknowledgment of the expansion of corporate purpose that has occurred over time, neither the property conception nor the social entity view has decisively triumphed. Legal and other scholars have remained engaged in a lingering yet constant debate over the proper purpose of the for-profit corporation. Particular trends and events have alternately amplified and diminished the intensity of this debate at different times in U.S. history.

For the better part of the 20<sup>th</sup> century, debate was sporadic. Following the rise of the “natural entity theory,” initial personification of the corporation, and subsequent exchange between Berle and Dodd, U.S. courts attempted to quell controversy “by invoking a murky distinction between long-term profit maximization and short-term profit maximization.”<sup>42</sup> Decisions such as those rendered in *Barlow* and *Shlensky* resulted, as the courts recognized the legitimacy of the social entity conception of corporate purpose while still respecting the established property conception. Corporations thus continued to grow in social significance as directors and managers operated under the assumption that they could heed the interests of an array of stakeholders while still pursuing a vision of long-run shareholder wealth maximization consistent with the interests of these shareholders. Apart from periodic expressions of support for a restrictive property conception from adherents of neoclassical economics,

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<sup>41</sup> Rostow, *supra* note 19 at 60

<sup>42</sup> Allen, *supra* note 1 at 272

this legally-endorsed détente persisted for decades before being undone by circumstances that highlighted the sometimes divergent interests of corporate stakeholders.

Divergence of interest between shareholders and stakeholders occurs when purely profit-seeking equity holders sense an opportunity to increase the value of their holdings at the expense of all others.<sup>43</sup> Under normal circumstances, directors of profit-maximizing corporations are able to maintain a tenuous balance between the interests and demands of all corporate stakeholders. Instances of takeover eliminate their ability to do so and thus undermine the accommodating model put forth by U.S. courts in cases like *Barlow* and *Shlensky*. When faced with premium-laden tender offers for their shares, purely profit-seeking equity holders pursue a short-term optimum that often conflicts with the long-term interests of their fellow stakeholders.<sup>44</sup> They are inclined to pressure directors to accept these offers irrespective of the bidder's future plans for the firm, potentially jeopardizing the well-being of debt holders, employees, and surrounding communities.<sup>45</sup>

The takeover and restructuring wave of the 1980s provided ample opportunity for shareholders to pursue personal monetary gains to the detriment of non-equity corporate constituencies. Takeovers and takeover defenses resulted in previously unprecedented leverage ratios, as “merger exchanges of debt and cash for equity,” defense-related equity repurchases, and the subsequent rise of the ‘junk bond’ market led to substantial equity

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<sup>43</sup> Stephen Ross, Randolph Westerfield, and Jeffrey Jaffee, *Corporate Finance Topics* at 438-439

<sup>44</sup> See, among others, John C. Coffee, “The Uncertain Case for Takeover Reforms,” 1988 *Wis. L. Rev.* 435; Michael C. Jensen and Richard S. Ruback, “The Market For Corporate Control,” 11 *J. Fin. Econ.* 5 in which the authors respectively point to sizable premiums and general benefits provided to target shareholders

<sup>45</sup> See, for example, Alexander C. Gavis, “A Framework for Satisfying Corporate Directors’ Responsibilities Under State Nonshareholder Constituency Statutes: The Use of Explicit Contracts,” 138 *U. Pa. L. Rev.* 1451 in which the author cites L. Solomon, D. Schwartz, and J. Bauman, *Corporations: Law and Policy* (2d ed. 1988) at 1131: “restructuring plans often call for sales of whole divisions or some assets of the corporation in order to service new debt”

“shrinkage.”<sup>46</sup> A boon to purely profit-seeking equity holders with short-term horizons, this trend toward leverage, “‘bust-up’ takeovers,”<sup>47</sup> and restructuring undermined the interests of debt holders, employees, and peripheral stakeholders by putting the successful long-term operations of target corporations at risk.<sup>48</sup> Scholarly opinion differed as to how these divergent interests might be rectified or, in the absence of compromise, whose interests directors should serve.<sup>49</sup> This question ultimately prompted U.S. courts and legislatures to endorse one consistent model of director responsibility.

The Delaware Supreme Court’s decision in *Paramount Communications, Inc. v. Time, Inc.* is cited by Chancellor Allen as a clear endorsement of the social entity view. Justice Horsey’s opinion explicitly states “that Paramount’s tender offer was reasonably perceived by Time’s board to pose a threat to Time” and that the board was not “unreasonable in precluding...shareholders from accepting the tender offer.”<sup>50</sup> Court support of the entity view was bolstered by so-called “nonshareholder constituency statutes”<sup>51</sup> passed in a majority of states during the late-1980s and early-1990s. Such legislation asserts the varied responsibilities of corporate directors and rejects the model of stockholder-centric director responsibility adhered to under the property conception. Statutes enacted in states such as Indiana go so far as to explicitly limit certain instances

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<sup>46</sup> John C. Coffee, Jr., “Shareholders versus Managers: The Strain in the Corporate Web,” 85 Mich. L. Rev. 1, 42-43

<sup>47</sup> Id.

<sup>48</sup> Morey W. McDaniel, “Bondholders and Corporate Governance,” 41 Bus. Law 413-414 citing the statements of former Federal Reserve Chairman Paul Volcker and former SEC Chairman John Shad regarding potential dangers of increased leverage and leverage buyouts

<sup>49</sup> Id.; See also Jensen and Ruback, *supra* note 34 at 5 citing the exclusion of potential bidders as a harmful managerial action

<sup>50</sup> *Paramount Communications, Inc. v. Time, Inc.* (571 A.2d 1140)

<sup>51</sup> James J. Hanks, Jr., “Playing With Fire: Nonshareholder Constituency Statutes in the 1990s,” 21 Stetson L. Rev. 97

of takeover.<sup>52</sup> The U.S. Supreme Court seemingly conferred legitimacy upon such statutes via its ruling in *CTS Corp. v. Dynamics Corp. of America* “which held that a state statute regulating tender offers did not violate either the Commerce Clause, by unjustifiably interfering with interstate commerce, or the Supremacy Clause, by conflicting with the federal statute regulating tender offers.”<sup>53</sup> This decision represented a clear departure from those rendered in earlier cases like *Edgar v. MITE Corp.* in which the court deemed a similar, albeit far more comprehensive, statute unconstitutional.<sup>54</sup>

Combined judicial and legislative endorsement of the entity view failed to answer the persistent question of corporate purpose. It validated the opinion of prominent managers<sup>55</sup> and the public-at-large, but stood in direct opposition to the views of property conception defenders by seemingly diminishing the financial interests of profit-seeking shareholders. The direct result was a stratification of reaction among theorists, with the strongest objectors among the loudest. The endorsement prompted them to both highlight the “competitive failures” of U.S. corporations amid rampant “shareholder passivity”<sup>56</sup> and contemplate means by which the property conception might be restored to prominence.

