Sustainability Meets Profitability: The Convenient Truth of How the Business Judgment Rule Protects a Board's Decision to Engage in Social Entrepreneurship

Janet E. Kerr[1]
Pepperdine University School of Law

Abstract

The world of publicly held companies sits on the brink of change. Corporate focus that has traditionally been fully consumed with shareholder profit maximization is rapidly diverging into a new sector that takes a more social view. Whether by choice or force, this change is inevitable. On one hand traditionalists with shareholder tunnel vision resist; on the other, community activists and socially concerned corporate leaders are embracing the change. Leaders of publicly traded corporations such as eBay's Jeff Skoll and Pierre Omidyar and Google's Larry Page and Sergey Brin "have done so in ways that seem likely to shape their generation's philanthropic legacy—first poking at the firewall between the nonprofit and business worlds, then punching through and building a network of investments that cross back and forth."[2]

Thus, social entrepreneurship is born. Put simply, social entrepreneurship takes proven business tools and applies them to generate a social good. To clear any misconception, social entrepreneurship is an investment, not a gift, and not charity. Investments in social entrepreneurship are two-fold: pecuniary and social; thus, a double bottom line is developed. Decisions to engage in social entrepreneurship look beyond the corporate wall and to outside stakeholders where "the social mission and the business mission [are] inseparable."[3]

Naturally, a question arises: Are these corporate decisions that look beyond shareholder profit maximization allowed and supported by the law of corporate governance and business objectives? The short answer is: Yes. While some research and scholarly articles may suggest that corporate law must be revisited and completely or partially revised to support social entrepreneurship decisions, this Article proves that our existing legal system already allows for corporate decisions to look outside immediate shareholder interests. Thus, this Article shows that social entrepreneurship is supported by existing corporate law,[4] *within the duty of care as protected by the business judgment rule. First, a growing number of stakeholder constituency statutes, in addition to judicial corporate holdings, have opened the door to allowing consideration of non-shareholders when making investment decisions. Second, investments in social entrepreneurship are just that—"investments." Third, there is a growing body of knowledge that allows measurement of the social impact and financial success of social entrepreneurship. In sum, this Article asserts that corporate decisions which consider outside stakeholders can increase shareholder value both socially and financially and therefore these decisions directly correlate with shareholder profit maximization and are within the scope of corporate governance. Furthermore, the availability of knowledge that such social investments exist and can be profitable for the company and its shareholders, both socially and financially, invokes the board of director's duty to be informed when making investment decisions.*

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[2] Douglas McGray, *Network Philanthropy: The Men Behind eBay Are Leading a High-Tech Revolution That is Turning Charitable Giving on its Head,* WEST MAGAZINE, L.A. TIMES, Jan. 21, 2007, at 15.

[3] *Id.* at 32.

[4] Embodied in the scope of corporate governance is the duty of care and the business judgment rule. American Law Institute, *Duty of Care of Directors and Officers; The Business Judgment Rule*, 1 PRINCIPLES OF CORPORATE GOVERNANCE § 4.01 (2007) (hereinafter "*ALI Principles § 4.01").*

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I. Introduction

Social entrepreneurship is a growing dynamic movement which is gaining respect among the younger generation of tomorrow's tech and business leaders as well as with long existing publicly-held corporations. These leaders don't talk about shareholders; they talk about the community; they talk about growth; they talk about sustainability.[5] The idea of social entrepreneurship was born in the early 1990s when "a handful of wealthy executives and investors, most of them connected in some way to the budding tech boom, began to think about how philanthropy might work differently and about how they could take what made them rich in business and apply those tactics to charity."[6] For example, when eBay's founders Pierre Omidyar and Jeff Skoll decided to take their company public in 1998, "they didn't talk about customers; they talked about 'the community.' Shutting the community out of eBay's upcoming

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[5] Sustainability is defined as "meeting the needs of the present without compromising the ability of future generations to meet their needs." David Hahn-Baker, *Daniel Sitarz's Sustainable America: America's Environment, Economy, and Society in the 21st Century*, 7 BUFF. ENVT'L. L. J. 259, 264 (2000) (book review).
[6] *Id.* at 16.

IPO . . . seemed ungrateful. So they decided that eBay would endow a charitable foundation with pre-IPO stock and share its wealth that way."[7] Yet, this generous and experimental offer was met by the charitable world with skepticism, and after a chain of "nos," Peter Hero of Community Foundation Silicon Valley[8] finally accepted shares of eBay's pre-IPO stock worth $1 million.[9] The skepticism quickly faded a year later when the Community Foundation Silicon Valley sold their shares for an estimated worth of $40 million.[10]

Now, Omidyar and Skoll, worth $8 billion and $5 billion respectively, are "at the edge of something else—a wave of new thinking that . . . could shape the way huge sums of private capital get invested in social change."[11] That "something else" is social entrepreneurship. Currently, Skoll "runs an influential foundation (The Skoll Foundation) that gives mezzanine funding (in venture capitalist lingo) to small nonprofits, that with infusions of cash are ready to grow."[12] Through his foundation, Skoll established the Skoll Centre for Social Entrepreneurship,[13] Institute for Oneworld Health, Benetech,[14] and The PBS Foundation Social Entrepreneurship Fund.[15] In addition, Skoll runs a for-profit film production company,

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[7] *Id.* at 14.
[8] In 2006 Community Foundation Silicon Valley merged with Peninsula Community Foundation, and in January 2007 Silicon Valley Community Foundation ("SVCF") was launched as a product of the merger. With over $1.5 billion in assets and over 1400 philanthropic funds, SVCF is the fourth largest community foundation in the United States. SVCF "is a partner and resource to organizations improving the quality of life in our region (Santa Clara and San Mateo counties), and to those who want to give back locally, nationally and internationally." Silicon Valley Community Foundation, *About the Foundation*, www.siliconvalleycf.org (last visited Feb. 17, 2007).
[9] Omidyars's and Skoll's only condition in their pre-IPO endowment was that Hero must hold the stock for at least 12 months. McGray, *supra* note 2, at 14.
[10] *Id.*
[11] *Id.* at 16.
[12] *Id.* Mezzanine funding is funding that is provided in the "second-round." Skoll Foundation, *Skoll Awards for Social Entrepreneurship Guidelines*, http://www.skollfoundation.org/skollawards/index.asp# (last visited Feb. 21, 2007).
[13] The Skoll Centre for Social Entrepreneurship promotes entrepreneurial solutions to social problems and has received $7.5 million from the foundation. McGray, *supra* note 2, at 16.
[14] The Institute for Oneworld Health is a developer for nonprofit drugs. Benetech develops socially beneficial technology and other social entrepreneurial. Investment in both from the foundation is $25 million. *Id.*
[15] The PBS Foundation of Social Entrepreneurship Fund invests in documentaries; it receives $2.5 million from the foundation. *Id.*

Participant Productions, which invests in films that are written and produced to promote a social platform and spark public debate.[16]

Omidyar's investment strategy is even less conventional. Omidyar "has completely abandoned the traditional foundation structure . . . and is putting up his entire fortune to back both for-profit and nonprofit projects that will add up to social good and market-rate returns."[17] Omidyar "began to find for-profits that advanced social goals like nonprofits, and nonprofits that earned money like for-profits."[18] Through the Omidyar Network, Omidyar has invested in KaBOOM![19] and DonorsChoose,[20] among others. After a meeting with Nobel Peace Prize Winner Muhammad Yunus, the father of microcredit and the founder of the Grameen Bank,[21]

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[16] Participant Productions has produced such films as FAST FOOD NATION, AN INCONVENIENT TRUTH, SYRIANA, AND GOOD NIGHT, AND GOOD LUCK. *Id.*

[17] *Id.*

[18] *Id.* at 32.

[19] KaBOOM! helps communities build playgrounds and sports fields; the Network has invested $5 million. *Id.* For more information on KaBOOM!, see www.kaboom.org.

[20] DonorsChoose connects investors with teachers who need support in school projects; the Network has invested $2.75 million. McGray, *supra* note 2 at 32. For more information on DonorsChoose, see www.donorschoose.org.

[21] Michael M. Phillips, *Microloan Father Yunus is Awarded Nobel Peace Prize*, WALL ST. J., Oct. 14, 2006, at B1. *See also* Celia W. Dugger, *Peace Prize to Pioneer of Loans for Those Too Poor to Borrow*, N.Y. TIMES, Oct. 14, 2006, at A1 (further describing Yunus' work). Grameen Bank functions in stark contrast to conventional banks with its "overarching objective . . . to bring financial services to the poor." Muhammad Yunus, *Is Grameen Bank Different From Conventional Banks?*, Dec. 2006, http://www.grameen-info.org/bank/GBdifferent.htm. In October 2006, Yunus was honored with the 2006 Nobel Peace Prize. Phillips, *supra* note 21. This award solidified social entrepreneurship as a movement that is gaining much respect in both the business and philanthropic worlds. In Yunus' native Bangladesh, more than 300 million people live on less than $1 a day and have no access to traditional credit. *Id.* Yunus knew that mere handouts were not working to help these people overcome their poverty, but he also recognized the need for affordable access to small amounts of capital. *Id.* Realizing that even loans of $100 or less would significantly impact these rural villagers' ability to start or augment their own businesses, Yunus founded Grameen Bank in 1983 and pioneered the business of microlending. *Id.* Yunus began with a $27 loan to a group of 42 basket weavers and has since lent out $5.7 billion to 6.6 million borrowers. *Id.* The risk of granting unsecured loans to desperately poor people was managed by organizing the borrowers into groups that would help ensure each member repaid his or her share. It has been reported that Grameen Bank has maintained a loan recovery rate of nearly 99%. *Id.* Yunus's efforts have spurned an entire industry. As many as 10,000 microlending institutions now serve more than 100 million borrowers. *Id.* Large commercial banks such as Citigroup, Inc., ABN Amro, and HSBC have begun entering the market for microloans. According to Syed Aftab Ahmed, senior manager for global microfinance at the International Finance Corp. in Washington, microlending "has caught the attention of serious investors . . ." Mark Sappenfield, *Big Banks Find Little Loans a Nobel Winner, Too*, CHRISTIAN SCIENCE MONITOR, Oct. 16, 2006, at 1-3. The microfinance industry has led insurance mainstays like American International Group (AIG) and Allianz to develop microinsurance policies that provide life and disability coverage. Liam Pleven, *Out of 'Microfinance' Work Springs Insuring Loans for the Impoverished*, WALL ST. J., Oct. 14, 2006, at B5. These tiny insurance polices are typically paired with a microloan and protect the insured from defaulting on their loan payment if they become disabled or die, or perhaps more likely, if "the sewing machine or motorcycle the borrower bought

Omidyar Network has recently turned its focus "to commercializing microfinance—turning it into a mainstream investing opportunity."[22] Omidyar Network's recent investments include Grameen Foundation,[23] Prosper,[24] and The Omidyar-Tufts Microfinance Fund.[25]

Influenced by eBay, Google's founders Larry Page and Sergey Brin outlined their strategy for Google as a public company. Page and Brin declared that they viewed Google as holding an obligation not just to its customers, employees and future shareholders, but also to the greater global community.[26] In a famous (or perhaps infamous) passage, Brin and Page assert the Google vision: "Don't be evil. We believe strongly that in the long term, we will be better served—as shareholders and in all other ways—by a company that does good things for the world even if we forgo some short term gains."[27] As part of this commitment, Page and Brin announced to potential investors in their pre-IPO filing that they intended to invest 1% of Google's equity and profit in philanthropy work.[28] The initial commitment, which was funded with seed money from the Google IPO, was equal to over $1 billion.[29]

The beneficiary of this money is Google's humanitarian arm, Google.org, a *for-profit* company with the purpose of tackling worldly social issues.[30] Focusing on global poverty,

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with the loan is stolen or broken." *Id.* An example of such a program exists in Uganda, where AIG charges around $12 to $15 for coverage on loans that have an average value of $400. AIG has over 1.5 million microinsurance policies in other countries, including India, El Salvador and Guatemala. *Id.* With projections showing that annual revenues could reach $100 million in 7 to 10 years, AIG predicts that this could be a very sizeable business. *Id.*

[22] McGray, *supra* note 2, at 32.

[23] Omidyar's investment in the Grameen Foundation is $4 million. *Id.* at 17.

[24] Prosper connects people looking for investments with the working poor and those looking for fair-interest loans; Omidyar's contribution is non-disclosed. *Id.*

[25] The Omidyar-Tufts Microfinance Fund invests in for-profit microfinance institutions; contribution is $100 million. *Id.*

[26] Larry Page & Sergey Brin, *An Owner's Manual for Google Shareholders*, http://investor.google.com/ipo_letter.html (last visited Jan. 31, 2007).

[27] *Id.*

[28] Jessi Hempel, *Google For Charity*, BUSINESS WEEK, Oct. 20, 2005, *available at* http://www.businessweek.com/technology/content/oct2005/tc20051020_721687.htm.

[29] Jessi Hempel, *Google's Brilliant Philanthropist*, BUSINESS WEEK, Feb. 22, 2006, *available at* http://www.businessweek.com/technology/content/feb2006/tc20060222_088020.htm.

[30] In 2006 Dr. Larry Brilliant was chosen by Page and Brin as Executive Director of Google.org. Dr. Brilliant is the "founder and director of The Seva Foundation, a Policy Advisory Council Member at the University of California,

health, the environment, and energy, Google.org involves the work of Google Foundation, Google's own projects, and partnerships with other for-profit and nonprofit organizations.[31] Google.org possesses a competitive edge over traditional charities because as a for-profit company it can, among other things, fund start-ups, obtain venture capital, and lobby Congress.[32] Page and Brin "hope that someday this institution will eclipse Google itself in overall world impact by ambitiously applying innovation and significant resources to the largest of the world's problems."[33]

Unlike other organizations that wait until later in their lifetime to start philanthropic pursuits, Google established and funded Google.org during Google's infancy. In other words, whereas most traditional companies wait for excess cash generated by years of positive earnings, Page and Brin committed to social investment during Google's inception.[34] Furthermore, the financial commitment comes not out of Page's and Brin's personal wallets, but instead right out of the pockets of Google's investors.[35] The Google Board of Directors signed off on a twenty year financial commitment to Google.org and has recently approved a more rapid disbursement rate of funds—$175 million over the next two years.[36] This innovative approach situation presents a string of questions: What happens a few years down the road if Google stumbles and

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Berkeley School of Public Health, and a member of the Strategic Advisory Group of Kleiner-Perkin's Pandemic and Bio-Defense Fund." Google, *Google Names Larry Brilliant as Executive Director of Google.org*, http://www.google.com/intl/en/press/pressrel/brilliant.html (last visited Feb. 20, 2007).