In the early 1990s, Bernard Black, Ronald Gilson, Reinier Kraakman and others pointed to institutional investor action as a means of reestablishing the property conception, realigning the interests of shareholders and managers, and ushering in a

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<sup>52</sup> John C. Coates, “State Takeover Statutes and Corporate Theory,” 64 NYU L. Rev. 808, 859

<sup>53</sup> Id. Coates cites the Commerce Clause (Article I, Section 8, Clause 3) and Supremacy Clause (Article VI, Clause 3) of the U.S. Constitution and the federal statute regulating tender offers, the Williams Act of 1982, in describing the Supreme Court’s decision in *CTS Corp. v. Dynamics Corp.* (481 U.S. 69)

<sup>54</sup> See *Edgar v. MITE Corp.* (457 U.S. 624) and Coates, *supra* note 52

<sup>55</sup> See The Business Roundtable, “Corporate Governance and American Competitiveness,” 46 Bus. Law. 241 in which it is stated that corporations “are chartered...to benefit both the shareholders of the corporation and society as a whole”

<sup>56</sup> Bernard S. Black, “Agents Watching Agents: The Promise of Institutional Shareholder Voice,” 39 UCLA L. Rev. 811, 812-813

“Golden Age for corporate governance.”<sup>57</sup> They posited that large owners of concentrated holdings such as CalPERS<sup>58</sup> could reassert the power of the corporate shareholder by exercising “institutional voice”<sup>59</sup> and, potentially, effecting the election of “a critical minority of professional directors”<sup>60</sup> to the boards of their holdings. The spirit of this advocacy continues to the present day, as it has been observed that “activist institutional investors, at the leading edge of shareholder primacy” have been successful at driving “corporations to alter their sense of purpose.”<sup>61</sup>

Buoyed by the SEC<sup>62</sup>, institutional investors are united in their effort to further affect corporate purpose toward the aim of shareholder interest fulfillment through controversial means such as shareholder nomination of directors.<sup>63</sup> Scholars like Lucian Bebchuk extend their advocacy beyond this issue of director election reform and call for direct shareholder involvement in the corporate decision-making process.<sup>64</sup> Bebchuk, in particular, has proposed to strengthen corporate governance and subsequently increase valuations<sup>65</sup> by “providing shareholders with power to initiate rules-of-the-game decisions” such as whether “to change the governance arrangements in the company’s

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<sup>57</sup> Allen D. Boyer, “Activist Shareholders, Corporate Directors, and Institutional Investment: Some Lessons From The Robber Barons,” 50 Wash. & Lee L. Rev. 977, 978

<sup>58</sup> Ronald Gilson and Reinier Kraakman, “Reinventing the Outside Director: An Agenda for Institutional Investors,” 43 Stan. L. Rev. 863 citing the fact that California Public Employees’ Retirement System (CalPERS) equity portfolio’s “average holding period for particular stocks is between six and ten years”

<sup>59</sup> Black, *supra* note 56 at 886

<sup>60</sup> Gilson and Kraakman, *supra* note 58 at 892

<sup>61</sup> See John Haberstroh, “Activist Institutional Investors, Shareholder Primacy, and the HP-Compaq Merger,” 24 Hamline J. Pub. L. & Pol’y 65; “The Institutional Investor’s Goals for Corporate Law in the Twenty-First Century,” 25 Del. J. Corp. L. 35, 36 in which it is said that “a revolution has occurred in corporate law through the advent of the institutional investor.”

<sup>62</sup> Martin Lipton, “Shareholder Activism and the ‘Eclipse of the Public Corporation,’” Keynote Address at the 25<sup>th</sup> Annual Institute of Federal Securities, 4

<sup>63</sup> Security Holder Director Nominations, Exchange Act No. 48,626, Investment Company Act Release No. 26,206, 68 Fed. Reg. 60,784 (proposed Oct. 23, 2003) / Security Holder Director Nominations, Exchange Act Release No. 34-48626 (October 14, 2003)

<sup>64</sup> See Lucian Bebchuk, “The Case for Increasing Shareholder Power,” 118 Harvard L. Rev. 833, 836-37; Lipton, *supra* note 62 at 4

<sup>65</sup> Bebchuk, *supra* note 64 at 842

rule book by changing the corporate charter or...state of incorporation.”<sup>66</sup> He has received criticism from Strine<sup>67</sup> and Bainbridge<sup>68</sup>, among others, with Bainbridge advocating for the ‘director primacy model’<sup>69</sup> to remain in effect on the grounds that “inefficiencies” present “in a complex and interdependent system...should be tolerated if ‘fixing’ them would lead to even greater inefficiencies.”<sup>70</sup> However, both Strine and Bainbridge recognize the legitimacy of the shareholder primacy view within the context of their respective critiques. The apparent presence of conditions favorable to the property conception has led to claims that the proper objective of corporate law and, presumably, the correct aim of corporate purpose are no longer in question.<sup>71</sup>

Support for an entity conception of the corporation persists in spite of the observed trend toward profit-centric shareholder primacy. Proponents of this view can be separated into two groups on the basis of their advocacy. The first is comprised of traditionalist defenders of a ‘managerialist’, ‘director primacy’ model of the large public form of the profit-maximizing corporation who rightly equate the interests of these corporations’ shareholders with personal wealth maximization and who therefore consider the property and social entity conceptions in opposition to one another. The second is made up of individuals principally interested in utilizing an expansive view of corporate and business purpose as a means of addressing particular social concerns rather than maximizing profits. Because they seek to develop corporations expressly devoted to

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<sup>66</sup> Lucian Bebchuk, “Letting Shareholders Set The Rules,” 119 Harv. L. Rev. 1784-85

<sup>67</sup> Leo E. Strine, Jr., “Toward A True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution For Improving Corporate America,” 119 Harv. L. Rev. 1759

<sup>68</sup> Stephen M. Bainbridge, “Director Primacy and Shareholder Disempowerment,” 119 Harv. L. Rev. 1735

<sup>69</sup> Stephen M. Bainbridge, “Director Primacy: The Means and Ends of Corporate Governance,” NW. U. L. Rev. 547

<sup>70</sup> Bainbridge, *supra* note 58 at 1741 in which the author cites Michael P. Dooley, “Two Models of Corporate Governance,” 47 Bus. Law. 461, 525

<sup>71</sup> Henry Hansmann and Reinier Kraakman, “The End of History for Corporate Law,” Harvard Law School Discussion Paper No. 280, March 2000

social welfare-maximization, they must attract investors whose interests cannot be reduced to personal wealth maximization. As suggested below, it seems as if these shareholders' acceptance of a given corporation's social purpose minimizes the traditional conflict between the property and social entity conceptions of corporate purpose.

Advocates of the 'director primacy' model favor the discretion granted to directors and managers of large, profit-maximizing, public corporations by U.S. courts and legislatures. They echo concerns raised by Rock and Boyer regarding the potential for new agency costs<sup>72</sup> and "corporate buccaneering"<sup>73</sup> to arise in an era of unchecked, dominant, purely profit-seeking shareholders. In order to combat the increasing power of such shareholders, Lipton and Rosenblum, among others, have voiced strong opposition to proposed SEC amendments to proxy rules "that would permit shareholders to use a company's proxy statement to run a director election contest."<sup>74</sup> This follows their earlier proposal to extend the terms of directors.<sup>75</sup> The advocacy of both authors has been driven by issue-specific concerns, such as fear of "balkanized and dysfunctional boards," as well as the fundamental belief that the "modern public corporation" is not simply a "piece of

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<sup>72</sup> Edward B. Rock, "The Logic and Uncertain Significance of Institutional Shareholder Activism," 79 *Geo. L. J.* 445, 452 in which the author makes reference to "the potential divergence of interests between money managers and their principals"

<sup>73</sup> Boyer, *supra* note 57 at 978 in which "corporate buccaneering" is used to describe eras of "audacity, lucre, and slaughter" in which shareholders sought "to make their profit in the market, either by raising their holdings' value...or by selling control of these firms to their competitors" in lieu of "business profit."

<sup>74</sup> Martin Lipton and Steven A. Rosenblum, "Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come," 59 *Bus. Law.* 67 citing opposition to Security Holder Director Nominations, Exchange Act Release No. 34-48626

<sup>75</sup> Martin Lipton and Steven A. Rosenblum, "A New System of Corporate Governance: The Quinquennial Election of Directors," 58 *U. Chi. L. Rev.* 187



personal or real property,” but “the growth engine of our economy” in whose “operation, governance, and success” the public understandably has an interest.<sup>76</sup>

Consistent with the ‘managerialist’ model of the large, public, profit-maximizing corporation is the idea of ‘corporate social responsibility.’ The subject of an extensive yet still growing body of work, corporate social responsibility (‘CSR’) is an extension of the belief that directors and managers of profit-maximizing corporations can consider non-shareholder interests in the process of making business decisions.<sup>77</sup> Adherents claim that corporate officers *must* respect and fulfill these interests, as they regard the sustainable success of a modern public corporation as dependent upon its ability to generate “profit for its shareholders while protecting the environment and improving the lives of those with whom it interacts.”<sup>78</sup> Recent forays into social innovation and responsibility by corporate powers like Wal-Mart and Toyota, coupled with favorable media attention and an upsurge in interest surrounding ‘socially responsible’ investment opportunities, lend credence to this view.<sup>79</sup> In fact, compiled statistics suggest that anywhere from seventy to ninety percent of CEOs believe “that CSR is vital to their companies’ profitability” or creation of “shareholder value.”<sup>80</sup>

Despite their expansive view of director purpose and observed success in convincing some large, public, profit-maximizing corporations to address social

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<sup>76</sup> Lipton and Rosenblum, *supra* note 74 at 67-68

<sup>77</sup> See, e.g., Andrew W. Savitz and Karl Weber, *The Triple Bottom Line* (2006); David Vogel, *The Market for Virtue* (2005); Simon Zadek, “The Path to Corporate Responsibility,” *Harvard Business Review*, December 2004; Bob Willard, *The Sustainability Advantage: Seven Business Case Benefits of a Triple Bottom Line* (2002), among others

<sup>78</sup> Savitz and Weber, *supra* note 77 at “Introduction”

<sup>79</sup> See Pete Engardio, “Beyond the Green Corporation,” *BusinessWeek* Jan. 29, 2007, in which the author documents the increased emphasis placed on social and environmental responsibility by corporations like Wal-Mart and Toyota, also a host of unconventional “financial performance metrics” developed by Innovent; the creation of the Dow Jones Sustainability Index and FTSE4Good Index Series, among other things

<sup>80</sup> Vogel, *supra* note 77 at 20 citing two surveys addressing CSR’s relation to profitability and/or shareholder value creation

concerns, proponents of CSR do not transcend the ‘traditionalist’ group of social entity conception defenders because they do not transcend profit maximization. They consider the confrontation of social ills to be part and parcel of the corporation’s profit-maximizing operations rather than a legitimate aim itself. In the context of CSR, profit maximization remains the corporation’s ultimate purpose and social responsibility functions as a means to achieving this end.

Moreso than CSR, Einer Elhauge’s “Sacrificing Corporate Profits in the Public Interest” represents a critical juncture in the path between traditionalist and emergent support of the entity conception. It aims to “challenge the canonical law and economics account regarding the social responsibility of firms” and, to an extent, does so.<sup>81</sup> Elhauge disputes the existence of “an enforceable legal duty to maximize corporate profits” and establishes “that managers have some discretion to sacrifice corporate profits in the public interest,”<sup>82</sup> but acknowledges legal limitations placed on the manager to “sacrific[e] no more than a ‘reasonable’ degree of profits.”<sup>83</sup> Managers are said to act in a manner consistent with public interest in order to avoid “social and moral sanctions” such as “the embarrassment of bad publicity” and “the moral guilt and loss of inner worth” that sometimes accompany illegal activity.<sup>84</sup> He alleges that managers, as agents charged with the day-to-day business operations of the public corporation, are subject to the sanctions that normally impact owners directly in smaller business structures. Because distant, detached shareholders are viewed as “uninformed” or somewhat

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<sup>81</sup> Einer Elhauge, “Sacrificing Corporate Profits in the Public Interest,” The Harvard Law School Program on Corporate Governance, Working Papers, February 10, 2004

<sup>82</sup> Id. at 3

<sup>83</sup> Id. at 7 in which the author cites I American Law Institute, “Principles of Corporate Governance: Analysis and Recommendations, Section 2.01 (b)(2)-(3)”

<sup>84</sup> Id. at 14

sheltered from such considerations, Elhauge contends that corporations operated solely in their financial interest “would be soulless” and therefore undesirable.<sup>85</sup>

Though Elhauge’s discussion exists in the context of the large, public, ostensibly profit-maximizing form of the corporation and documents an entity view that conflicts with shareholder primacy in this context, it describes several important ideas that relate to emergent forms of the corporation. The first is the notion of ‘social and moral sanctions.’ His recognition of these is akin to an acknowledgment of the complex business landscape of the 21<sup>st</sup> century. The acceptability of his second significant idea, that of ‘sacrificing profit in the public interest,’ is predicated upon an understanding of this reality and the widespread expectations of socially and environmentally responsible behavior that exist within it.<sup>86</sup> Furthermore, the belief that ‘reasonable sacrifice’ is tolerable reflects an accurate assessment of the attitudes of a growing number of influential U.S. managers.<sup>87</sup>

Elhauge’s depictions of ‘social and moral sanctions’ and managers willing to sacrifice ‘reasonable’ amounts of profit “in making operational decisions” and “donations”<sup>88</sup> are clearly reflective of a continuation of the previously documented evolution of accepted views of corporate purpose. However, the significance of such ideas to emergent and, specifically, social welfare-maximizing forms of the corporation stems from their possible acceptance by owners rather than agents and the subsequent minimization of conflict between the property and social entity conceptions as well as reduction of legal and other limitations that would follow. Elhauge observes that owners

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<sup>85</sup> Id. at 42

<sup>86</sup> Engardio, *supra* note 79 at 52 in which the author notes “costly setbacks from environmental disasters, political protests, and human rights or workplace abuses.”