[31] Google, *Welcome to Google.org*, www.google.org (last visited Feb. 21, 2007). Google Foundation, a 501(c)(3) charity, is a part of Google.org and has an endowment of approximately $90 million. Katie Hafner, *Philanthropy Google's Way: Not the Usual*, N.Y. TIMES, Sept. 14, 2006, at A1. Some of Google Foundation's initial commitments were: Acumen Fund, TechnoServe, Water Research, and PlanetRead. *Id.* In addition to Google.org and Google Foundation is Google Grants which gives free advertising to selected nonprofits (to date 850 recipients resulting in $33 million of free ads). *Id.* Current recipients of Google Grants include: Grameen Foundation, Doctors Without Borders, Room to Read, and Make-a-Wish Foundation. *Id.*

[32] In order to keep their tax-exempt status, 501(c)(3) nonprofits must conform to a series of operational obligations. For a summary of these restrictions, *see* IRS, *Frequently Asked Questions about Tax-Exempt Organizations*, http://www.irs.gov/charities/content/0,,id=96986,00.html, (last visited Jan. 31, 2007).

[33] *Welcome to Google.org, supra* note 31.

[34] Hempel, *Google for Charity*, *supra* note 28.

[35] *Id.*

[36] Hafner, *supra* note 31.

is short on cash? How can the Google board justify signing off on such a financial outlay that seemingly has nothing to do with Google's core business and sacrifices corporate profits in favor of public interest goals?

How is this decision in the best interests of the corporation and its shareholders? How does a $1 billion dollar commitment to a so-called "charity" maximize the wealth of shareholders? Peter Hero, the current senior advisor of the Silicon Valley Community Foundation, provides a glimpse into the answer to those questions: "I think how you count profit is the issue here . . . Google.org is measuring return on cleaner air and quality of life. Their bottom line isn't just financial. It's environmental and social."[37] Neither eBay's Skoll and Omidyar nor Google's Page and Brin "set out to remake philanthropy. They're simply doing what Silicon Valley entrepreneurs do: testing new markets, teaching and learning from competitors and diversifying their industry."[38] What's more, they are recognizing that economic and social returns are now coming together to satisfy shareholders and stakeholders alike. They are ensuring that these groups no longer have to be at odds with each other. They are social entrepreneurs.

It is not only new or emerging industry leaders that are incorporating social ventures into their business strategies. Several large and long-existing corporations are also seeing the potential for profit in social entrepreneurship. For example, Dow Chemical is working to sell cutting-edge water filtration devices to the poor in third world countries.[39] The United Nations predicts that 1.2 billion people lack clean drinking water, and Dow estimates that Dow has the

[37] *Id.* The Silicon Valley Community Foundation was the product of a 2006 merger between Community Foundation Silicon Valley and the Peninsula Community Foundation in 2006. Silicon Valley Community Foundation, *supra* note 8.
[38] McGray, *supra* note 2, at 32.
[39] Pete Engardio, *Beyond the Green Corporation*, BUSINESS WEEK, Jan. 29, 2007, at 64

ability to serve 300 million of them and return $3 billion in sales.[40] When GlaxoSmithKline decided to start selling 90% of their vaccines at or below cost in developing countries, CEO Jean-Pierre Garnier acknowledged that doing so gives it a major competitive advantage: "Top scientists are drawn to GSK because they want their research to make a difference. Doing good, and being admired for it, also boosts general morale at the company… [which] creates a more aligned workforce, which helps us outperform our competitors."[41] In addition, the reputable producer of fuel-efficient vehicles, Toyota has seen its brand value increase 47% to $28 billion since it released the Toyota Prius gas-electric hybrid car in the United States five years ago.[42] These three examples represent the larger change that is sweeping through corporate decision making—there is a lot of money to be made by investing in social entrepreneurship, and boards, shareholders and consumers are noticing.[43]

A. The Tipping Point[44]

Social entrepreneurship is at its tipping point; it is at "that magic moment when an idea, trend, or social behavior crosses a threshold, tips, and spreads like wildfire."[45] The drive to incorporate proven profit-making techniques into socially beneficial ventures has emerged slowly over the last two decades but has recently become a global phenomenon.[46] A Lexis-

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[40] *Id.* Dow states that they are committed to sustainability and has a mission to "constantly improve what is essential to human progress by mastering science and technology." Dow, *Our Commitments,* http://www.dow.com/commitments/intro (last visited Feb. 11, 2007).

[41] Kerry Capell, *GlaxoSmithKline: Getting AIDS Drugs to More Sick People*, BUSINESS WEEK, Jan. 29, 2007 at 60.

[42] David Kiley, *Toyota: How the Hybrid Went to the Swift*, BUSINESS WEEK, Jan. 29, 2007, at 58. Toyota currently makes more profit than any other automaker. *Id.*

[43] In January, BUSINESS WEEK highlighted the top three "sustainability" leaders in the following industries: automobiles, communications equipment, computers and peripherals, financial services, health care, household durables, oil and gas, pharmaceuticals, retail, and utilities. *Who's Doing Well by Doing Good*, BUSINESS WEEK, Jan. 29, 2007 at 53. Several large companies were mentioned, including Volkswagen, Motorola, Dell, Quest Diagnostics, Sony, and Royal Dutch Shell, among many others. *Id.*

[44] *See generally* Malcolm Gladwell, THE TIPPING POINT: HOW LITTLE THINGS CAN MAKE A BIG DIFFERENCE (First Back Bay 2002) (2000).

[45] *Id.* at back cover.

[46] In the last decade, the number of nonprofit organizations in the United States has doubled, from 500,000 to over one million. Developing countries have seen similar growth. In Brazil, the number of nonprofits has evolved from

Nexis news search for the term "social entrepreneur" returned just 94 articles from 1986 to 1996, but a search from 1997 to 2006 yields over 1400 results.[47] It appears that social entrepreneurship is reaching its tipping point.[48] Popular media outlets, such as the *Wall Street Journal*, *Financial Times*, *The Economist*, *Time*, *Newsweek*, *U.S. News & World Report*, *Fast Company* and *Inc.* regularly offer glimpses into the world of the social entrepreneur.[49] For instance, *Fast Company* honors twenty-five social entrepreneurs annually in its "Social Capitalist Awards" issue. And in March 2006, *Fast Company* recognized "The Fast Fifty"—the group who will change how the world works and lives over the next ten years.[50] "The Fast Fifty is an annual worldwide search for ordinary people doing extraordinary things and is conducted to "remind the world of all the good that's created when passionate people with big ideas and strong convictions are determined to make a difference."[51]

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about 1,000 organizations to over one-million in a 20 year period. Des Dearlove, *Interview: Jeff Skoll*, BUSINESS STRATEGY REVIEW, Summer 2004, *available at* http://www.skollfoundation.org/media/press_releases/external/2004/Business%20Strategy%20Review%20-%20Skoll%20Interview.pdf

[47] The Lexis-Nexis search was performed on www.lexisnexis.com using the "Terms and Connectors" search for "social entrepreneur" in the Major Newspapers and Magazine Stories databases, combined. Search last performed Nov. 17, 2006.

[48] The phrase "the tipping point" comes from Malcolm Gladwell's book by the same name. Gladwell's book is based on the idea that little changes can have big effects and the world can be changed as small numbers of people start behaving differently and their behavior ripples outward until a critical mass or "tipping point" is reached. *See generally* Gladwell, *supra* note 44.

[49] Social entrepreneurship is also burgeoning as an academic interest. Universities such as Stanford University, Oxford University, Columbia University, Harvard University, Duke University, IESE University, Yale University, and Pepperdine University have all set up comprehensive social entrepreneurship programs, initiatives, or research centers. For more information on these programs, see Stanford University's Center for Social Innovation at www.gsb.standford.edu/csi; Oxford University's Skoll Center for Social Entrepreneurship at http://www.sbs.ox.ac.uk/skoll; Columbia University's Social Enterprise Program at http://www2.gsb.columbia.edu/socialenterprise/academics/research/; Harvard University's Foundation Fellowships in Social Entrepreneurship at http://www.ksg.harvard.edu/leadership/reynolds/index.php; Duke University's Center for the Advancement of Social Entrepreneurship at www.fuqua.duke.edu/centers/case; IESE Business School's International Social Entrepreneurship Research Conference at http://www.iese.edu/en/events/anselmorubiralta/InternationalSocial/Home/Home.asp; the Yale School of Management's Program on Social Enterprise at http://www.iese.edu/en/events/anselmorubiralta/InternationalSocial/Home/Home.asp, and Pepperdine University School of Law's Geoffrey H. Palmer Center for Entrepreneurship and the Law at http://law.pepperdine.edu/palmer.

[50] Fast Company.com, *About the Fast 50*, Mar. 2006, http://www.fastcompany.com/fast/50_06/aboutthefast50.htm.

[51] *Id.*

Included in "The Fast Fifty" was David Green, the founder of the nonprofit Project Impact.[52] Project Impact's approach is described as embodying the "economic paradigm of 'compassionate capitalism' . . . utilizing production capacity and surplus revenue . . . in a way that is both financially self-sustaining and affordable to all members of society. . . In this paradigm, profit is the MEANS to an END, not the other way around."[53] Green's success with Project Impact is remarkable, and his organization has revolutionized the way developing countries produce, distribute, and service high-quality, affordable health care products.[54]

Project Impact's initial venture was Aurolab, a nonprofit company in India that combined Green's engineering know-how with his background in the healthcare industry.[55] Aurolab developed systems that could produce surgically implanted artificial lenses for cataract patients. Project Impact was able to sell these lenses for $4 to $6 each, as opposed to the average industry price of $100 to $150,[56] making the lenses affordable to the desperately poor in developing countries. Without David Green's lenses, six million individuals would be functionally blind and unable to earn a living.[57] Green's strategy to manufacture and sell the lenses instead of purchasing and giving them away characterizes social entrepreneurship's "double bottom line—the quest for measurable social impact coupled with a financial return. The strategy has worked. Aurolab is currently the world's second largest manufacturer of these lenses and is self-sustaining

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[52] Cheryl Dahle, *Number 13—Vision-ary, David Green*, Mar. 2006, http://www.fastcompany.com/magazine/103/open_13-green.html.
[53] Project Impact Homepage, http://www.project-impact.net/ (last visited Feb. 16, 2007).
[54] In 2002, David Green was elected to be an Ashoka Fellow and his profile is available on Ashoka's website at http://www.ashoka.org/node/3146 (last visited Feb. 16, 2007). Ashoka is a global organization of social entrepreneurs that seek to inspire others to become powerful change-makers, and "Ashoka Fellows inspire others to adopt and spread their innovations—demonstrating to all citizens that they too have the potential to be powerful change-makers and make a positive difference in their communities." Ashoka, *Everyone a Changemaker,* http://www.ashoka.org/ (last visited Feb. 16, 2007).
[55] Kris Herbst, *Compassionate Manufacturing: Aurolab Does Business With the Poor,* CHANGEMAKERS.NET JOURNAL, Jan. 2003, *available at* http://www.changemakers.net/journal/03january/herbst.cfm#jump. Aurolab is now a non-profit trust that partners with Project Impact. Project Impact, *Our Partners,* http://www.project-impact.net/partners.htm#aurolab (last visited Feb. 17, 2007).
[56] Herbst, *supra* note 55.
[57] *Id.*

by earning revenues 30% above expenses.[58] This ability to self-sustain allows Project Impact to provide "endurance over dependence on charity," and it also proves that markets do exist in poorer countries, which "creates a competitive environment for other companies to enter."[59] Clearly, Project Impact is making an impact.

More proof that social entrepreneurship has reached a tipping point can be found in *Business Week's* January 29, 2007 issue which featured a series on socially-responsible and eco-friendly businesses and the social entrepreneurs that are leading the changes.[60] For instance, Unilever, a soap and shampoo conglomerate, was featured because of their broad approach to developing and supporting the communities in the emerging markets that they are targeting. Unilever CEO Patrick Cescau discussed his company's decisions to have a free community laundry, financing for eco-friendly drip irrigation, and waste recycling in San Paulo, Brazil.[61] Unilever also has a free hospital in Bangladesh, provides potable water to deprived communities in Ghana, and helps women in India start microenterprises.[62] According to Cescau, "You can't ignore the impact your company has on the community and environment . . . helping such nations wrestle with poverty, water scarcity, and the effects of climate change [is about] . . . growth and innovation. In the future, it will be the only way to do business."[63] Indeed, future environmental regulations are likely to get tighter and implementing sustainable strategies now can "help avert costly set backs" in the future.[64] *Business Week's* spread emphasizes how social and environmentally-oriented business ventures are no longer at the fringe of the business

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[58] *Id.* The revenues are put back into the organization to fund the tiered pricing model, which charges more from communities that can pay more and less from those who cannot. Project Impact, *Sustainable Development,* http://www.project-impact.net/sustainable.htm (last visited Feb. 17, 2007).
[59] Project Impact, *Our Approach,* http://www.project-impact.net/approach.htm (last visited Feb. 16, 2007).
[60] *See generally* Engardio, *supra* note 39, at 50-64.
[61] *Id.* at 50.
[62] *Id.*
[63] *Id.* at 52.
[64] *Id.*

community. In fact, the number of companies that are shifting business practices, out of concern for the communities in which they operate or as part of a strategic plan for future regulations, is rapidly increasing.[65] The following section will elaborate on this dual focus on financial profits and social good known as the "double bottom line."

B. Social Entrepreneurship and the Double Bottom Line

What sets social entrepreneurship apart from classic philanthropy or charity is the pursuit of profitable ventures. Whereas nonprofit organizations have strict requirements regarding capital raising activities,[66] the for-profit structure is more flexible. Social entrepreneurship scholar Gregory Dees notes that the future of the social change field is in these market-based solutions: "If there is something that can be done and done well through a business or market-based structure, it's probably better to take advantage of that and use philanthropy for something that can't be well funded simply through the market."[67] Ultimately, Dees' concept of the "blending" of sector boundaries typifies the for-profit social venture movement. Dees notes that "[people] realize that social and environmental problems are entangled with economics. It's almost impossible to separate them and solve them without paying attention to economic factors. Long-term solutions to social problems will cut across sector boundaries."[68]

The key aspect of these "for-profit social ventures" is what has become known as the "double bottom line." The concept of the double bottom line views profit as having financial

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[65] This series highlights the practices of several companies in the automobile, communications, computers, financial services, health care, household durables, oil and gas, pharmaceuticals, retail, and utilities industries. *Id.* at 53. The general theme of this spread is: "Imagine a world in which eco-friendly and socially responsible practices actually help a company's bottom line. It's closer than you think." *Id.* at 50.

[66] Gregory J. Dees, *Enterprising Nonprofits*, HARVARD BUSINESS REVIEW, Jan.-Feb. 1998, at 55. *See also* William Foster and Jeffrey Bradach, *Should Nonprofits Seek Profits?*, HARVARD BUSINESS REVIEW, Feb. 2005, at 92; Gail A. Lasprogata and Marya N. Cotton, *Contemplating Enterprise: The Business and Legal Challenges of Social Entrepreneurship*, 41AM. BUS. L. J. 67 (2003) (all summarizing challenges related to the nonprofit legal structure).

[67] Duke University's Center for Advancement of Social Entrepreneurship, *Past, Present and Future of Social Entrepreneurship: A Conversation with Greg Dees*, (2006) http://www.fuqua.duke.edu/centers/case/documents/Dees%20Interview-final.pdf.

[68] *Id.*

and social components; it achieves measurable results in both areas by harnessing innovation, people, and resources to develop an enterprise that is self-sustaining, makes money, and solves a social problem. For-profit social ventures are better equipped than traditional charities or government social programs *because* their business-oriented structure enables them to: 1) promote efficiency and innovation; 2) leverage scarce financing and resources; 3) respond and adapt quickly to demand; and 4) improve access to skilled personnel.[69] For these reasons, social entrepreneurship is significantly impacting traditional philanthropy as there is a growing push for charities to become more business-like in how they are operated. Charities are being heavily scrutinized to evaluate their methods and approaches and not only account for how much money they raise or donate, but what exactly those funds are accomplishing.[70]

While there is much to be said about the positive changes in philanthropy, this Article will look at the implications that social entrepreneurship has on big business and the traditional corporate law that governs it. Part II sets out the thesis of the Article which states that social entrepreneurship projects are investments that add both social and financial value to corporations' bottom line and are therefore within the scope of the business judgment rule, and furthermore, that the board of directors has a duty to be informed of the potential for social entrepreneurship in their company. Part III provides a historical look at the area of corporate governance through the fiduciary duty of care and the business judgment rule as they apply to maximizing shareholder wealth. Part IV traces the evolution of business strategy though the last few decades and demonstrates how social entrepreneurship established itself as an important method of generating value. Finally, Part V argues that the decision to engage in social

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[69] Gregory Dees & Beth Battle Anderson, *For-Profit Social Ventures*, INTERNATIONAL JOURNAL OF ENTREPRENEURSHIP EDUCATION, 2002, at 3-4, *available at* http://www.fuqua.duke.edu/centers/case/news/documents/DeesAndersonCASE.pdf.
[70] *Id.*

entrepreneurship fulfills the Board's fiduciary duties to the shareholders. This Article's analysis, in conjunction with the Conclusion in Part VI, intends to reduce the hesitancy of the boards that are eager to expand into social entrepreneurial ventures by showing that there is a direct linkage between these ventures and profits for shareholders; this is smart business, not charity or profit-sacrificing behavior.[71]

II. Thesis

Social entrepreneurship projects in the public sector can fulfill the social and financial interests of publicly held corporations and their shareholders. Therefore, these double bottom line decisions are supported by laws governing corporate decision making, within the board of directors' duty of care and duty to be informed as protected by business judgment rule. Social entrepreneurship is strategic investing that generates two interrelated results: social progress and financial returns. These profitable, non-traditional investments are gaining legitimacy as they embody the movement that applies the tools of both business and enterprise to social problems. Reacting to the inability of governments, charities and other nonprofits to solve the world's most obstinate social ills of poverty, disease, and pollution, social entrepreneurship approaches a social problem in the same way a traditional business entrepreneur approaches a market opportunity.

While the ultimate goal of the social entrepreneurship project is to build a sustainable solution to a social problem, the traditional business entrepreneur seeks pecuniary gain as the ultimate end. However, there is an important similarity between these two goals: both traditional and social entrepreneurs are in business to make a profit. Social entrepreneurship is not giving, it is investing. Using proven business methods to attain various social goals, these

[71] The Chairman of McKinsey & Co., Lenny Mendoca, has said, "This is uncomfortable territory because most CEOs have not been trained to sense or react to the broader landscape. For the first time, they are expected to be statesman as much as they are functional business leaders." Engardio, *supra* note 39, at 64.

new entrepreneurs are blurring the boundaries previously thought to divide the business, government, and nonprofit sectors.

Corporate directors are being held more accountable for the effects of their decisions on the environment and society. This Article will prove that social entrepreneurship within the public sector is supported by corporate governance within the definition of the business judgment rule and due care for three main reasons. First, judicial action and recent shareholder constituency statutes have opened the door to allow directors of public companies to take non-shareholder interests and concerns into consideration when making investment decisions. Second, investments in social entrepreneurship are just that—"investments." And third, there is a growing body of knowledge that measures social and financial impact and shows that corporations are profiting from social entrepreneurship. This information is material to responsible board decisions and invokes the board of directors' duty to be informed about such opportunities.

Investments in social entrepreneurship have potential to maximize shareholder profits by both quantitative and qualitative measures, and profits generated by social entrepreneurship are three-fold: 1) monetary revenue generated from the project; 2) additional positive externalities; and 3) the reduction of negative externalities. With the explosion of advanced science and technology the world is shrinking. This is affecting public corporations in two ways: 1) the separation between the for-profit and social sectors is becoming unclear; and 2) competition is driving corporations towards involvement in emerging markets. Now more than ever the line between generating shareholder wealth and creating value within the community is becoming blurred, and public corporations are realizing that they cannot profit by working in isolation.

This Article will prove that directors of publicly held corporations who make social investment decisions have support behind them from both legal and investment perspectives.

III. Corporate Governance: Duty of Care and the Business Judgment Rule

Part I proved that many corporations are making sound business judgments by investing in social entrepreneurial ventures—they are profiting and contributing to the betterment of communities around the world. These decisions are being made by focusing on effects beyond pure shareholder profit maximization. Is this legal? In short, yes. This section discusses why social entrepreneurship is supported by the laws under corporate governance.

It is widely recognized that those who control and direct the decisions and operations of the corporation are instilled with the duties of good faith and due care. These duties form the core of corporate governance and build an overarching foundation of trust and confidence.[72] Under MBCA § 8.30(a), "each member of the board of directors, when discharging the duties of a director, shall act in good faith and in a manner the director reasonably believes to be in the best interests of the corporation."[73] In addition to setting the baseline standard for due care, MBCA § 8.30(b) states that "directors must discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances."[74] Also incorporated in the directors' fiduciary duty of due care is the duty to act on an informed basis, which requires "considering all material information reasonably available" before making a decision.[75]

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[72] *ALI Principles § 4.01, supra* note 4.
[73] MODEL BUS. CORP. ACT § 8.30(a) (2005).
[74] *Id.* at §8.30(b).
[75] Meredith M. Brown & William D. Regner, *The Duties of Target Company Directors Under State Law: The Business Judgment Rule and Other Standards of Judicial Review*, PRACTICING LAW INSTITUTE: CORPORATE LAW & PRACTICE HANDBOOK SERIES, Jan. 24, 2007, at 200. The Supreme Court in Delaware has interpreted the duty to be informed to mean that the Board of Directors does not have to be informed of *all* facts, just those that are material and within the Board's reasonable reach. *Id.* at 201.

Fundamentally related to directors' duty of care is the business judgment rule. The business judgment rule gives a rebuttable presumption that, when making business decisions, directors act "on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation."[76] Although for the most part not codified in statutes, the business judgment rule is well established in case law and the presumption holds true even in states that have their own statutory due care standards.[77] "Thus, the party attacking a board decision as uninformed must rebut the presumption that its business judgment was an informed one."[78] Other ways to overcome the presumption include proving that the director was acting fraudulently, illegally, or in conflict of interest, or showing that the director's action lacked any rational business purpose.[79] Justification for maintaining this presumption is based on three policy goals, as it: 1) encourages risk taking; 2) avoids judicial meddling; and 3) encourages directors to serve.

Corporate law has traditionally been shaped primarily by case law established in state courts.[80] This has resulted in varying standards and considerable debate over the role that corporate governance plays. A question core to this debate is to whom do officers and directors owe fiduciary duties? Traditionally, the answer was thought to be clear: "a corporation was nothing more or less than the sum of its owners' aggregate interests and the object of the

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[76] ABA Committee on Corporate Laws, Business Law Section, CORPORATE DIRECTOR'S GUIDEBOOK 13 (2001).
[77] Alan R. Palmiter, EXAMPLES AND EXPLANATIONS: CORPORATIONS 197 (Aspen Publishers 2003). *See also ALI Principles* § 4.01, *supra* note 4.
[78] Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (reaffirming that under the business judgment rule presumes that directors of a corporation act on an informed basis, that the duty of care is closely linked with being sufficiently informed, and that not being informed constitutes a breach of board's fiduciary duty of care).
[79] *Id.*
[80] Although, the State of Delaware stands out in its statutory treatment of laws that govern business entities, particularly publicly held companies. *See generally* Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749 (2006) (reviewing the mechanisms by which Delaware creates its corporate law and identifying various explanations for Delaware's prominence and its corporate lawmaking); E. Norman Veasey & Christine T. DiGuglielmo, *What Happened in Delaware Corporate Law and Governance From 1992-2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399 (2005) (looking back at twelve years of corporate law and governance developments including the corporate jurisprudence of the Delaware Supreme Courts).

enterprise was solely value maximization."[81] Interestingly though, courts asserted early on that "non-shareholder" interests or impacts can also be considered. In a highly cited 1968 opinion, the court in *Shlensky v. Wrigley* interpreted potential liability of directors' decisions under the business judgment rule and held that "the effect on the surrounding neighborhood might well be considered by a director."[82] In addition, the Supreme Court of Delaware, the most prominent state of incorporation,[83] has several holdings that have sanctioned the consideration of outside stakeholders' interests. Two of those are in the context of hostile takeovers and shareholder instituted derivative actions. In the context of hostile takeovers, the Court in *Unocal Corp. v. Mesa Petroleum Co.* and in *Paramount Communications, Inc. v. Time Inc.* expressly held that the directors could consider the impact on non-shareholder constituents including employees, suppliers, customers, creditors, and the community generally.[84]

Today with recent developments and the expansion and differentiation of shareholder and corporate interests, the answer to that same question of fiduciary duty is not so clear. "No longer is the corporate entity viewed as simply a collection of shareholders. Instead, some modern legal theorists view the corporate enterprise as a varied collection of stakeholders: employees,

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[81] Gregory V. Varallo & Daniel A. Dreisbach, ABA Business Law Section, FUNDAMENTALS OF CORPORATE GOVERNANCE: A GUIDE FOR DIRECTORS AND CORPORATE COUNSEL 4 (1996). The traditional view relied on the assumptions that shareholders always shared like interests and those interests coincided with the interests of the corporation. *Id.*

[82] Shlensky v. Wrigley, 95 Ill. App. 2d 173, 181 (1968).

[83] According to the State of Delaware Division of Corporations, "More than half a million business entities have their legal home in Delaware including more than 50% of all U.S. publicly-traded companies and 60% of the Fortune 500. Businesses choose Delaware because we provide a complete package of incorporation services including modern and flexible corporate laws, our highly-respected Court of Chancery, a business-friendly state government, and the customer service oriented Staff of the Delaware Division of Corporations." State of Delaware Division of Corporations, *Why Choose Delaware as Your Corporate Home?* http://www.state.de.us/corp/ (last visited Feb. 11, 2007). *But see* Philip S. Garon, Michael A. Stanchfield, & John H. Matheson, *Challenging Delaware's Desirability as a Haven for Incorporation*, 32 WM. MITCHELL L. REV. 769 (2006) (arguing that Delaware is not the most favorable jurisdiction and citing laws in other states that are more favorable).

[84] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (discussing how boards should consider the impact on constituencies other than shareholders when analyzing the reasonableness of takeover defensive measures). *See also* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. 1990) (discussing the appropriate use of the Unocal analysis).

creditors, suppliers, [and] community groups."[85] During the 1980s the large majority of state legislatures across the country passed corporate governance statutes which generally permit but do not require corporate officers and directors to consider the interests of non-shareholder constituents (stakeholders) when making business decisions.[86] These "constituency statutes" were enacted to provide corporate leaders with a mechanism for considering stakeholder interests without breaching their fiduciary obligations to shareholders.[87] Corporate decisions have moved beyond ". . . to create jobs, deliver goods and services, increase shareholder wealth, and demonstrate goodwill to the community through philanthropy."[88] In general, these constituency statutes have given more freedom in making decisions to board of directors sitting across the nation.

In 1986 the Delaware legislature enacted the Delaware General Corporation Law Code § 102(b)(7),[89] "a statutory provision that largely protects directors from monetary liability for any actions arising from a breach of their duty of care if the corporation's shareholders incorporate into the certificate of incorporation a provision exculpating directors from such liability."[90] The

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[85] Varallo & Dreisbach, *supra* note 81, at 5.

[86] Kathleen Hale, *Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes*, 45 ARIZ. L. REV. 823, 829 (2003). Although most state constituency statutes are relatively similar to the other states, the specifics vary. There are four general variations: 1) whether stakeholder consideration is mandatory or permissive; 2) whether stakeholder consideration applies to officers in addition to directors; 3) in which circumstances the statutes apply; and 4) as to what the corporate leaders are allowed to consider. *Id.* at 834-36. In 1983, Pennsylvania was the first state to enact such a statute. *Id*. at 833. Pennsylvania's general corporate statute for the board of director's fiduciary duty states: "In discharging the duties of their respective positions, the board of directors, committees of the board and individual directors of a business corporation may, in considering the best interests of the corporation, consider to the extent they deem appropriate: (1) The effects of any action upon any or all groups affected by such action, including shareholders, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located. (2) The short-term and long-term interests of the corporation, including benefits that may accrue to the corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the corporation. (3) The resources, intent and conduct (past, stated and potential) of any person seeking to acquire control of the corporation. (4) All other pertinent factors." 15 PA. CONS. STAT. ANN. § 1715(a) (West 2007).

[87] Hale, *supra* note 86, at 832.

[88] Bradley K. Googins, *A New Business Model for the 21st Century*, BOARDROOM BRIEFING, Winter 2006 at 6.

[89] DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

[90] Bernard S. Sharfman, *Being Informed Does Matter: Fine Tuning Gross Negligence Twenty Plus Years After Van Gorkom*, 62 BUS. LAW 135, 136 (2006).

majority of other states were quick to follow Delaware's lead and enact these board of director shield provisions.[91] In addition to giving directors leniency and freedom in their decision making capacity, exculpatory clauses encourage directors to take strategic risks. "Yet, being informed still matters."[92]

These statutory and judicially derived laws play a significant role in the realm of corporate governance because prior to, "corporate leaders were unsure whether they were legally permitted to consider stakeholders' interests because their fiduciary duties required them to act in accordance with shareholders' interests."[93] The current trend is that corporate boards are accepting the legitimacy of learning about and taking consideration of non-shareholder interests in making their business decisions. The following section of the Article will describe how business strategies have evolved over the last several decades towards a more appropriate balance between shareholder and non-shareholder interests. The development of social entrepreneurship will also be traced to show that social entrepreneurship fulfills the board's fiduciary duties, is protected by the business judgment rule, and furthermore, that the growing amount of information which measures social and financial impacts invokes the board of directors' duty to be informed of this material when making their decisions.