<sup>87</sup> Id. at 52: “Now, sustainability is “right at the top of the agendas” of more U.S. CEOs, especially young ones, says McKinsey Global Institute Chairman Lenny Mendonca”

<sup>88</sup> Elhauge, *supra* note 81 at 6, 7

or investors who “become subject to a host of social or moral processes” or ‘sanctions’ can become more similar to “philanthropists” than “materialists.”<sup>89</sup> He associates the acceptance of these sanctions with the assumption of managerial responsibility and resultant observation of social ills, but it is possible that such a process could occur through some other instance of social observance. Irrespective of cause, there is reason to suggest that this process is occurring amongst certain constituencies of society and has the capacity to impact the institution of the for-profit corporation in form, purpose, and deed.

## **II. The Emergent Forms of the Corporation**

Nearly forty-five years ago, Kenneth Arrow observed that “a profit-maximizing, self-centered form of economic behavior” results in an “unequal” income distribution and “tends to point away from the expression of altruistic motives.”<sup>90</sup> Going further, he expressed the opinion that “altruistic motives are motives whose gratification is just as legitimate as selfish motives” and whose “expression...we probably wish to encourage” as a society.<sup>91</sup> Still, he acknowledged the profit motive as a powerful motivator of human behavior that arises from our natural “impulse to gain.”<sup>92</sup>

In a sense, the documented history of the for-profit corporation in the United States may be characterized as a protracted public expression of Arrow’s own struggle: an attempt to reconcile the efficiency of for-profit activity as a means of maximizing societal resource production with the widespread desire for an end result more equitable

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<sup>89</sup> Elhauge, *supra* note 81 at 40, 41

<sup>90</sup> Kenneth Arrow, “Social Responsibility and Economic Efficiency,” 21 *Pub. P’cy* 303, 305-306

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

than the one profit maximization provides. U.S. legal institutions clearly attempted to achieve some semblance of balance when they endorsed a social entity view while still recognizing the legitimacy of profit maximization as a long-term aim. Such attempts have found some success, but have fully satisfied neither property conception supporters nor individuals principally interested in addressing social concerns.

Sectoral boundaries arising from both law and from public perceptions have long tended to shape the aims and functions of particular organizations within the U.S. In doing so they may have closed the eyes of some to what is possible. For a long time, “certain goods...[were] seen as inappropriate for market exchange or require[d] certain protection from corruption by the profit motive”<sup>93</sup>; they have been the province of government and, later, the non-profit sector.<sup>94</sup> Individuals principally interested in rectifying particular social ills have, by and large, chosen to work within these institutions. Though necessary in certain instances, this obvious fragmentation of purpose across sectors legitimizes the view that the profit motive and, by extension, the corporation are inevitably corrupt or ‘soulless’. The proliferation of the non-profit sector suggests that neither managerial acceptance of the social entity conception nor the rise of CSR have succeeded in completely discouraging this notion or convincing many social welfare-minded individuals to devote their efforts to corporations. By embracing social purpose above all else, certain emergent forms of the corporation and their supporters aim to succeed where the efforts of profit-maximizing corporations have failed.

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<sup>93</sup> Paul J. DiMaggio and Helmut K. Anheir, “The Sociology of Nonprofit Organizations and Sectors,” 16 *Amer. Rev. of Soc’lgy* 137, 144

<sup>94</sup> Lester M. Salamon, “The Rise of the Nonprofit Sector,” *Foreign Affairs* Jul./Aug. 1994 in which the author cites the formation of “associations, foundations and similar institutions” intended to “deliver human services...protect civil rights and pursue a thousand other objectives formerly unattended or left to the state.”

Individuals interested in leveraging the strengths of the for-profit corporate form toward the goal of long-term social welfare-maximization comprise a subset of a growing number of ‘social entrepreneurs’. Thus far, social entrepreneurs’ search for an organizational form best-suited to this purpose has led to the creation of various entities featuring for-profit, non-profit, and hybrid characteristics.<sup>95</sup> Pamela Hartigan has classified these entities into three broad categories of organization: leveraged non-profits, hybrid not-for-profits, and hybrid for-profits or social businesses.<sup>96</sup> The first grouping includes conventional non-profits normally associated with the goal of long-term social welfare-maximization, while the last describes innovative ventures in which “profits are generated” but “the main aim is...to grow the social venture and reach more people in need effectively” rather than “maximise financial returns for shareholders.”<sup>97</sup> The social welfare-maximizing corporation is one, potentially transformative instance of ‘social business’. By soliciting and attracting shareholders who envision the corporation as a social entity, expect it to pursue a particular vision of societal betterment that they support above all else, and are therefore willing to accept a haircut on monetary returns, its managers and directors can freely sacrifice varying amounts of profit in acting to maximize social welfare while simultaneously fulfilling the short-term and long-term interests of shareholders. This minimizes the conflict between the property and social entity views of corporate purpose and, in a sense, recognizes merits of both.

### *The Corporation As A Vehicle For Social Welfare-Maximization*

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<sup>95</sup> J. Gregory Dees, “The Meaning of ‘Social Entrepreneurship’,” Center for the Advancement of Social Entrepreneurship, Duke University

<sup>96</sup> Pamela Hartigan, “It’s about people, not profits,” 17 Business Strategy Review 42, 44-45

<sup>97</sup> Id.

The organizations Hartigan recognizes as ‘socially entrepreneurial’ entities exist on a spectrum of dependency, with the first group completely dependent upon “outside funding for its survival in the form of grants and donations”<sup>98</sup> and the last dependent upon only its own profits and the initial capital of its owners. ‘Social entrepreneurs’ driving the growth of this last group perceive utility in reduced dependence on external charity. This utility arises from profit generation, and further advantages arise from combining for-profit operations with the corporate form.

Social businesses’ ability to generate and control profits liberates them from the constraints associated with full dependence on charity. It grants them the ability to plan over longer horizons and insulates them from temporary or even prolonged instances of reduced philanthropic activity or unavailability of external charitable funding.<sup>99</sup> Furthermore, it allows them to continue and even expand operations during periods in which non-profits are seen as “barely scraping by.”<sup>100</sup> Certain ‘hybrid’ non-profit corporations may be able to generate earnings and accumulate limited sources of internal funding due to their involvement in particular industries – such as education and health care – that allow them to receive revenue in exchange for some services, but large numbers of conventional non-profits are engaged in the practice of addressing cost intensive social problems, lack any sources of revenue, and are thus fully reliant upon external sources of donor funding. Though some of these entities have achieved lengthy periods of viability and success, their existence – along with the existence of hybrid non-profits – is ultimately reliant in full upon the continued existence of willing donors. Non-

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<sup>98</sup> Id.