IV. The Evolution of Business Strategies and the Establishment of Social Entrepreneurship

Social entrepreneurship is a new concept that is now in focus, but its earliest roots can be traced back to the end of the nineteenth century, a time period that witnessed the rise of the

[91] Palmiter, *supra* note 77, at 209.
[92] Sharfman, *supra* note 90, at 137. Sharfman emphasizes six reasons why being sufficiently informed still matters despite the board of director shield provisions: 1) These clauses only protect from monetary damages; 2) Courts see the clause more as an affirmative defense; 3) Directors want to protect their reputation; 4) Directors want to protect future demand for their services; 5) Noncompliance may violate directors' insurance coverage; and 6) Shareholders have the right to take the exculpatory clause away. *Id*. at 137-38.
[93] Hale, *supra* note 86, at 830.

"scientific charity" movement.[94] This approach was marked by achieving a more systematic and strategic change in addressing society's ills. Gregory Dees notes, "That period represented a shift away from the idea of charity as simply giving alms to the poor to charity as something that can create lasting and systematic change."[95] Out of this movement, many of the largest nonprofits that we know today, such as the Salvation Army, Boy and Girl Scouts, and Goodwill Industries, were founded.[96] However, the idea that social projects could do more than give did not gain a strong hold on 20th century business theory.

A. The Shift Towards Social Entrepreneurship

In 1970, *New York Times Magazine* interviewed the soon-to-be famous 1976 Nobel Laureate, Milton Freidman.[97] In his interview he stated, "There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."[98] Another economist, Michael E. Porter, discussed how creating and maintaining comparative advantage[99] over other states was a common goal in

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[94] Dees, *supra* note 66.
[95] *Id.*
[96] *Id.*
[97] Milton Freidman, *The Social Responsibility of Business is to Increase Profits*, N. Y. TIMES MAGAZINE, Sept.13, 1970, at 126.
[98] *Id.*
[99] The theory of comparative advantage is one of the oldest economic theories and dates back to the early 19th century writings of David Ricardo. The theory is often used to justify free trade and states that trading countries will be better off if they specialize in the industry in which they have a comparative advantage. *Why Trade is Good for You*, THE ECONOMIST, Oct. 3, 1998, at 4-6. THE ECONOMIST article provides an explanatory example:
". . . imagine two countries, East and West, which both produce two kinds of goods, bicycles and wheat. In a year, an Eastern worker can make two bikes or grow four bushels of wheat. A Westerner, however, can manage only one bushel or one bike. Each country has 100 workers, and initially both of their workforces are split evenly between the two industries. So East produces 200 bushels of wheat and 100 bicycles, whereas West produces 50 bushels and 50 bikes. Since East can produce both wheat and bicycles more cheaply than West, it has an absolute *advantage* in both industries. Even so, Easterners will benefit from trading with Westerners. This is because East is relatively more efficient at growing wheat, where it is four times as productive as West, than it is at making bikes, where it is only twice as productive. In other words, it has a *comparative advantage* in wheat. At the same time, West has a *comparative advantage* in making bikes, even though it has no absolute *advantage* in anything. According to Ricardo's theory, both countries will be better off if each specializes (sic) in the industry where it has a *comparative advantage*, and if the two trade with one another. Specialization (sic) increases world output. Suppose that East

the 1970s.[100] This strategy focused on overall cost leadership in an industry through a set of functional policies aimed at this basic objective. "Cost leadership requires aggressive construction of efficient-scale facilities, vigorous pursuit of cost reductions from experience, tight cost and overhead control, avoidance of marginal customer accounts and cost minimization in areas like R&D, service, sales force, advertising and so on."[101]

Both Friedman and Porter were describing the realities facing American corporations in the 1970s and 1980s. In this environment of high interest rates, oil supply shocks and a flood of substitute imports available from overseas, the industries of steel, heavy equipment, and automotive manufacturing were particularly sensitive. Gaining a competitive advantage[102] was imperative if these publicly held companies were to be equipped to deal with new entrances, fluctuations in commodity prices and, ultimately, price wars. Thus, those companies that could

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specializes (sic) in wheat growing, shifting ten workers from its bicycle factories to its fields, and producing 240 bushels and 80 bikes. West moves 25 workers from wheat farming into bike making, where its *comparative advantage* lies, and produces 75 bikes and 25 bushels. Global production rises. . .In essence, the theory of *comparative advantage* says that it pays countries to trade because they are different." *Id.*

[100] Michael E. Porter, COMPETITIVE STRATEGY: TECHNIQUES FOR ANALYZING INDUSTRIES AND COMPETITORS 35 (The Free Press 1998).

[101] *Id.* The financial pressures of the earlier eras of the 20th century to the 1980s drove some companies to take risks and make irrational decisions that actually harmed outside stakeholders for the sake of short-term positive economic returns. Two examples of this are Occidental Chemical Corporation and Ford Motor Company. Beginning in 1942 and continuing through the next decade, Hooker Chemical Corporation, Occidental's predecessor, dumped 20,000 tons of toxic chemicals (dioxide) into a neighboring abandoned canal, the Love Canal, located in Niagara Falls City in western New York. Unbeknownst to the buyers or the surrounding community, the infected property was later sold to Niagara Falls School Board. It was not until 1977 that complaints from area residents of chemical substances oozing into their basements began to filter into authorities. Responding to this toxic emergency, in 1980 Congress enacted the Superfund law establishing a cleanup effort of the area. In December of 1995, sixteen years after the Justice Department filed suit against Occidental Chemical Corporation, Occidental settled to reimburse the government $129 million to cover the clean up costs. United States Department of Justice Office of Public Affairs, *Occidental to Pay $129 Million in Love Canal Settlement*, http://www.usdoj.gov/opa/pr/Pre_96/December95/638.txt.html (last visited Feb. 17, 2007). In June 1978, Ford Motor Company agreed to recall 1.5 million Ford Pintos and 30,000 Mercury Bobcat sedans and hatchback cars because of fuel tank design defects that caused the cars to have a greater risk of catching fire when hit from the rear end at moderate speeds. Documents from the Center of Auto Safety, including internal Ford documents, claim that Ford had knowledge of the model defect before the vehicle went to market but because the cost of paying for liability was less than the cost of modifying the fuel tank, Ford released the car to market with the defective fuel tank design. The Center for Auto Safety, *Ford Pinto Fuel-Fed Fires*, http://www.autosafety.org/article.php?scid=96&did=522 (last visited Feb. 18, 2007).

[102] Here, competitive advantage and comparative advantage are not synonymous. Comparative advantage is a specific theory of economics, *see* THE ECONOMIST, *supra* note 99. Here, the term "competitive advantage" is used to indicate a general state of being at an advantage when competing.

fully utilize the synergies between operations and experience and exercise effective power over capital and labor suppliers would be able to drive down the prices of inputs and help maintain their advantage in the long run.[103]

Throughout the late 1980s and 1990s, "differentiation" was emerging as a better strategy for achieving and maintaining a competitive advantage, especially for developing industries such as cable, telecommunications, personal computers, and the internet.[104] Differentiation involves creating something that is perceived by the industry to be unique, and this perception directly relates to the value perceived by the consumer.[105] As an illustration, for Firm A's differentiation strategy to result in a truly successful competitive advantage, three conditions must be met: 1) the perceived value of Firm A must be greater than the perceived value of Firm B; 2) the attributes-to-price ratio in Firm A must be greater than the attributes-to-price ratio in Firm B; and, 3) the prices for both Firm A and B have to be at relative price parity.[106]

Because the differentiation strategy focused on increasing perceived value through unique attributes, the door was opened for companies to provide such socially valuable attributes as environmentally friendly policies, loyalty to worker programs, fair-trade partnerships, and investments in the community. Accordingly, this strategy instigated a shift away from an exclusive focus on cost minimization as more corporations began trying to differentiate themselves in order to obtain and sustain a competitive advantage.[107] The social entrepreneurship movement was an extension of the groundwork laid by this change, and today we are seeing the effects. Throughout this Article, successful leaders and companies who have created positive social outcomes while profiting and growing have been highlighted. It seems as

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[103] Porter, *supra* note 100.
[104] *Id.*
[105] *Id.* at 37.
[106] *Id.*
[107] *Id.*

these leaders have recognized that "the Milton Friedman business model has lost its relevance in the 21st century . . . [and that] business cannot succeed if society fails."[108] The following section will demonstrate the methodology that can be used to determine the value of the social and financial impacts of a social entrepreneurship decision. Such investigation is important to meeting the double bottom line and corporate boards should be knowledgeable about these methods as part of responsible decision making.

B. Measuring the Effectiveness of Social Entrepreneurship Decisions as Applied to Publicly Held Corporations

The driving force behind social entrepreneurship is the ability to maximize the positive social impact that results from profitable business decisions.[109] Thus, the ability to numerically measure both the financial return and social impact is crucial to determining whether such decisions meet the double bottom line and thus add value to the shareholder. Measuring the financial return is relatively easy and well-understood: profits.[110] Indeed, there are a growing

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[108] Googins, *supra* note 88, at 6.

[109] According to Pete Engardio at BUSINESS WEEK, "serious money is lining up behind the sustainability agenda. Assets of mutual funds that are designed to invest in companies meeting social responsibility criteria have swelled from $12 billion in 1995 to $178 billion in 2005". Engardio, *supra* note 39, at 56 (citing estimates from the Social Investment Forum trade association). In addition, Engardio states that "rising investor demand for information of sustainability has spurred a flood of new research", and he tells how "Goldman Sachs, Deutsche Bank Securities, UBS, Citigroup, Morgan Stanley, and other brokerages have formed dedicated teams assessing how companies are affected by everything from climate change and social pressure in emerging markets to governance records." *Id.* at 56-57.

[110] Making financial decisions is becoming more sophisticated and the use of "quantum mathematics" with complex algorithms is advancing the high-stakes game of corporate decision making. *See Math Will Rock Your World*, BUSINESS WEEK, Jan. 23, 2006, *available* at http://www.businessweek.com/magazine/content/06_04/b3968001.htm. "Partnerships between mathematicians and computer scientists are bulling into whole new domains of business and imposing the efficiencies of math" as quantum mathematicians and financiers are "mapping out ad campaigns and building new businesses from mounds of personal data" available on the internet. *Id.* For instance, Inform Technologies is somewhat of a "robotic librarian" that combs through the internet every day and uses mathematical algorithms to analyze and group together thousands of press clippings, articles, and blog entries. *Id.* Inform's creator, Neal Goldman, describes how a combination of math and geometry can work to provide businesses with better strategic tools: "Imagine an object floating in space that has an edge for every known scrap of information. It's called a polytope and it has near-infinite dimensions, almost impossible to conjure up in our earthbound minds. It contains every topic written about in the press. And every article that Inform processes becomes a single line within it. Each line has a series of relationships. A single article on Bordeaux wine, for example, turns up in the polytope near France, agriculture, wine, even alcoholism. In each case, Inform's algorithm calculates the relevance of one article to the next by measuring the angle between the two lines." *Id.* These mathematical models are selling for hundreds of millions of dollars and is changing the way businesses research their next profit-making venture. *Id.*

number of large and small corporations that are achieving significant financial gains by undertaking social entrepreneurship. In the introductory material of this Article, the profit-making ventures of eBay, Google, GlaxoSmithKline, Aurolab, Grameen Bank, and several others were highlighted as proof of this important change.[111]

There is currently no single, standardized metric that is used by all companies to measure social impact, but several methods do exist. An understanding of the realities of how a business decision impacts shareholders and outside stakeholders is crucial to informed decision making, so it is important to know about the techniques that are available to measure social impact. When social impact can be measured, it can be compared to financial impact, or profits, allowing the board of directors to make a fully informed business decision in regards to pursuing social entrepreneurship. Social impact measurement is a dynamic field because assigning numerical values to results such as positive interpersonal interactions and avoided harms is not a hard science and these calculations must constitute elements of both art and science. Several organizations have undertaken the task of developing metrics to measure social impact, and the following section surveys three recent reports on the variety of approaches that are being taken in the area of social impact measurement.

1. The Double Bottom Line Project Report

In 2004 the RISE (Research Initiative on Social Entrepreneurship) Center at Columbia University released a study entitled, "The Double Bottom Line Project Report: Assessing Social Impact in Double Bottom Line Ventures" ("DBL Report").[112] The DBL Report responded to

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See also Microsoft, *SQL Server 2000: Data Mining Helps Customers Make Better Decisions,* http://www.microsoft.com/presspass/features/2000/04-24sql.mspx (last visited Feb. 18, 2007).

[111] Part I, *supra* notes 5-70 and accompanying text.