<sup>99</sup> Steve Case, “Purpose and Profit Go Together,” Wall Street Journal, May 10, 2005 in which the author highlights the fact that “competition for philanthropic dollars is rising faster than the dollars themselves.”

<sup>100</sup> Id.

profits' reliance on external funding forces them to constantly spend valuable time addressing short-term donation needs, impedes their ability to comprehensively plan over long-term horizons, and places the continued funding of operations fully beyond their control.

While profit-generating ability is inherent to all successful for-profit businesses, the corporate form possesses further characteristics particularly suited to the goal of efficient long-term social welfare-maximization. First, the form enables multiple parties to pool capital in the pursuit of long-term social welfare-maximization and thereby share risk to a degree rivaled only by government. It limits the personal liability of these parties by capping their potential losses at the individual amount of capital contributed. Second, the voluntary rather than coercive nature of corporate activity ensures a level of stakeholder commitment greater than that accorded to an institution like government. In the context of the social welfare-maximizing corporation, this commitment can be especially intense.

Further strength lies in the well-functioning, for-profit corporation's governance structure. This unique structure, in which – ideally – directors monitor managers, and stakeholders, most notably shareholders, monitor both parties, provides for a clear line of monitoring that forces a degree of accountability upon managers and employees and thus incentivizes them to operate the corporation in an efficient manner toward a well-defined purpose or set of goals while maintaining certain standards of performance. The strength of this governance structure is demonstrated by the fact that government has attempted to incentivize efficiency using performance-based systems of compensation, but has



achieved only limited success<sup>101</sup> because “the lack of well-defined goals and residual claimants in government bureaucracies make it unlikely that incentives will improve efficiency in public bureaucracies in the same way as private ones.”<sup>102</sup> Successful for-profit corporations possess both well-defined goals and, more importantly, residual claimants in the form of shareholders who discourage low levels of performance, perverse incentives, and the misuse of incentive systems by collectively serving as the final actor in a clear line of monitoring that is obscured in government bureaucracy. This line of monitoring is similarly obscured, or weakened, in non-profit corporations. Some of these entities may be able to incentivize and support operations with a level of efficiency by featuring a degree of performance monitoring through boards<sup>103</sup> but, on the whole, lack the residual claimants in the form of shareholders – to whom boards and managers are in some way ultimately accountable – who can collectively serve as an absolute monitor of a given entity’s operational efficiency and effectiveness by demanding that the corporation recognize their interests – monetary or other.<sup>104</sup>

For-profit operations reinforce the incentive for efficient and effective operational performance provided by monitoring and the presence of residual claimants. Whereas inefficiency in government and non-profit entities does not always bring about

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<sup>101</sup> Courty and Marschke, *supra* note 6 at 383

<sup>102</sup> *Id.*

<sup>103</sup> I recognize the possibility that boards of non-profits may provide a degree of monitoring, but cite Oliver Williamson’s comments regarding this possibility from “Organization Form, Residual Claimants, and Corporate Control,” 26 *J. Law & Econ.* 351, 359: “But what about boards where inside participation is great? And what about boards where responsibilities are taken casually rather than seriously? It may help if the trustees of these boards are by themselves large contributors, but many trustees are not and some have agendas of their own. The upshot is that nonprofit organizations pose genuine problems with which both the public at large and intended beneficiaries are legitimately concerned.”

<sup>104</sup> *Id.*; at 358-359 Williamson asserts that “because the beneficiaries, real or pretended, are among those who stand to lose most if nonprofits are badly run, beneficiaries can be said to have residual claimant status in the nonprofit organization,” that “one could make a case for including intended beneficiaries on the board of directors,” and that “there could be gains if some agency...were to oversee the uses of funds in nonprofits”; such statements indicate that, at present, there are no parties in the nonprofit organization who serve as residual claimants in the same manner as corporate shareholders.

their insolvency, for-profit corporations are faced with the alternatives of profit generation or failure. Inability to generate profits can serve as an indicator of inefficiency, dissuade potential investors from contributing capital, and result in insolvency. A for-profit corporation's long-term success, and potential ability to function as an effective vehicle for social welfare-maximization, is thus contingent upon its ability to control renewable streams of internal funding. The incentive for efficiency provided by this and other unique characteristics of the for-profit corporation discussed above makes it attractive to social entrepreneurs cognizant of the fact that current "major social sector institutions are often viewed as inefficient, ineffective, and unresponsive."<sup>105</sup>

Due to the relatively recent nature of the social entrepreneurship movement, the social welfare-maximizing potential of the corporate form is only beginning to be realized. There are, however, several examples of successful social welfare-maximizing corporations currently in existence. Some of these organizations attempt to principally achieve their purpose through the ways in which they conduct everyday business and the particular products they produce, while others aim to do so by devoting all of their residual profits to addressing various social concerns. One such organization, the U.S.-based Greyston Bakery, chooses to conduct social welfare-minded operations and subsequently devote residual profits to cost-intensive projects intended to improve society. Examination of its operational structure and overall purpose provides an accessible idea of one incarnation of the social welfare-maximizing corporation and serves as a useful precursor to a discussion of the model's long-term viability.

### *Greyston Bakery*

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<sup>105</sup> Dees, *supra* note 95 at 1

The defining trait of any social welfare-maximizing corporation is its commitment to some vision of societal betterment. Greyston Bakery has chosen to exhibit this commitment by operating as “a force for personal transformation and community economic renewal in Yonkers, New York.”<sup>106</sup> It is a private corporation founded in 1982 “by a Zen Buddhist meditation group led by Bernard Tetsugen Glassman, a former aerospace engineer” using a \$300,000 loan.<sup>107</sup> Twenty-five years later, it has grown from “a small storefront bakery” to an organization of approximately sixty-five employees and “\$6 million in revenues”<sup>108</sup> that specializes in producing brownies for Ben & Jerry’s and Stoneyfield ice cream products as well as individual stores and households. Though these brownie products are its source of actual revenue, Greyston prides itself on the social welfare-maximizing activities it is able to sustain using these revenues and related profits.

The corporation considers its “dynamic social mission” to be a factor as integral to [its] business as...butter, flour, and sugar.”<sup>109</sup> Greyston’s operational practices and overall structure suggest that this mission is, in fact, the corporation’s defining factor. Brownie production serves as a means of achieving two principal social aims: providing “the chronically disenfranchised” with “opportunities for self-sufficiency through on-the-job training, good wages, support services, and benefits,” and generating profits used to

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<sup>106</sup> Greyston Bakery Company Brochure, 2006; see also “The Greyston Bakery Story,” Greyston Bakery, Inc. Website, 2007

<sup>107</sup> *Id.*

<sup>108</sup> “Greyston Bakery CEO Provided Recipe for Corporate Citizenship Success,” The Center for Corporate Citizenship at Boston College, May 1, 2006

<sup>109</sup> Greyston, *supra* note 106

fund the “community development initiatives” supported by the non-profit Greyston Foundation.<sup>110</sup>

Greyston fulfills its first social aim through a process it refers to as “open hiring.”<sup>111</sup> Chronically unemployed or underemployed individuals are sought out and “brought into the work environment on a first-come, first-served basis” in order to participate in a “six-month apprenticeship.”<sup>112</sup> Because the company eschews interviews, successful completion of the program ensures employment “with full benefits” and the “access to social services,” “education grants,” and “career services assistance” that follows.<sup>113</sup> Through this friendly and accommodating ‘open hiring’ process, Greyston is able to effectively attract and retain candidates it hopes to empower.