[112] William Rosenzweig, *Double Bottom Line Project Report: Assessing Social Impact In Double Bottom Line Ventures*, CENTER FOR RESPONSIBLE BUSINESS WORKING PAPER SERIES, Jan. 1, 2004, *available at* http://repositories.cdlib.org/crb/wps/13 [hereinafter *DBL Report*].

growing pressure from grant-makers and investors to identify and evaluate current approaches to measuring and monetizing social impacts. The DBL Report notes that "the movement toward social accountability is not sector specific. In corporate boardrooms across the globe, managers are being asked to describe their impacts on the environment, the local economy, and the lives of future generations of customers."[113] "Impact" is defined in the DBL Report as "the portion of total outcome that happened as a result of the activity of the venture, above and beyond what would have happened anyway."[114] The DBL Report contributes to the body of knowledge on measuring social impact by describing a series of best practices that are emerging to "document, define, and report on the non-financial performance."[115]

Ultimately, the DBL Report breaks the social impact metrics into three categories: process methods, impact methods, and monetization methods.[116] Process methods are tools used to track and monitor the effectiveness of outputs, variables, or indicators of ongoing operational processes in order to assess whether the operational outputs correlate or cause the desired social outcomes. Impact methods are tools that assess the relationship between outputs and outcomes by attempting to prove incremental outcomes relative to the next best alternative. Finally, monetization methods are tools that monetize outcomes or impact by assigning a dollar value to them.[117] These three categories of metrics complement one another and using all three is necessary to a complete assessment.[118] According to the DBL Report,

> "One cannot get to a high quality assessment of impact without having good tools to track process outputs, and one cannot make any use of impact assessment data unless

[113] *Id.* at 3. Many companies are now issuing corporate social responsibility reports as part of their annual communications with their shareholders.
[114] *Id.* at 7. The London Business School has a similar definition for impact: "outcomes minus an estimate of what would have happened anyway." The London Business School, *The SROI Primer: Glossary*, http://sroi.london.edu/glossary.html (last visited Feb. 11, 2007).
[115] *DBL Report, supra* note 112 at 4.
[116] *Id.* at 8.
[117] *Id.*
[118] *Id.*

> they inform process management. Similarly, monetization methods depend entirely on good process data and assumptions about the economic value of outcomes drawn from historical evidence and other outside data."[119]

A brief discussion of some of the measurement methods that various organizations engaged in social entrepreneurship use as analyzed by the DBL Report follows. Notice that each method fits into one or more of the process, impact, or monetization method categories.[120]

The *Theories of Change (Process)* model is used when evaluating community-wide initiatives where it is difficult to use experimental and quasi-experimental methods to assess social impacts. By determining whether logical connections exist between the problem, the action that is taken, and the long and short term consequences, it can build a compelling case for the social impacts of the initiative.[121] The *Balanced Scorecard Method (BSc) (Process and Impact)* proposes that companies measure the performance of their operations in terms of financial, customer, business process, and learning-and-growth outcomes.[122] By not focusing exclusively on financial measures, the BSc's view of the long and short term performance is stronger and has been used successfully by large corporations such as Mobil, Apple Computer, and Advanced Micro Devices, as well as the venture philanthropy fund, New Profit, Inc. [123]

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[119] *Id.*

[120] The authors of the DBL Report describe how the social investor and the social entrepreneur can effectively use this catalogue. For the social investor that manages a nonprofit or for-profit fund that invests in double bottom line ventures, they suggest looking though the catalogue to find a similar fund and learn from its experience assessing social impact. For the social entrepreneur, they advise looking though the appendix and creating a set of output indicators that can be tracked relatively easily over time. *Id.* at 5.

[121] *Id.* According to the DBL Report, Carol Wiess and other academics developed this theory. *Id. See also* The Aspen Institute, *Establishing Causality in Evaluations of Comprehensive Community Initiatives,* 1998, http://www.aspeninstitute.org/site/c.huLWJeMRKpH/b.613729/k.7967/Establishing_Causality_in_Evaluations_of_Comprehensive_Community_Initiatives.htm.

[122] *DBL Report, supra* note 112 at 20.

[123] *Id.* New Profit helps "social entrepreneurs to achieve their visions [by providing] multi-year financial and strategic support to a portfolio of organizations focused on a range of issues from childhood literacy and college access to workforce development and civic engagement." New Profit Inc., *About New Profit Inc.* http://www.newprofit.com/about.asp (last visited Feb. 16, 2007). "New Profit is also committed to advancing a broader agenda by sharing lessons from [their] work with the field, [and the organization aspires] to build a community dedicated to creating high-impact social change through a new approach to philanthropy." *Id.*

The *AtKisson Compass Assessment for Investors (Process and Impact)* method provides a framework for investors to incorporate the reporting guidelines of the major corporate social responsibility[124] standards into their business decision making process.[125] In particular, this method focuses on the Global Reporting Initiative and the Dow Jones Sustainability Index, and it uses a point rating system for each area in accordance with the specific, measurable indicators of nature, society, economy, well-being, and synergy.[126] The *Benefit-Cost Analysis (Impact and Monetization)* is a long-existing metric whereby the costs and social impacts of an investment are expressed in monetary terms and then assessed according to one or more of three measures: 1) net present value; 2) benefit-cost ratio—the discounted value of revenues and positive impacts divided by discounted value of costs and negative impacts; and 3) internal rate of return—the net value of revenues plus impacts expressed as an annual percentage return on the total costs of the

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[124] Corporate Social Responsibility (CSR) is a term that has been used frequently over the last several years and is mentioned throughout this paper. A Google™ search of CSR will turn up thousands of hits. In general, it simply refers to the responsibility of corporations to take definitive action to minimize the harmful and increase the positive impacts on the environment, the communities they interact with, and their employees. CSR is in addition to the requirement to follow the law. Not all business commentators support the assertion that CSR is good for business. For example, Betsy S. Atkins expresses one of the most common critiques of CSR when she wrote in the Winter 2006 edition of Boardroom Briefing that "the notion that the corporation should apply its assets for social purposes rather than for the profit of its owners—the shareholders—is an irresponsible use of assets." *See* Betsy S. Atkins, *CSR: Is it Corporate "Irresponsibility"?*, BOARDROOM BRIEFING, Winter 2006, at 8. Atkins further contends that "the shareholders can certainly spend their own money/assets on socially responsible charities that promote the causes they believe in. However, if the CEOs and executive management team of the corporations whose stock the investors purchased decides to deploy corporate assets for social causes, this would not be responsible." *Id.* Deborah E. Wallace argues the opposite view. Deborah E. Wallace, *Is Corporate Reputation a Liability on Your Balance Sheet?,* BOARDROOM BRIEFING, Winter 2006, at 32. Wallace asserts that "the best boards…not only understand that reputation is an asset that can contribute to or undermine a company's value, they also actively manage it taking advantage of substantive data to support their decision to do so." *Id.* She points out that "the disturbing increase in the number of cases of corporate behavior that is unacceptable, illegal, or marginal has catapulted [reputation] to the foreground." *Id.* In general, her article supports CSR as a corporate strategy: "Because a company's reputation impacts its relationships so broadly—internally with its employees and shareholders and externally with its customers, vendors, and peer groups—it needs to be managed systematically…" *Id.* at 33.

[125] *DBL Report, supra* note 112 at 26. This method was developed in 2000 by a sustainability consultant, AtKisson Inc, in collaboration with an early stage venture fund that invests in for-profits that advance sustainable outcomes, Angels with Attitude, LLC. *See also* www.atkisson.com and www.soundpointventures.com/angelfund.

[126] *DBL Report*, *supra* note 112 at 26.

investment.[127] Finally, the *Poverty and Social Impact Analysis (PSIA) (Impact and Monetization)* metric emphasizes a systematic approach by identifying the key assumption on which the method is based, the transmission channels through which the program effects will occur, and the relevant stakeholders and institutional structures.[128]

The DBL Report is a valuable introduction to social impact measurement as it provided a look at what certain organizations have done to structure the way they measure their own social impacts. The following two reports further develop the body of knowledge that is available by presenting a framework and guidelines for existing and emerging organizations that have not yet developed social impact metrics to do so in a legitimate and informed way.

2. The Social Return on Investment: Standard Guidelines Report

A report from the Haas School of Business' Center for Responsible Business at the University of California Berkeley ("CRB Report") presented ten standard guidelines for calculating the social return on investment (SROI).[129] The CRB Report asserts that using these guidelines in the future will make "SROI metrics more comprehensive, credible, and useful for entrepreneurs, managers, and analysts to use to maximize positive social and environmental impact alongside financial returns."[130] For this reason, the CRB Report contributes to the body of knowledge that is available for boards to consult when fulfilling their duty to be informed about social ventures and exercising their business judgment in this arena.

For the sake of clarity, SROI was defined in the CRB Report as "the social impact of a business or nonprofit's operations in dollar terms, relative to the investment required to create

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[127] *Id.* at 32. The Center for Responsible Business ("CRB") was founded in 2003 and has a vision to create a more sustainable, ethical, and socially responsible society" and a mission to "create a new generation of business leaders who are knowledgeable and committed to CSR." Center for Responsible Business, http://www.haas.berkeley.edu/responsiblebusiness/ (last visited Feb. 16, 2007).
[128] *Id.* at 34. This approach was generated by the World Bank in 2000. *Id.*
[129] Sara Olsen & Alison Lingane, *Social Return on Investment: Standard Guidelines,* Center for Responsible Business Working Paper Series, 2003, *available at* http://repositories.cdlib.org/crb/wps/8/.
[130] *Id.* at 1.

that impact and exclusive of its financial return to investors."[131] The CRB Report acknowledges that because standard accounting methods do not incorporate environmental and social performance, there is great value in having a system whereby company funds could be managed to maximize both social and financial returns.[132] The CRB Report conducted an analysis of such systems when it examined the business plans of 88 entrants of the 2000-2002 Global Social Venture Competition ("GSVC").[133] The GSVC is a "business plan competition for profitable businesses with a social mission" and represented the first large group to develop comprehensive analytical methods that could translate business' social impacts into monetary values.[134]

The study of the GSVC business plans revealed that there are five major steps that must be taken to calculate the SROI of a business venture.[135] Organizations that have yet to develop their own social impact metrics can benefit by following these steps. The first is to quantify the non-financial impact of operations per unit. For example, suppose a 6% reduction in CO2 emissions per year equals a reduction of 12,000 tons of CO2. The second step is to translate this into dollar terms per unit to achieve "social cash flows (SCFs)." In their example, CO2 costs $1.25 per ton, so a 12,000 ton reduction equals $15,000. The third step sums all of the SCFs in question, and the fourth step discounts the SCFs to present value using an appropriate discount

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131 *Id.* at 4. The London Business School contends that "the SROI calculation is a straightforward approach to demonstrate value creation for society to social investors of all profiles." London Business School, *The SROI Primer*, http://sroi.london.edu/ (last visited Feb. 11, 2007).
132 Olsen & Lingane, *supra* note 129 at 2.
133 *Id.* at 3. The GSVC Competition was a student-led initiative out of the Haas School of Business in 1999. Haas partnered with Columbia Business School and the Goldman Sachs Foundation in 2001, and in 2003 the London Business school joined as well. In 2006, the Indiana School of Business and the Yale School of Management joined, and the University of Geneva and the Social Venture Competition—Korea are now affiliated partners. The prize includes over $45,000 in cash and travel, with a grand prize of $25,000 going towards "the plan that achieves the best blended value (high economic and social returns)." Global Social Venture Competition, *About the GSVC*, http://socialvc.net/ (last visited Feb. 11, 2007).
134 Olsen & Lingane, *supra* note 129 at 3.
135 *Id.*

rate. Finally, dividing this number by the investment to date gives the SROI.[136] These five steps provide a fairly straight forward approach to calculating the social impact of a venture. This is extremely useful because the approach can help corporate decision makers make informed decisions about whether an investment in social entrepreneurship will have the social impact the company seeks. This social impact analysis can then be coupled with a financial measurement of profits to ensure that the company is meeting the double bottom line.

The SROI number on its own is not very useful, however, so it must be presented in an appropriate context. Thus, the CRB Report advocates establishing a contextual framework that can be consistently applied by a large number of companies and offers ten guidelines to be followed to implement such a framework.[137] The first guideline urges companies to "include both positive and negative impacts in their SROI assessment."[138] The second guideline is to "consider impacts made by and on all stakeholders, including those inside the company itself, before deciding which are significant enough to be included in the assessment."[139] The third guideline suggests that a company "include only impacts that are clearly and directly attributable to the company's activities. Be conservative with leaps of faith, and don't take credit for more than your organization can realistically affect."[140] The fourth guideline says to "avoid double counting the value (financial and social) created by the company, and do not use market

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[136] *Id.* at 6. The GSVC now releases guidelines on how to calculate the SROI. *See generally* GSVC, *Social Impact Assessment Guides*, http://socialvc.net/index.cfm?fuseaction=Page.viewPage&pageId=96&parentID=58&nodeID=1 (last visited Feb. 1, 2007).
[137] Olsen & Lingane, *supra* note 129 at 7.
[138] *Id.* Many companies only focus on the positive. For example, a paperless company claims the environmental benefit of reduced consumption of paper but fails to discuss the impact of manufacturing the computers that are substituting for the paper. *Id.*
[139] *Id.*
[140] *Id.* at 8. An example of claiming too much is a microfinance institution that claimed the full benefit of all microfinance institutions, while another mistake is forgetting that "simply increasing money flow into nonprofits does not guarantee a positive social impact." *Id.*

valuations of social impacts where they do not reflect full costs and benefits."[141] The fifth guideline states that "in industries or geographic areas in which impacts would be created by the existence of any business, these impacts should not be counted in an SROI. The SROI should describe what makes the company different from a standard venture in the industry or region."[142] The sixth guideline is to "only quantify or monetize impacts if it is logical given the context of the business or industry."[143] The seventh guidelines advises "put[ting] numeric metrics into context (e.g. this period versus last period, or this company versus similar companies) to give the SROI meaning."[144] The eighth guideline says to "address risk factors affecting the SROI in the assumptions, and carefully consider and document the choice of discount rate for social cash flows."[145] The ninth guideline suggests "carry[ing] out a sensitivity analysis to identify key factors influencing projected outcomes."[146] Finally, the tenth guideline encourages "includ[ing] ongoing tracking of social impact."[147]

The CRB Report's steps and guidelines were presented to improve the science of SROI calculation, and knowledge of these methods can enhance the reasonableness of the decisions of companies that are choosing to invest in social entrepreneurship. Being fully informed in this area also requires knowledge of the limitations with SROI calculation analysis, and the CRB

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141 *Id.* The authors emphasize the importance of distinguishing social returns from financial returns because the market's valuation is imperfect and often does not value all externalities and affected stakeholders. *Id.*

142 *Id.* at 9. Here, the analysts must understand a company's social impact in the context of its competitors, i.e. "the next best thing". It is not enough to say that any investment will provide an investment; there must be date on how the particular venture will perform compared to the next best alternative. *Id.*

143 *Id.* If one determines that monetization is appropriate, the authors suggest two techniques. The first is to use comparison costs, i.e. "how much it would cost to create the same benefit". The second is to "estimate the value of some benefits by analyzing what one would pay for a guarantee of that benefit." *Id.* at 10.

144 *Id.* at 10.

145 *Id.* There are many different rates that can be chosen for the discount rate, including the municipal bond rate and the Treasury bond rate. The authors of this study state that much more research needs to be done but believes that "the best solution to the question of discount rate is to use one that reflects the uncertainty of the projections of the company's financial success and effectiveness achieving its social impacts, and includes consideration of the time required before social impacts are evident." *Id.* at 11.