The corporation is able to fulfill its second social aim through the maintenance of a sustainable, profitable business model. Naturally, this includes “providing quality products and customer service, responding to technology changes, determining capability gaps, and building a winning team.”<sup>114</sup> It also entails growing the business, which Greyston has been able to do in a consistent and responsible manner through the usage of debt, among other things. This capability has been illustrated as recently as 2004, the year in which Greyston “moved to a new 23,000 square foot facility.”<sup>115</sup> Equally as important as consistent growth has been the recognition of stakeholder interests. By engaging in open and honest dialogue with employees and providing ‘fair’ rather than ‘free market’ wages, Greyston has earned the trust and loyalty of its staff. This is vital to

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<sup>110</sup> Id.

<sup>111</sup> Center for Corporate Citizenship, *supra* note 108

<sup>112</sup> Id.

<sup>113</sup> Id.

<sup>114</sup> Id.

<sup>115</sup> Id.

the continued success of the corporation and its ability to maximize social welfare in a long-term sense.

Greyston Bakery CEO Julius Walls describes his corporation as a case study in “compassionate capitalism.”<sup>116</sup> This claim appears to be accurate. Greyston’s adherence to a ‘double bottom line’, hybrid economic-and-social method of success measurement coupled with its utilization of all profits for either the provision of “low-income housing, childcare, health services, and technology education”<sup>117</sup> or short-term business growth needs position it as a fully operational example of the social welfare-maximizing corporation.

#### *The Viability of the Social Welfare-Maximizing Corporation*

The further development of social welfare-maximizing corporations such as Greyston Bakery looks to be possible due to a number of supportive factors currently present in American society. Among these factors are availability of information, an amenable social environment comprised of an established base of philanthropic individuals, willing consumers, and potential employees, internet-enabled search networks or ‘e-channels’, and well-defined property and corporation laws.

A 1969 commission convened by the Organization for Economic Cooperation and Development (OECD) was charged with examining “the information needs of the changing society that constitutes our global village.”<sup>118</sup> Chief among the conclusions of its members was the identified need for “various types of information” by “decision

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<sup>116</sup> Id.

<sup>117</sup> Greyston, *supra* note 106

<sup>118</sup> Edward L. Brady and Lewis M. Branscomb, “Information For A Changing Society,” 175 Science 961, 962

makers at all levels throughout society.”<sup>119</sup> Nearly half a century later, developed nations have met and exceeded this need. Residents of the U.S. are now privy to an extraordinary number of information sources. Facilitated by advances in communications technology and “data processing”<sup>120</sup> as well as “the introduction of public information infrastructures, such as the Internet,”<sup>121</sup> widespread and immediate availability of information has come to define the age in which we live.

Unencumbered access to media documenting social ills like homelessness, environmental degradation, and inadequate health care has fostered an environment of concern surrounding such problems and, by extension, shaped a social environment conducive to the development of social welfare-maximizing corporations. To an extent, social concern has always existed due to the general principles of fairness and equity that permeate American society. Still, widespread coverage and awareness of the aforementioned social troubles, as well as specific instances of environmental and societal devastation such as “the Asian tsunami, Pakistani earthquake and Hurricanes Katrina and Rita,” prompted individual U.S. citizens to donate “more than \$260 billion...to charitable works” in 2005.<sup>122</sup> This figure represents a six-percent increase over the amount donated in 2004.<sup>123</sup> Nearly \$200 billion of the \$260 billion total was contributed by individuals, implying donations of “2.2 percent of...average disposable (after-tax) income.”<sup>124</sup> Though this average is skewed by the outsized donations of

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<sup>119</sup> Id.

<sup>120</sup> Richard M. Kesner, “Historians in the Information Age: Putting the New Technology to Work,” 4 *The Public Historian* 31

<sup>121</sup> Jeffrey L. Sampler, “Redefining Industry Structure for the Information Age,” 19 *Strategic Management Journal* 343

<sup>122</sup> Michael Jay Friedman, “Charitable Donations Rise,” USINFO, U.S. Department of State, <http://usinfo.state.gov/scv/Archive/2006/Jun/22-515647.html>, June 22, 2006

<sup>123</sup> Id.

<sup>124</sup> Id.

individuals like Bill Gates, it nevertheless indicates the unquestionable existence of a relatively large group of philanthropic citizens willing to contribute some portion of their wealth or earnings to institutions committed to some vision of societal betterment.

Though the 2005 charitable donation figures point to an established base of philanthropic individuals, they say nothing of possible additions to this base. These include individuals who might be prone to contribute to social sector institutions but share in the perception that these entities are “inefficient, ineffective, and unresponsive,”<sup>125</sup> or those interested in the alleviation of poverty both domestically and abroad but jaded by the seeming inability “of Big Western Plans to help the poor.”<sup>126</sup> The donation figures also fail to account for individuals who comprise networks such as the Social Enterprise Alliance – dedicated to “catalyzing the growth of nonprofit organizations running for-profit ventures to finance social change”<sup>127</sup> – and the Investors’ Circle, members of which invest in companies that offer some type of “external rate of return.”<sup>128</sup> Finally, not reflected in the numbers is the fact that “people’s willingness to help a charitable organization” has been found to be “greater when the act is presented as an economic transaction than when it is presented as an act of charity.”<sup>129</sup> Individuals have been found to donate increased sums even “when offered a product” of only “little appeal” to them, as such a product provides “psychological cover for...act[s] of compassion” to persons who may want to view themselves as rational maximizers of self-

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<sup>125</sup> Dees, *supra* note 95 at 1

<sup>126</sup> William Easterly, *The White Man’s Burden* (2006)

<sup>127</sup> Case, *supra* note 99

<sup>128</sup> “IC Mission,” Investors’ Circle Website, <http://www.investorcircle.net>

<sup>129</sup> John G. Holmes, Dale T. Miller, and Melvin J. Lerner, “Committing Altruism under the Cloak of Self-Interest: The Exchange Fiction,” 38 *J. Exp’mntl Soc. Pysch.* 144

interest.<sup>130</sup> Some of these individuals would thus be willing to support certain types of social welfare-maximizing corporations as consumers or even investors, as receipt of even a nominal good or substantially below-market monetary return would provide ‘cover’ for philanthropy in a way that traditional charitable donations do not.