146 *Id.* at 11. Sensitivity analyses test how the outcome of the SROI calculation would be different using various assumptions. *Id.*

147 *Id.*

Report presents some of them.[148] First, SROI analysis requires subjective value judgments about the measured outcomes and is sometimes measured personally or politically.[149] Second, the quality and availability of data presents issues of causality versus correlation.[150] Thus, it would not be useful to "compare two or more different businesses, or businesses in different industries, unless the method used to generate the analyses was consistent."[151] In addition, since many organizations start at different points when measuring their outcomes, this must be considered before comparing the SROI of seemingly similar organizations.[152] The third major limitation is the fact that there is a lack of data from a large number of companies, and this can result in frustration for those looking for a full industry context for their SROI.[153] Finally, since the SROI analysis is only one measure of success and social performance, it cannot be relied on as the sole indicator.[154]

Despite these manageable limitations, the SROI analysis is an affordable[155] tool that is valuable to businesses that are looking to better understand the social ramifications of their decisions. The authors of the CRB Report "call upon investors to require SROI of all their investees . . . and maintain ongoing records of the actual social performance of their investments and make these available to outside analysts."[156] The body of data that would result would allow insights into how social value is created and destroyed and how much it costs, thereby advancing

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[148] *Id.* at 12.
[149] *Id.*
[150] *Id.*
[151] *Id.* at 12. The comparisons could be of little value if they did not use standardized measurements or data sets. *Id.*
[152] *Id.* at 13 For instance, take two job training programs, one that helps homeless teenagers and another that helps college-track teenagers. Using only the percentage of teenagers who get jobs as the key metric in their SROI may distort the comparative success of the college-track organization, while having a metric that incorporates the difficulty of serving homeless youth would allow for a better comparison. *Id.*
[153] *Id.* Regardless of the limitations, the CRB Report argues that more SROI analyses should be conducted to improve the understanding of social impact measurement. *Id.*
[154] *Id.*
[155] According to the CRB Report, "the price of a projected SROI like those in this study ranges from zero to a few thousand dollars. Some benefits may result from analysis of projected SROI even without ongoing tracking efforts." *Id.* at 14.
[156] *Id.*

the interests of the public and private sectors.[157] The CRB Report presents valuable guidance for companies that are looking to analyze the social impacts of their business decisions, and increased use of the SROI analyses will further contribute to the body of knowledge that directors have to refer to when making business judgments. The following section discusses another report that takes understanding of the SROI analyses further.

3. A Framework of Approaches to SROI

Some of the researchers in the CRB Report described *supra* contributed to another study on SROI entitled "A Framework for Approaches to SROI" ("Framework").[158] This Framework was developed in response to the growth of the number of people who have conducted SROI analyses since the method was first outlined by the Roberts Enterprise Development Fund (REDF) in 2001.[159] The authors hoped to accomplish four main goals: 1) establish a shared understanding of the various methods used for the monetization exercise within SROI analysis by collecting, including, and explaining the different options for calculating monetized SROI; 2) ensure that organizations at different states of development and capacity and across many sectors can conduct SROI analysis; 3) ensure that SROI analyses are presented in a way that avoids misinterpretation; and 4) lay the groundwork for standardization so that results become more

157 *Id.* There are many other organizations that are contributing to this body of knowledge. Two of the most prominent and well known include the New Economics Foundation (NEF) and REDF (formerly Roberts Enterprise Development Fund). NEF uses SROI to bring about change in public procurement, public expenditure, social economic, grant giving and financial investment, and CSR. NEF, *Social Return on Investment*, http://www.neweconomics.org/gen/newways_socialreturn.aspx (last visited Feb. 12, 2007). The NEF was founded in 1986 and "aim[s] to improve quality of life by promoting innovative solutions that challenge mainstream thinking on economic, environment, and social issues…" NEF, *About Us*, http://www.neweconomics.org/gen/m1_i1_aboutushome.aspx (last visited Feb. 18, 2007). REDF has published several papers on SROI methodology and analysis because they contend that "the true impact of the collective work taking place in the nonprofit sector is under-valued . . .due to an absence of appropriate metrics by which value creation may be tracked, calculated, and attributed to the philanthropic and public "investments" financing those impacts." REDF, *SROI,* http://www.redf.org/results-sroi.htm (last visited Feb. 12, 2007).

158 Sarah Olsen & Jeremy Nicholls, *A Framework for Approaches to SROI*, DRAFT for Haas Social Metrics Conference Reviewers, March 2005, *available at* http://www.haas.berkeley.edu/responsiblebusiness/conference/documents/SROIFrameworkv.Haas.pdfSaraOlsen.pdf

159 *Id.* at 4. *See* note 157, *supra* for more information on REDF.

comparable over time.[160] The accomplishment of these goals will strengthen the ability of companies to measure the social impacts of their business decisions, and when directors combine such measurements with an understanding of the financial impacts, the double bottom line can be achieved.

To assist double bottom line achievement, the Framework presents ten design principles that should characterize an organization's overall SROI analysis and calculations.[161] The first is that the SROI analysis should be feasible, i.e. something the "organization can afford to prepare itself."[162] The second is that the process should be accessible i.e. "understandable and relevant to organizations at various stages of development."[163] The third states that the method should be rigorous, i.e. "substantive and well-executed and based upon premises that are validated by informed practitioners."[164] The fourth is that the framework should be replicable, i.e. "result in similar conclusions when applied by different practitioners who use similar parameters."[165] The fifth is that the "process by which the analysis was prepared and the context in which results would be seen, should be transparent."[166] The sixth requires the results to be "credible to investors, purchasers, managers, and other users."[167] The seventh principle is that the framework

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[160] *Id.* at 5. The audience of this paper is those people who are already familiar with SROI analysis and those who are "developing ways to of understanding and quantifying organizations' impact on stakeholders." *Id.*
[161] *Id.* at 8.
[162] *Id.* Some researchers have noted that the "cost of establishing an effective social reporting system is viewed as 'too much' for many groups to bear" and that "the development of effective social tracking and measurement information systems within organizations (whether for-profit or nonprofit) is viewed largely as an 'unfunded mandate.'" Jed Emerson & Shiela Bonini, *The Blended Value Map: Tracking the Intersects and Opportunities of Economic, Social, and Environmental Value Creation*, BLENDEDVALUE.ORG BLENDED VALUE PUBLICATIONS AND PAPERS, Oct. 2003, at 78, *available at* http://www.blendedvalue.org/media/pdf-bv-map.pdf. They are viewed as unfunded mandates because these measurements tend to be viewed "not as a core part of organizational operations (say, for example, in the way that financial reporting is viewed), but rather is perceived as an optional activity or a marketing effort to satisfy the requirements of certain stakeholder groups," and the debate over who should pay for such reporting systems continues. *Id.*
[163] Olsen & Nicholls, *supra* note 158 at 8.
[164] *Id.*
[165] *Id.* Adherence to this principle will allow the results to be comparable over time and among organizations that use similar and clearly noted options. *Id.*
[166] *Id.*
[167] *Id.*

should be integrative, i.e. "relate to, and where possible integrate with, other approaches to understanding social value."[168] The eighth principle is to avoid misuse by reducing the risk of misuse or misleading SROI numbers and analyses.[169] The ninth principle is that the framework should be an open source, i.e. it should be "continuously informed and improved by the collective wisdom of practitioners in an inclusive, iterative process."[170] Finally, the framework should be useful, in that its application results "in information that enables users to make decisions or take actions that further their goals."[171] Following these guidelines increases the likelihood that an organization's SROI analyses will be strong and reliable, thus improving the ability to make informed business decisions and improving the body of knowledge that is available on social impact measurement.[172]

It is apparent that economists and investors are taking social entrepreneurship seriously. Even though there may not be one set of standardized metrics that everyone uses (yet), the DBL Report, CRB Report, and Framework all show that there is a growing field of experts that are

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[168] *Id.* A similar idea on how to improve social impact measurement and performance metrics suggests "creating a common understanding with regard to language, terms and concepts" because it is "difficult to achieve leverage off each other's work" when most of the discussions about exploring how to measure social value created by nonprofit and for-profit corporations "take[] place within individual silos each with its own language and jargon." Emerson & Bonini, *supra* note 162 at 92.
[169] Olsen & Nicholls, *supra* note 158 at 8.
[170] *Id.*
[171] *Id.* These ten principles show the distinction between the SROI as an actual number, and the SROI as a form of analysis. The SROI analysis "encompasses: a) in formation about the process by which the number was calculated; b) context information to enable accurate interpretation of the number itself; and c) additional non-monetized social value and information about its substance and context." *Id.* at 4. The authors note that this study focuses on how to treat monetized value, and suggests that there needs to be more research done on analyzing non-monetized social value. *Id.*
[172] *See id.* The Framework also details the four main stages and ten activities that are involved in calculating the SROI. The first stage is Construction and consists of the first five activities: 1) understand your goals for the analysis; 2) identify the subject organizations' stakeholders; 3) determine the scope of the analysis; 4) analyze income and cost; and, 5) map the impact value chain. *Id. at 15.* The second stage is Content and it has two activities: 6) set indicators and collect data; and 7) create projections. *Id. at 16.* The third stage is Credibility and it also has two activities: 8) calculate social return; and 9) report. *Id.* The fourth stage is Continuity and it consists of the final activity: 10) monitor. *Id. at 16-17.* Each activity contains several different options of what can be chosen, and the Framework report provides guidance and descriptions for each one that can be useful for organizations implementing an SROI analysis. *Id.* at 18-27. The Framework also provides a timeline of SROI from the 1970s to 2005, *id.* at 29-30, as well as additional resources for assisting in completion of each of the ten activities. *Id.* at 32-34.

measuring sustainability and social impact. Thus, directors have access to this type of information that can and should be analyzed alongside financial impacts when making business decisions. Indeed, the fact that social impact measurements are getting better and more sophisticated supports the argument that directors have a fiduciary duty to seek out this information and either hire consultants or do the analyses themselves. As this field of measurement continues to grow, there will undoubtedly be an increase in investment in social entrepreneurship. The following section discusses another sector that is seeing growing investment in social entrepreneurship—the venture capital and venture philanthropy sectors.

C. The Influence of Venture Finance on Social Entrepreneurship

Venture capital ("VC") firms are outside investors who fund and advise new, growing or struggling businesses. Typically known for their high risk and high return financial investment strategies, VCs pool their shareholders' money to invest in uncertain but potentially very profitable ventures. VCs seek out risky projects that are projected to have substantial returns, and there is an increasing amount of VC investment in social entrepreneurship. This new branch of investment strategy is becoming known as "venture philanthropy."[173] Through investing in social projects both VC firms and venture philanthropy organizations promote positive societal impacts. The difference between the two entities is that VC firms are for-profit while venture philanthropy organizations, for the most part, are nonprofits. While the focus of this Article is maximizing the double bottom line, seeking both social and financial return, the following section on venture philanthropy is important because it shows the growing fusion between business and social ventures and the influence they have had and continue to have on the other.

[173] Venture philanthropy's roots were established from venture capital principles, but "there are also big parts of venture capitalism that simply didn't translate to the nonprofit world. Venture philanthropists preached greater impact with every dollar, but venture capitalists make their money backing a lot of losers in search of a few blockbuster successes. And there is no such thing as a nonprofit IPO." McGray, *supra* note 2 at 16.

1. Venture Philanthropy

Venture philanthropy adapts the principles of venture capital to the principles of philanthropy to establish a deeper interaction between the donor and recipient with an emphasis on measurable social and economic goals. In short, venture philanthropy combines the passion and commitment of the nonprofit sector with the efficiency, rigor, and economic expectations of the venture capital sector. According to the Peninsula Community Foundation,[174] venture philanthropy was built around five key elements: 1) managing partner relationships; 2) investing in long-term (3 to 6 years) business plans; 3) an accountability-for-results process "demanding flexibility, creativity, and rigorous data collection"; 4) providing cash and expertise; and 5) installing an exit strategy.[175]

To date, the field of venture philanthropy is relatively small and extremely centralized. The most recent surveys show that while there are about 50,000 charitable foundations, there are only 42 pure venture-philanthropy firms.[176] Additionally, the majority of the 42 venture philanthropy organizations are confined to the New York and Silicon Valley areas.[177] Yet, despite the small numbers, venture philanthropy has and continues to have a strong impact. These firms have seen success in bringing proven venture capital investment strategies to the social sector by looking for and taking on risks when others won't. These venture philanthropy organizations "see themselves [as] active investors—not just providing funding but also helping .

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[174] Previously referred to in the Introduction, Peninsula Community Foundation merged in 2006 with Community Foundation Silicon Valley to become Silicon Valley Community Foundation. Within CFSV the Center for Venture Philanthropy was opened in 1999. For more information, see www.siliconvalleycf.org.
[175] Center for Venture Philanthropy, *Defining Virtue: Five Key Elements of Venture Philanthropy and Five Years of Documented Results*, at 3-23, http://www.siliconvalleycf.org/docs/DefiningVirtueFiveKeyElements.pdf (last visited Feb. 27, 2007).
[176] Knowledge @ Wharton, *Does Venture Philanthropy Work?* CNET NEWS.COM, May 8, 2004, http://news.com.com/2030-1030_3-5206330.html.
[177] *Id.*

. . social entrepreneurs achieve their maximum potential through a range of supports."[178] This Article wants to emphasize that firms that engage or invest in social entrepreneurship projects can make both social and financial returns, for example VC firms; nevertheless, venture philanthropy is important because it sets the stage for and promises a high potential for growth in social investments. Thus, several profiles of the more prominent venture philanthropists are featured in the following discussion.

In 1987, General Atlanta, LLC, a leading global private equity firm, merged with Atlantic Philanthropies, a foundation that worked internationally to support organizations and leaders dedicated in identifying and mitigating urgent social problems, to form Echoing Green.[179] Echoing Green, an angel investor in the social sector, provides first-stage funding and support to "visionary leaders with bold ideas for social change."[180] To date, Echoing Green has invested more than $25 million to support over 400 social entrepreneurs in seed and start-up grants. A 2004 study found that since inception Echoing Green has raised close to $930 million, a return on investment of 44 times their initial investment.[181]

Venture Philanthropy Partners ("VPP"), founded in 2001 to address the needs of at-risk children, "has been quietly showing that many of the business practices that helped build the region into an economic powerhouse can be adapted to the philanthropic and nonprofit sectors to yield high social returns."[182] VPP identifies visionary nonprofits[183] in need of financing,

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[178] Echoing Green, *About Us-How We Started*, http://echoinggreen.org (last visited Feb. 12, 2007).
[179] *Id.*
[180] *Id.* Echoing Green has invested in 30 countries in the fields of "education, youth development, health care, housing, environmental justice, human and civil rights, economic and social justice, the arts, and immigration." *Id.*
[181] *Id.* "Less than two percent of all foundation support is available for seed funding, making Echoing Green a leading global social venture fund that invests in new organizations at their earliest stages." *Id.*
[182] *Venture Philanthropy Partners Invest in Social Change*, WASHINGTON LIFE MAGAZINE, May 2006, at 2, *available at* http://www.washingtonlife.com/issues/may-2006/cover-story/.
[183] In selecting the nonprofits in which to invest, VPP does not grant proposals. Instead, to assess a compelling investment VPP performs a preliminary analysis of each prospective project. The assessment begins with a reconnaissance of the nonprofits which support the needs of children from low-income families; following, VPP

commits large sums of money to those organizations, and provides hands-on strategic assistance by serving as an integral advisor to the organizations' boards.[184] In the five years since their inception, VPP has leveraged the initial investment grants of $30 million into nearly $70 million in value received by the region's nonprofit sector.[185]

This Article's discussion on venture philanthropy was provided to show that the field of philanthropy is changing and incorporating business and venture capital principles. However, the profiled venture philanthropists are not necessarily focused on making profits in addition to the social impact they create. The following section returns to the Article's assertion that there is money to be made by investing in social entrepreneurship, as venture capitalists are proving.