All of the individuals mentioned above are, to varying degrees, interested in some moral or conscience-driven, socially beneficial end beyond the maximization of personal wealth.<sup>131</sup> Together they constitute a substantial base of potential contributors to, or owners of, social welfare-maximizing corporations and one aspect of a necessary social environment. Two equally important aspects of this environment are consumers and providers of human capital. Both appear to be present in U.S. society.

Marketing researchers have documented the existence and characteristics of individual American buyers who can be labeled “socially conscious”<sup>132</sup> and “ecologically concerned.”<sup>133</sup> Surveys conducted in the early 1990s suggest that “75% of consumers have said their purchasing decisions are influenced by a company’s reputation with respect to the environment, and eight in ten have said they would pay more for products that are environmentally friendly.”<sup>134</sup> Further research is devoted to corporate “policy entrepreneurs” who drive organizations’ “socially responsible buying” based upon “moral reasoning.”<sup>135</sup> Additional researchers interested in matters of social responsibility have reported that “a firm’s CSP [corporate social performance] may provide a

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<sup>130</sup> Id.

<sup>131</sup> This is consistent with Anthony Kronman’s argument, articulated in “The Value of Moral Philosophy,” 111 Har. L. Rev. 1751, that “economics cannot tell us what our purposes or goals should be” and that moral philosophy is of “a higher prestige” than economics because of its ability to do so; See also Elster, et. al., *supra* note 3 for evidence that discusses humans as boundedly rational agents

<sup>132</sup> Anderson and Cunningham, *supra* note 9

<sup>133</sup> Kinnear, Taylor, and Ahmed, *supra* note 10

<sup>134</sup> Drumwright, *supra* note 8 at 1 citing Klein 1990

<sup>135</sup> Id.



competitive advantage in attracting applicants,”<sup>136</sup> while others have provided evidence of individuals “willing to supply labor to nonprofit organizations at lower than market wages in return for the opportunity to provide goods with positive social externalities.”<sup>137</sup> Their proof includes wage differentials between ‘white-collar’ workers in the for-profit and non-profit sectors “that cannot be fully explained by differences in employees’ human capital, differences in the broad industrial locus of nonprofit firms, or the existence of compensating differentials in the characteristics of similar jobs in the two sectors.”<sup>138</sup> The findings documented herein comprise a body of research that describes American consumers and human capital providers who value social welfare and would presumably be willing and able to invest in the particular visions of social welfare-maximizing corporations. Along with the philanthropic individuals noted above, they are part of a social environment amenable to the development of these corporations.

While the presence of a friendly social environment is necessary to the development of social welfare-maximizing corporations, it is availability of information that enables ‘social entrepreneurs,’ other philanthropic individuals, and potential investors to interact and share ideas in a cheap, efficient, and immediate manner irrespective of physical proximity. Whereas philanthropic tendencies of past generations were somewhat constrained to local activities or donations to heavily publicized social sector institutions of national scale due to barriers to connectivity and awareness, Internet-enabled search networks remove all such barriers. The rise of self-described ‘online communities’ and ‘social networks’ such as ‘My Space’ and ‘Facebook’ has

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<sup>136</sup> Daniel B. Turban and Daniel W. Greening, “Corporate Social Performance and Organizational Attractiveness to Prospective Employees,” 40 *Academy of Mgmt. J.* 658

<sup>137</sup> Preston, *supra* note 12 at 438-439

<sup>138</sup> *Id.*; Preston cites Mervis and Hackett (1983) and Weisbrod (1983)

made it possible for individuals dispersed across regions and states to make contact and discuss shared interests. The nature and purpose of these online networks facilitates widespread dissemination and discussion of ideas and, more importantly, allows for the organization of groups and networks devoted to specific goals. Their existence is thus conducive to the formation of social welfare-maximizing corporations.

Contemporary research pertaining to ‘electronic markets’ documents the existence of markets for “obscure” products brought about by the ‘electronic markets’ themselves.<sup>139</sup> Such products would be “prohibitively” expensive to obtain “in physical markets,” but “convenient search facilities allow Internet consumers to discover and evaluate” them and thereby prevent these products from remaining “undiscovered.”<sup>140</sup> Compelling parallels may be drawn between these ‘obscure’ products and similarly ‘obscure’ ideas. Their diffusion is stifled by “conventional” channels and enabled by the internet. To many, they are considered “new” by virtue of their absence from traditional determinants of public consciousness like major retail outlets and evening news programs. Finally, those who seek and supply them are able to locate one another with ease using e-channels.

The internet-enabled rise of markets for ‘obscure’ products bodes well for the potential spread of the social welfare-maximizing corporation. As “new goods,” ‘obscure’ products “are at the heart of economic progress.”<sup>141</sup> In the same way, ‘obscure’ ideas are ‘new’ ideas that can serve as drivers of social progress. Through e-channels,

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<sup>139</sup> Erik Brynjolfsson, Michael D. Smith, and Yu (Jeffrey) Hu, “Consumer Surplus in the Digital Economy: Estimating the Value of Increased Product Variety at Online Booksellers,” Paper 176, Center for e-Business at MIT, November 2003

<sup>140</sup> Id.

<sup>141</sup> Id. citing Timothy F. Bresnahan and Robert J. Gordon, *The Economics of New Goods* (1997)

philanthropic individuals with singular visions of social welfare-maximization situated in different locations across the U.S. are likely to encounter others who share those visions. They may come across existent organizations worthy of their support, or even choose to become ‘social entrepreneurs’ by forming ‘social businesses’ with the similar-minded individuals they encounter. Current ‘social entrepreneurs’ have seemingly identified the value of e-channels to their movement, as the recent development of websites like ‘1bloc’<sup>142</sup> indicate a growing awareness of e-channel significance. The expansion of such networks and the dissemination of ‘obscure’ ideas that they facilitate represent factors invaluable to the creation and development of social welfare-maximizing corporations.

The power of the for-profit corporation and, by extension, the social welfare-maximizing corporation ultimately rests upon the strength of U.S. property and corporation laws. The history of American or, in a larger sense, Western capitalism and its dominant corporate form can be viewed as an implicit signal of the legitimacy of the legal institutions upon which it is built. The U.S. legal system facilitates that which Hernando de Soto refers to as “a vast hidden process that connects...all assets to the rest of the economy.”<sup>143</sup> In contrast, the underdeveloped and at times non-existent nature of property and corporation laws in less-developed nations results in “ownership rights...not adequately recorded” and “unincorporated businesses with undefined liability.”<sup>144</sup> The grim consequences of underdevelopment are inefficiency, lack of institutional power, and reduced levels of social welfare. Thus, U.S. property and corporation laws constitute

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<sup>142</sup> 1Bloc.com is an online tool created for the express purpose of serving as a “central locus where leaders in the field of sustainability, corporate social innovation, and social entrepreneurs can network.”

<sup>143</sup> de Soto, *supra* note 14

<sup>144</sup> Id.

what is perhaps the factor most vital to the realization of the social welfare-maximizing potential of the corporate form.

The presence of the supportive factors discussed above suggests that the social welfare-maximizing corporation may have a base upon which to grow in the U.S. Potential owners with access to various sums of founding capital, networks through which these potential owners can meet and disseminate information to interested parties, willing consumers and providers of human capital, and laws that confer the full benefits of property ownership and limited liability so vital to corporate business are equally important to the development of social welfare-maximizing corporations as they have been to the continued vitality of profit-maximizing corporations. If this new form of for-profit corporation is unable to take hold in the U.S., a country in possession of a unique mix of particularly helpful factors and an incomparably high level of capital availability, it is questionable that, at present, it will be able to do so elsewhere.

There are, in fact, several difficulties that may impede the growth of the social welfare-maximizing corporation in the U.S. Chief among these are the questions that ‘social entrepreneurs’ must ask of themselves. The desire to utilize the for-profit corporate form toward the end of social welfare rather than profit maximization is admirable and innovative, but it is both necessary and challenging to determine which vision of social betterment to pursue, to what extent scaling should be explored, how best to retain the commitment of consumers and employees and measure the effectiveness of particular social welfare-maximizing corporations, and what type of return can realistically be expected by owners and other stakeholders.

The issue of vision or purpose is one that will inevitably be decided by individual ‘social entrepreneurs’ themselves, likely in accordance with their own personal feelings and beliefs. Their decisions will dictate the stakeholders and shareholders they attract and must satisfy, and this process will occur on a company-by-company basis. Similar in nature is the decision of whether and to what extent scaling should occur. Individual social welfare-maximizing corporations that believe they can best maximize social welfare by sacrificing profit in the course of operations and production of social welfare-minded goods can decide to use a large portion of residual profits in pursuit of scale. This pursuit may include attracting greater numbers of shareholders with varying levels of willingness to accept haircuts to risk-adjusted market return. The more scaling is pursued, the greater the likelihood that a social welfare-maximizing corporation will exhaust the base of funds offered by willing and able philanthropic or altruistic individuals and be forced to solicit funds from standard equity market participants who demand risk-adjusted market returns. Such investors possess different interests than the philanthropic individuals willing to invest in particular visions of societal betterment, and profit sacrifice is not likely to be one of them. They could attempt to force a given entity to temper its profit-sacrificing activities and thus compromise its purpose by weakening the chief attribute that makes it social welfare-maximizing. Social welfare-maximizing corporations must individually decide the extent to which they may pursue scale and still remain able to fulfill their purpose. A final question that such corporations must answer individually is how best to retain the commitment of employees and consumers. An organization can lose both if it is perceived to be inefficient or ineffective at addressing its vision of social welfare, empowers managers or ‘social entrepreneurs’ who

significantly and with little support alter that vision over time, or begin to compromise purpose in pursuit of scale, among other things. Active monitoring by boards and, especially, interested shareholders who have committed capital toward their vision of social welfare-maximization reduce the probability that such things will occur, but corporations must individually ensure that they do not.

Different in scope from individual vision, scaling, and commitment issues are those of success measures and overall returns. The manner in which they are dealt with may prove critical to the long-term viability of social welfare-maximizing corporations and the ‘social entrepreneurship’ movement itself. As such, they must be addressed on a macro or community-wide level.

Useful success measures must express the ways in which social welfare-maximizing corporations positively contribute to their individual visions of societal betterment. They must also be somewhat standardized in order to facilitate legitimate comparison. Measures like the “Triple Bottom Line,” currently utilized by certain ‘socially responsible,’ profit-maximizing corporations in compliance with ‘Global Reporting Initiative’ conventions “conceived by CERES in 1997,”<sup>145</sup> and the ‘double bottom line’ used by Greyston Bakery represent progress toward this goal, but may not be applicable in their current forms to all conceivable types of social welfare-maximizing corporations.

The success measures ultimately decided upon by ‘social entrepreneurs’ will influence all owners’ and other stakeholders’ perceptions and expectations regarding return. If they are not to disappoint, social welfare-maximizing corporations must be

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<sup>145</sup> Savitz and Weber, *supra* note 77 at 211-213

honest and open about their goals from the moment of incorporation. Owners of residual profit-sacrificing corporations must be willing to accept returns in the form of moral, rather than economic, reward. The aforementioned base of altruistic individuals is almost certain to be amenable to this mode of return and therefore represents a vital and concordant but limited source of initial and expansionary capital. Those firms discussed above that seek to sacrifice profits and maximize social welfare through operations and the production of certain goods or services but use a large portion of residual profits in pursuit of scale must be even clearer in regard to their communications with potential investors, as they will ostensibly offer some level of monetary return, albeit below-market, in addition to moral reward.

As noted above, potential for serious conflict and difficulty lies in the desire to expand beyond a level that is feasible for a base of philanthropic individuals to support. Attempting to raise additional capital in the public markets will necessitate compromises capable of jeopardizing the long-term viability of the social welfare-maximizing corporation. Sacrificing varying amounts of profit in the name of social welfare becomes unfeasible once owners and debt holders cease to agree with this practice. Interestingly, even residual profit-sacrificing organizations like Greyston have been able to successfully justify short-term instances of debt-raising and corresponding temporary reductions in social welfare-maximizing activity based upon the claim that such actions increase long-term social welfare-maximizing capability. If taken too far, however, these activities may prove detrimental to the aim of long-term social welfare-maximization that all social welfare-maximizing corporations intend to pursue.

*Conclusion*

At the present time, it seems likely that a mass of social welfare-maximizing corporations can serve as a powerful complement to our conventional social sector institutions. Largely self-perpetuating, social welfare-maximizing entities can make it possible for the funds of philanthropic individuals to support more rather than fewer visions of societal betterment. Those corporations that seek to address cost intensive social concerns through activities like construction of affordable housing will likely pursue a residual profit-sacrificing strategy, provide moral reward rather than monetary return, and can thus function most effectively as small-to-mid-sized private corporations with shareholders willing and able to forego risk-adjusted monetary returns. Other firms that pursue social welfare-maximization through profit-sacrificing operations and production of social welfare-minded goods may choose to utilize some residual profits in an attempt to achieve scale, find themselves able to attract a broader base of philanthropic investors willing and able to take partial but not full haircuts to monetary return, and progress beyond small-to-mid-sized private status. There are still limitations to scale due to the characteristics of current standard financial market participants, but it is possible that future trends of increased societal interest in the rectification of social problems, growing bases of philanthropic individuals in foreign and developing nations, and larger generations of ‘social entrepreneurs’ will enable various types of social welfare-maximizing corporations to attain further scale and even public status without compromising their shared purpose.

Irrespective of public or private status, the emergence of social welfare-maximizing corporations signifies a powerful and potentially transformative utilization of the prominent institution of capitalism. It is not hard to believe that the for-profit



corporate form, with its capacity for self-renewal through successful profit-generating operations, can infuse the social welfare-minded sector with a degree of the 'creatively destructive' innovation that has served the purely profit-driven sector so well and for so long.