2. Venture Capital Investing in Social Entrepreneurship

In recent years many traditional VC firms have shifted their focus to the social sector. These VC firms have begun to see and take advantage of the investment market for social projects. Known for their high risk and even higher return investment strategies, these VC firms are finding social entrepreneurship to be a new avenue for investment and a new source for high return. This VC movement into the social sector is further proof that social entrepreneurship investment decisions can be profitable, and are therefore smart business moves for publicly held corporations to make.

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further researches through stakeholders, experts, and their peers. "And, [VPP] use[s] research to gain early assessments of the organization's history and patterns of growth, reputation and impact within the community, leadership, accomplishments for the children it serves, funding base, and so forth." VPP continues with a background check and initial meetings with the potential partner. VPP's selection process is very subjective. For more information on investment strategy, see VPP, *How We Support*, http://www.vppartners.org/about/approach/support/funding.html (last visited Feb. 12, 2007).

[184] *Venture Philanthropy Partners Invest in Social Change*, *supra* note 182 at 3.

[185] *Id.* at 5. This was accomplished through contributions from individuals, traditional foundations, and organizations totaling $27 million. An additional $14 million was provided through management consulting and tangential services by VPP's internal professional team as well as other firms, including McKinsey & Co. *Id.* VPP investors have no expectation of a financial return on their investment. VPP, *Frequently Asked Questions,* http://www.vppartners.org/about/ (last visited Feb. 12, 2007).

A prime example of VCs' social movement is Kleiner Perkins Caufield & Byers' (KPCB) Greentech initiative.[186] KPCB, branded as a venture capital powerhouse and recognized for their successful portfolio including AOL, Amazon, Google, and Compaq, has recently begun to apply their VC high risk and high returns investment strategy to social ventures. Since 1999, KPCB has been actively, and until recently quietly, investing in greentech innovation and entrepreneurs.[187]

Another VC pioneer in the social venture sector is Vinod Khosla. With his roots in engineering and his reputation in venture capital,[188] Vinod Khosla left KPCB in 2004 to form Khosla Ventures to "take on both 'for profit' and for 'social impact' ventures."[189] His focus is "to use technology and entrepreneurship to tackle big social and environmental problems: 'In venture capital, we fail far more often than we succeed . . . I've decided that I'd better focus on taking on problems that really matter, so that when I win it makes a difference to the world.'"[190] He formed Khosla Ventures to "assist great entrepreneurs determined to build companies with lasting significance."[191] Although his investment projects have migrated toward the social sector, his investment strategy and goals remain the same as they did with venture capital: "work and learn from fun and knowledgeable entrepreneurs, build impactful companies through the leverage of innovation, and spend time as a partnership making a difference."[192]

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[186] For more information, see KPCB, *KPCB Greentech Initiative*, http://www.kpcb.com/initiatives (last visited Feb. 1, 2007).
[187] *Id.*
[188] Kholsa holds a Bachelors in Electrical Engineering from the Indian Institute of Technology, a Masters in Biomedical Engineering at Carnegie-Mellon University, and a MBA from Stanford University. At Sun Microsystems he pioneered "open systems" and RISC processors. In 1982 he transitioned over to join KPCB where he still holds a general partner position. Khosla Ventures, *Focus: Assisting Entrepreneurs,* http://www.khoslaventures.com. (last visited Nov. 18, 2006).
[189] *Id.*
[190] *A Healthier Addiction*, THE ECONOMIST, Mar. 23, 2006, *available at* http://www.economist.com/displaystory.cfm?story_id=5655161.
[191] Khosla Ventures: *Focus, supra* note 188.
[192] Khosla Ventures, *Vinod Khosla*, http://www.khoslaventures.com (last visited Nov. 18, 2006).

Khosla Ventures targets their investments in technologies that have a beneficial impact in addition to an economic effect in the community.[193] Kholsa's passion is clear: "he has a passion for nascent technologies that can have a beneficial effect and economic impact on society."[194] While some of the projects that Khosla Ventures has taken on are in the traditional nonprofit sector, others are investments in for-profit organizations.[195] Kholsa Ventures explains: "Some of our 'social impact' interests also make for great businesses, such as alternative energy, or can at least be viable businesses ("no loss" self sustaining businesses that don't need continued outside support . . .) even if profit is not the primary goal."[196]

Khosla Ventures' primary initiative is finding a replacement for oil, with ethanol being the primary substitute.[197] Kholsa's present strategy is only a slight departure from his traditional VC investments with KPCB; his risk versus reward tradeoff is the same but the social avenue which he is taking to solve problems is different. "Here you have an enormous problem, but one where miracles of science may make the intractable tractable. And here you have a putative revolution that could lead to a financial jackpot."[198] A recent article in *The Economist* announced that "investors are falling over themselves to finance start-ups in clean technology, especially in energy."[199] The article states that "IT barons are busy investing in clean-energy technology" and Vinod Khosla is a leader among them.[200]

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[193] *Id.*
[194] *Id.*
[195] Examples of Khosla Ventures' investments are in Microfinance: SKS, SHARE, ASA, CFTS, Grameen USA, Unitus; Environment: CA for Clean Energy; Education: Indian School of Business, DonorsChoose.org; Health: Public Health Institutes of India, UNICEF; Affordable Housing: Global Home; and others including eBay Giving Works. Khosla Ventures, *The Things We Care About,* http://www.khoslaventures.com (last visited Nov. 16, 2006).
[196] *Id.*
[197] John Heileman, *The Constant Gardner,* BUSINESS 2.0 MAGAZINE, Dec. 1, 2005, *available at* http://money.cnn.com/magazines/business2.
[198] *Id.*
[199] *Tilting at Windmills*, THE ECONOMIST, Nov. 18, 2006, at 71, *available at* http://www.economist.com/business/displaystory.cfm?story_id=8168089
[200] *Id.* Venture Business Research has claimed that investment in clean technology has quadrupled in the past two years, from $500m in 2004 to approximately $2b so far this year. Clean energy investment is increasing rapidly as

Another clear indication of VC's emerging social interests and the profitability of social entrepreneurship is the National Venture Capital Association (NVCA) which represents approximately 470 VC and private equity firms. NVCA has taken active steps in support of its members' philanthropic movement by establishing partnerships with other philanthropic organizations. In addition to creating an alliance with Fidelity Charitable Services, NVCA has recently formed a partnership with the Entrepreneurs Foundation, an organization that "engages in high growth companies in corporate citizenship and philanthropic efforts so that new and leveraged resources are generated for community benefit."[201]

The induction of venture philanthropy firms and the growing social investments of traditional VC firms indicate the strength of the growing field of social entrepreneurship, as well as its promising future. There is tremendous support behind social investments and high potential for growth and this support exists because these investors have reason to believe that there are achievable social and financial gains in the social entrepreneurship sector.[202] However, a question remains in the minds of those individuals responsible for making the initial decisions to steer their corporations in the direction of social entrepreneurship. How do ventures that

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the risks of climate change become more obvious. In the Winter 2006 edition of BOARDROOM BRIEFING, Julie Fox Gorte discusses climate change and the risks and investments it presents to companies. Julie Fox Gorte, *Climate Change and Investment,* BOARDROOM BRIEFING, Winter 2006, at 27. In her assessment, Gorte discusses the risk of litigation and regulation on companies that emit greenhouse gases, the reputation risk of being perceived by consumers as irresponsive to an important issue, and the physical risk of damage to their assets from severe weather related losses. *Id.* On the other hand, she states that each of these risks "presents a competitive opportunity to companies that understand and take steps to manage climate risks" with energy conserving technologies and carbon reduction methods. *Id.*

[201] For more information on NVCA, see http://www.nvca.org/philanthropy.html.

[202] Also, notable financial institutions are engaging in social entrepreneurship. Examples include Credit Suisse Group and ING Investment Management. Credit Suisse Group is advocating corporate responsibility because it "knows that the assumption of its responsibilities vis-à-vis its various stakeholders, as well as society and the environment, is one of the keys to long-term business success." Credit Suisse Group, *Corporate Responsibility*, http://www.credit-suisse.com/responsibility/en/index.html (last visited Feb. 21, 2007). ING Investment Management is also committed to corporate responsibility and "wants to pursue profit on the basis of sound business ethics and respect for its key stakeholders . . . ethical, social and environmental factors play an integral role in our business decisions." ING, *Corporate Responsibility*, http://www.ing.com (follow link to "corporate responsibility") (last visited Feb. 21, 2007).

distribute value beyond mere profits and wealth development impact the board of directors' fiduciary duties? The following section will delve into the issues of how the duty of due care as protected by the business judgment rule and the duty to be informed are implicated in social entrepreneurship decisions.

V. The Strategy to Engage in Social Entrepreneurship Fulfills a Board's Fiduciary Duties

Social entrepreneurs have demonstrated that unmet social needs are market opportunities that boards in both private and publicly held companies can and should pursue.[203] With the right approach, opportunities that benefit society can yield a financial return, and therefore social entrepreneurship presents an opportunity for a financially successful business investment. Corporations that enter into these ventures add both financial and social value to their bottom line because social entrepreneurship can provide solutions to many of the world's most obstinate problems while giving the entity an entry into emerging markets. By starting now, these companies will gain a lead by building infrastructure and developing the communities, inputs and markets necessary to position their brands. It is important to note, however, that the strategy to pursue social benefits as part of a corporation's double bottom line assumes an acceptance of the principle that businesses have a role to play in solving social problems. The following section will discuss this concept in more detail.

A. The Role of Business in Affecting Social Problems

The role of business in society has been the subject of a long-standing academic debate. Should the board of directors have a duty to consider the interests of its non-shareholder constituents including employees, the environment, and local communities? Or is it the sole duty

[203] Several companies profiting from these market opportunities have been profiled in this Article, including Unilever, GlaxoSmithKline, eBay, Google, and many more. For a more complete discussion, see *supra* notes 5-65 and accompanying text.

of directors to maximize financial profits solely for the benefit of shareholders?[204] Given that the operating revenues of giant American corporations exceed most countries' GDPs,[205] the question of just how "socially responsible" a corporation must be is a valid one. Fortunately, this Article has shown that there is no longer a strict dichotomy between maximizing shareholder wealth and acting with a concern for non-shareholders.

IBM Chairman and CEO Sam Palmisano explains that, "What is different about business now is that the concept of shareholders has changed to stakeholders,"[206] meaning that taking an active role in developing and implementing solutions to social problems will actually add value to a corporation. It is equally important to note that a corporation's lack of response to either the problems they are causing, and the conditions they have the ability to improve, exhibits a lack of due care because this inaction can harm the future success of the company. The next section will discuss further how a corporation can add value through social entrepreneurship ventures and why it is within the fiduciary duties of the corporate directors to learn about and pursue such activities.

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[204] *See generally,* E. Merrick Dodd Jr., *For Whom are Corporate Managers Trustees?* 45 HARV. L. REV. 1145, 1148-50 (1932). *See also* Chancellor William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264 -76 (1992) ("The last quarter of the nineteenth century saw the emergence of social forces that would oppose the conception of business corporations as simply the property of contracting shareholders. The scale and scope of the modern integrated business enterprise that emerged in the late nineteenth century required distinctive professional management skills and huge capital investments that often necessitated risk sharing through dispersed stock ownership. National securities markets emerged and stockholders gradually came to look less like flesh and blood owners and more like investors who could slip in or out of a particular stock almost costlessly. These new giant business corporations came to seem to some people like independent entities, with purposes, duties, and loyalties of their own; purposes that might diverge in some respect from shareholder wealth maximization.").

[205] For instance Wal-Mart's revenues dwarf the GDP of such countries as Norway, Finland, Greece, Portugal, and Saudi Arabia. Sarah Anderson & John Cavanaugh, *The Rise of Corporate Global Power*, Institute for Policy Studies, Dec. 4, 2004, *available at* www.ips-dc.org/downloads/Top_200.pdf.

[206] Googins, *supra* note 88, at 6.

B. Social Entrepreneurship and the Double Bottom Line Add Value to a Corporation

Some companies "engage in activities that . . . create social value rather than directly produce financial results" out of a sense of moral obligation because directors, managers, and shareholders find that it is the "right thing to do." [207] Yet, "moral obligation aside, companies more commonly act on social matters because they see a business case for social response. They believe that, in either the short or longer run, such a strategy will produce direct benefits for the firm."[208] Ian Davis, the Worldwide Managing Director for the global management consulting firm McKinsey & Company, argues that the "business of business is business" mind-set masks the principle that "social issues are not so much tangential to the business of business as fundamental to it." [209] Social issues have a significant effect on the long-term prospects of the corporation, and even if the effect of social pressures may not be immediate, it is poor strategy for companies to delay preparing for or tackling them.[210] In the typical American and western European public markets, about 80% of stock market value depends on expectations of companies' cash flow beyond the next three years."[211] Therefore, because these social pressures indicate the existence of unmet social needs or consumer preferences, businesses can gain an advantage by spotting and supplying this demand before their competitors do.[212]

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[207] Herman B. Leonard & V. Kasturi Rangan, *Corporate Social Responsibility Strategy and Boards of Directors*, BOARDROOM BRIEFING, Winter 2006, at 13. Refer to Google's initial goal to "not be evil" and sacrifice some short term gains for the ability to create social good. Page & Brin, *supra* note 26 and accompanying text.

[208] Leonard & Rangan, *supra* note 207 at 14. For example, reducing environmental impacts can improve production efficiency, reduce waste, and save on bottom line costs, and encouraging employees to use paid-time-off to work on improving the community may positively influence public officials when creating and enforcing regulations. *Id.*

[209] Ian Davis, *What is the Business of Business?* THE MCKINSEY QUARTERLY, 2005. Subscription *available at* http://www.mckinseyquarterly.com/home.aspx.

[210] *Id.*

[211] *Id.*

[212] *Id.* For instance, "If you look at the Grameen Bank, that is a business, you can't call it anything else . . . Its revenues are greater than its expenses, and it is tremendously effective in pulling people out of poverty. It is proof that you can have it both ways." Stephanie Strom, *A Fresh Approach: What's Wrong With Profit?*, N.Y. TIMES, Nov. 13, 2006, at F1 (quoting eBay's Pierre Omidyar's comment on Nobel Peace Prize Winner Muhammad Yunus' microfinance institution in Bangladesh).

Breaking with the past's exclusive focus on financial results, most companies now "find it at least prudent—and many are finding it directly valuable—to manage a wider array of the impacts that they generate (or can influence)."[213] The board of directors not only has the fiduciary duty to seek out information to guide their decision making, both financially and socially, but they are also responsible for bringing "a visionary assessment of how such activities, when properly integrated, [can] deliver future value for the firm."[214] Thus, boards must implement these decisions with a strategic focus, considering "whether and how they are supposed to generate value for the firm"[215] because "it is the board's job to bring coherence to these investments."[216]

This realization is important, for the strategic management of a corporation can be referred to as the "creative tension" between maintaining both a vision for the future of the organization and a focus on its present operating needs.[217] Because many sets of individuals have a significant and ongoing economic stake in the performance of corporations,[218] good strategic managers must make decisions in consideration of these multiple stakeholders in the short-term and long-term.[219] Despite the primacy of generating shareholder value, "often the shareholder's interest in the corporation is transitory."[220] Thus, managers who focus solely on the immediate interests of these short term owners will often make poor decisions that lead to

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[213] Leonard & Rangan, *supra* note 207 at 12. *See also* this Article's discussion on the development of social entrepreneurship, *supra* notes 97-108 and accompanying text.
[214] Leonard & Rangan, *supra* note 207 at 12.
[215] *Id.*
[216] *Id.*
[217] *See generally* Peter Senge, Leading Learning Organizations: The Bold, The Powerful, and The Invisible, in THE LEADER OF THE FUTURE (Jossey-Bass, Inc. 1996).
[218] Refer to this Article's discussion on stakeholder interests, *supra* notes 81-93 and accompanying text. *See also* Edward S. Abrams & John H. Matheson, *A Statutory Model for Corporate Constituency Concerns*, 49 EMORY L.J. 1085 (2000).
[219] For an insightful discussion on how to manage diverse stakeholder groups, see D. A. Rondinelli & T. London, *How Corporations and Environmental Groups Cooperate: Assessing Cross-Sector Alliances and Collaborations,* Academy of Management Executive, 2003, at 61-76.
[220] *Other Constituencies Statues: Potential for Confusion*, 45 BUS. LAW. 2253, 2268 (1990).

negative, unanticipated outcomes. Consider decisions such as mass layoffs to increase profits, ignoring issues related to stewardship of the environment to save money, and exerting excessive pressure on suppliers to lower prices. Such outcomes can certainly harm the entity in the long run as they are likely to lead to alienated employees, increased governmental oversight and fines, and disloyal suppliers.[221]

The concept that strategic managers must look to the short and long term while balancing all stakeholders is easy to understand. However, actually implementing this principle is not as simple. There are two opposing ways of looking at the management of this creative tension.[222] The "zero sum" view states that the role of management is to look upon the various stakeholders as competing for the attention and resources of the organization and in essence, the gain of one individual or group is the loss of another individual or group.[223] The "symbiotic" view acknowledges that although there will always be some conflicting demands placed on the organization by its various stakeholders, there is value in exploring how the organization can achieve shared benefit through stakeholder symbiosis.[224] This symbiotic approach recognizes that stakeholders are dependent upon each other for their success and well-being.

1. The Symbiotic Approach to Stakeholder Management

Organizations that acknowledge the varying interests and demands of their shareholders, customers, suppliers, employees, and society while considering the needs of the broader community have a better opportunity to act in a socially responsible manner. "Corporate social responsibility is the term most often used to describe an evolving dialog that seeks to expand the

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[221] Gregory Dess, G.T. Lumpkin & Alan Eisner, STRATEGIC MANAGEMENT 21 (McGraw Hill Irwin 2006).
[222] *Id.*
[223] *Id.* War is also a zero-sum game which "motivate[s] competition whose aim is to harm or destroy the opponent . . ." Bjorn Anderson, BRINGING BUSINESS ETHICS TO LIFE: ACHIEVING CORPORATE SOCIAL RESPONSIBILITY TO LIFE 158 (American Society for Quality 2004).
[224] Dess, Lumpkin, & Eisner, *supra* note 221 at 21.

role of the corporation beyond the economic frame to include social and environmental aspects of community."[225] This demand for corporate social responsibility ("CSR")[226] is growing and is coming from a number of sources,[227] including corporate critics, social investors, activists, and consumers who increasingly claim that CSR affects their purchasing decisions. They are demanding more than just product and service quality; they also focus on labor standards, environmental sustainability practices, accounting and financial reporting, procurement, and supply chain management and relations.[228]

Recent corporate scandals have intensified the need for CSR, transparency, and accountability.[229] External critics can damage a corporation's reputation, as Nike, Levi Strauss, Gap, Adidas, and other global brands experienced when activists fairly or unfairly directed attention to abusive labor and human rights practices in their developing-nation suppliers. Corporations are increasingly susceptible to being affected by the consumers' perception of CSR initiatives,[230] thus these brands have implemented new systems to ensure they were consistent with their own codes of conduct and those demanded by the public.

The legitimacy of this issue was presented to the public when a 1999 issue of *Business Week* proposed the question: "Can business meet new social, environmental, and financial expectations and still win?"[231] Looking for numerical answers, many studies have been commissioned and written by people with varying degrees of opinion on the relationship

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225 Deborah Talbot, *From Shareholders to Stakeholders: The Corporate Board's Newest Challenge*, BOARDROOM BRIEFING, Winter 2006, at 10. Talbot further explains: "CSR derives from a broader emerging aspect of our culture where huge societal issues of sustainability or the health of our planet but also such nagging problems as education, the aging workforce, healthcare and related wellness issues, and an underlying loss of community." *Id.*
226 *See* discussion, *supra* note 124, for more about CSR.
227 S. Waddock & C. Bodwell, *Managing Responsibility: What Can Be Learned From the Quality Movement,* CALIFORNIA MANAGEMENT REVIEW, Nov. 1, 2004, at 25-37.
228 J.A. Pearce II & J.P. Doh, *The High Impact of Collaborative Social Initiatives*, MIT SLOAN MANAGEMENT REVIEW, Spring 2005, at 30-40.
229 *Id.*
230 C.B. Bhattacharya & S. Sen, *Doing Better at Doing Good: When, Why, and How Consumers Respond to Corporate Social Initiatives,* CALIFORNIA MANAGEMENT REVIEW, Nov. 1, 2004, at 9-24.
231 *See generally* BUSINESS WEEK, May 3, 1999.

between corporate social, environmental, and financial performance. For instance, the study "*Corporate Social and Financial Performance: A Meta-Analysis*" analyzed 52 studies that represented the population of prior quantitative inquiry and yielded a total sample size of 33,878 observations.[232] The findings suggested that corporate virtue in the form of social responsibility and, to a lesser extent, environmental responsibility, is likely to pay off for corporations. It also stated that portraying managers' choices with respect to social and environmental performance and financial performance as an either/or trade-off is not justified in light of 30 years of empirical data.[233] Instead, the meta-analysis showed that across studies, social and environmental performance is positively correlated with financial performance and that the relationship tends to be bidirectional and simultaneous.[234]

Several other studies have measured a strong positive relationship between CSR behaviors and consumers' reactions to a company's products and services. The 2002 *Cone Corporate Citizenship Study* found that "84 percent of Americans say they would be likely to switch brands to one associated with a good cause, if price and quality are similar."[235] A 2001 Hill & Knowlton/Harris Interactive poll reveals that "79 percent of Americans take corporate citizenship into account when deciding whether to buy a particular company's product and 37 percent consider corporate citizenship an important factor when making purchasing decisions."[236] Clearly, the long-term value of a corporation relies heavily on consumer perspective in how that corporation affects the various stakeholders in the world in which it operates. Therefore, when making business decisions, it is no longer acceptable for a board of

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[232] Marc Orlitzky, Frank L. Schmidt, & Sara L. Rynes, *Corporate Social and Financial Performance: A Meta-Analysis,* 2003, *available at* http://www.global100.org/Corporate%20Social%20&%20Environmental%20Performance.pdf.

[233] *Id.*

[234] *Id.*

[235] *Cone Corporate Citizenship Study, 2002,* http://www.coneinc.com/Pages/pr_30.html.

[236] Business for Social Responsibility, *Overview of Corporate Social Responsibility*, Oct. 2003, *available at* http://www.bsr.org/CSRResources/IssueBriefDetail.cfm?DocumentID=48809.

directors to ignore their impact on the environment or social system. Instead, they have a duty to be informed by seeking out material information that is reasonably available to them.

Some have described CSR as a combination of the “three Ps: profits, people (employees, customer and citizens), and place (environment and community),”[237] which shows that profitability is not disregarded or diminished by consideration of people and place, but is instead supplemented or augmented by these additional considerations.[238] Furthermore, the strongest strategies will most likely include a systematic plan to move beyond CSR to what a Harvard Business School study recently termed “social innovation.”[239] This study describes the new paradigm that considers community needs not as social ills that require "Band-Aid" solutions such as financial donations and volunteer work, but instead as valuable opportunities to develop ideas, demonstrate business technologies, and find and serve new markets. When companies approach social needs in this manner, they have a stake in the problems and they treat the effort in the same way that they would address any other project that is central to the company's operations. They deploy their best talent and their core skills. They direct their efforts to invent sophisticated solutions through a hands-on approach.[240]

Social innovation as described in the Harvard study is merely a semantic variant of what this Article have been describing as social entrepreneurship. Accordingly, what this section has shown is that social entrepreneurship is a strategic investment that adds value to the corporation and therefore merits the board’s attention. The following section will provide another important

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[237] Talbot, *supra*, note 225, at 10.
[238] *Id.* Talbot also states that “while socially responsible action may initially reduce profits, many corporations are finding that it may also create new opportunities for adding to profits and/or reduce a greater threat of operating losses due to legal/regulatory actions or loss of favor in the market place.” *Id.*
[239] R.M. Kanter, *From Spare Change to Real Change*, HARVARD BUSINESS REVIEW, May 1, 1999, at 122-132.
[240] *Id.*

reason to add social entrepreneurial ventures to a corporation's business strategy: the cost of externalities.

2. Strategic Management and The Cost of Externalities

In economic terms, an externality is an effect from one activity which has consequences for another activity but is not reflected in market prices. Externalities can be either positive, when an external benefit is generated, or negative, when an external cost is generated from a market transaction.[241] Negative societal externalities do not show up on financial statements, and therefore the corporation is not held accountable to pay for the damage they cause.[242] The most commonly discussed externalities involve pollution and environmental degradation and these are important problems that corporations must take an active role in solving if they are to stand out in the new generation of social entrepreneurs. In fact, according to the Organization for Economic Cooperation and Development, 51 of the 100 largest global economies as measured by GDP are American corporations.[243] As such, the externalities of these corporations need to be examined so that the negative consequences can be mitigated and positive consequences amplified.

Stuart Hart for the Harvard Business Review eloquently addressed the magnitude of the problems and challenges associated with global sustainability:

> "The challenge is to develop a sustainable global economy: an economy that the planet is capable of supporting indefinitely. Although we may be approaching ecological recovery in the developed world, the planet as a whole remains on an unsustainable course. Increasingly, the scourges of the late twentieth century—depleted farmland, fisheries, and forests; choking urban pollution; poverty; infectious disease; and migration—are spilling over geopolitical borders. The simple fact is this: in meeting our needs, we are destroying

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[241] THE ECONOMIST defines "externality" as "an economic side effect" at http://www.economist.com/research/Economics/alphabetic.cfm?term=europeanunion#externality (last visited Feb. 1, 2007).
[242] Except in the rare cases where litigation forced the corporation to pay for their negative impacts.
[243] Margarita Tsoutsoura, *Corporate Social Responsibility and Financial Performance*, UNIVERSITY OF CALIFORNIA CENTER FOR RESPONSIBLE BUSINESS WORKING PAPER SERIES, 2004, at 5, *available at* http://repositories.cdlib.org/cgi/viewcontent.cgi?article=1008&context=crb.

> the ability of future generations to meet theirs . . . corporations are the only organizations with the resources, the technology, the global reach, and, ultimately, the motivation to achieve sustainability."[244]

Hart's comment exemplifies the potential that corporations have if they want to make a positive impact on their global consumer base. Environmental sustainability is being embraced by more of the most competitive and successful multinational companies. The McKinsey Corporation's survey of more than 400 senior executives of companies around the world found that 92 percent agreed that the environmental challenge will be one of the central issues in the 21st century.[245] Virtually all executives responding to the survey acknowledged their company's responsibility to control pollution, and 83 percent agreed that corporations have an environmental responsibility for their products even after they are sold. Clearly, the concept that corporations can and should take charge of their environmental and social impacts is no longer on the fringe.

The main thrust of this discussion of externalities is that it is possible for corporations to exhibit positive externalities instead of negative ones. Examples of positive externalities that can be pursued include investment in products or services that result in more recycling, lower toxic emissions, friendlier employee benefits, safer products, and investment in local communities. Pursuance of these ends is a strategic way for a corporation to maximize their value for shareholders while balancing the needs of non-shareholders, which has been shown throughout this Article to fulfill the boards' fiduciary duties.

VI. Conclusion

Large publicly held corporations because of their size and resources are particularly well-positioned to seize social entrepreneurship opportunities. Boards, however, are still hampered by

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[244] Stuart L. Hart, *Beyond Greening: Strategies for a Sustainable World,"* HARVARD BUSINESS REVIEW (1997), at 67.
[245] McKinsey & Company, *THE CORPORATE RESPONSE TO THE ENVIRONMENTAL CHALLENGE (*Amsterdam 1991).

two misconceptions that this Article proved to be untrue: 1) that decisions that have a social impact cannot also have a positive financial impact and that there is no quantitative method to measure the financial impact of social decisions; and 2) that current laws do not protect socially outward looking decisions.

Concerning the first misconception, some boards still view shareholder profit maximization and consideration for outside stakeholders as an either/or proposition. This assumption is incorrect. With the advent of sophisticated computer models in the past few years, new methods have been created to quantify the financial impact of social business decisions, thus proving that social and financial returns can coexist. Furthermore, where social impact can be quantified with respect to shareholder profit, boards should take this information into consideration under the duty to be informed as required by the duty of care.

In regards to the second misconception, many argue that our legal system needs a separate body of law to manage social entrepreneurship decisions; other articles have proffered such complex alternatives. However, the existing framework of corporate governance law allows for social impact considerations. Under the laws of corporate governance, specifically the duty of care as protected by the business judgment rule, board decisions are protected. Fear from the consequences of decisions is further assuaged through constituency statutes adopted by the majority of state legislatures and exculpatory clauses adopted by the majority of publicly held corporations.

Thus, shareholder value is viewed through the lens of financial as well as social wealth. The convenient truth is that boards are now enabled to embrace a new era which realizes this.