Center for
Effective Public Management
at BROOKINGS

July 2016

Impact governance and management: Fulfilling the promise of capitalism to achieve a shared and durable prosperity

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Editor's Note: This paper is published as part of the Center for Effective Public Management's Initiative on 21st Century Capitalism. It is one of more than a dozen papers written by academics and practitioners about the changing role of the corporation and the importance of improving corporate governance. The authors of this paper are the co-founders of B Lab, a nonprofit organization that oversees the certification of B Corporations, and a major subject of this paper. The perspectives put forth in this paper are solely those of the authors, based on their professional expertise in this area.

INTRODUCTION

Capitalism is the most powerful economic system ever created. It has improved the quality of life for billions of people. However, in the past two decades, many people have come to feel that there is something wrong with the relationship between business and society.

By custom and, arguably, by law, the operating system of business and of the capital markets has followed Milton Friedman's maxim that "the social responsibility of business is to increase profits." Many feel that the operating system, as defined by Friedman, functions at the expense of the interests of society, and even at the expense of the long-term interests of shareholders. Even as capitalism's bi-products—technological innovation and economic growth—have unquestionably accelerated and benefited many, we are experiencing increasing inequality and environmental degradation, not to mention the Financial Crisis of 2008. No wonder that many people see increased systemic risk as the inevitable outcome of a flawed operating system. In short, our capitalist system is not fulfilling its unique promise.

Fortunately, we are in the early stages of a global culture shift that is transforming our vision of the purpose of business from a late 20th century view that it is to maximize value for shareholders to a 21st century view that the purpose of business is to maximize value for society. Significantly, this transition is being driven by market-based activism, not by government intervention.[1] Rather than simply debating the role of government in the economy, people are taking action to harness the power of business to solve society's greatest challenges. Business—what we create, where we work, where we shop, what we buy, who we invest in—has become a source of identify and purpose.

What can we do to increase the chance that this culture shift is meaningful and lasting?

This culture shift is at an inflection point. Innovative entrepreneurs are starting businesses whose purposes are to help millions lift themselves out of poverty or to address the challenges of climate change; CEOs are recognizing that to win the war for talent they need to compete on meaning, not just money; conscious consumers seek out products from companies they can trust whose actions align with their values; leading investors want to generate a positive impact, not just a positive return; and policymakers on both sides of the aisle want to enable market forces to solve social problems.

Even the largest institutions feel this culture shift. When the CEO of Walmart, one of the world's largest corporations, says that "business exists to serve society,"[2] and the CEO of Blackrock, the world's largest asset manager, says the interests of business must align with the interests of society in order to generate long term value, they are reflecting a shift in the debate about the role of business in society.[3]

The important question is not whether or not the culture is shifting, but "what can we do to increase the chance that this culture shift is meaningful and lasting?"

Current market infrastructure is not designed to support this culture shift. For business to be a long-term agent of change, two things are needed:

> First, *legal innovation* is necessary to align the interests of business with the interests of society and to allow companies and investors to pursue a higher purpose than just profit maximization, especially as they scale using the capital markets.
>
> Second, *credible standards and public transparency* are necessary for customers, investors, policymakers, and workers to differentiate good companies from just good marketing.

In short, we need to evolve our corporate governance and management systems to focus on impact with as much rigor as profit. This requires a market ecosystem that includes supportive corporate and investment fiduciary legal infrastructure, access to aligned capital markets, enabling public policy, and the ability for consumers, employees, and investors to differentiate "good companies" from good marketing.

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1 Rana Farhoohar, "American Capitalism's Great Crisis" Time Magazine, May 12, 2016 http://time.com/magazine/us/4327411/may-23rd-2016-vol-187-no-19-u-s/

2 Kathleen McLaughlin and Doug McMillon, "Business and Society in the Coming Decades," *Focusing Capital on the Long Term*, 2015, (http://www.fclt.org/en/ourthinking/perspectives.html).

3 Laurence Fink, "Our Gambling Culture," *Focusing Capital on the Long Term*, 2015, (http://www.fclt.org/en/ourthinking/perspectives.html).

The B Corp Movement is one example of impact governance and management that can help increase the chance that this culture shift to redefine success in business is meaningful and lasting. The B Corp Movement is a community of 1,700 Certified B Corporations in 50 countries and 130 industries. A Certified B Corporation is a company that has met high standards of verified social and environmental performance, public transparency, and legal accountability to create value for both shareholders and society, as determined by the independent nonprofit B Lab.[4] These companies are being followed by over 3,000 other companies that have registered as benefit corporations under new state corporate statutes, 40,000 businesses using the B Impact Assessment as a cloud-based tool to measure and manage their impact, and millions of consumers, workers, entrepreneurs, and investors who want to use business as a force for good.[5]

B Corporations are setting a higher standard for corporate social and environmental performance, accountability, and transparency. They have moved beyond declarations of purpose to verification of performance and expansion of fiduciary duty. As importantly, B Corporations work together as a community of business leaders and investors to develop the necessary market infrastructure to enable all companies, not just B Corps, to move one step closer to fulfilling the promise of capitalism to create a more shared and durable prosperity.

THE SHIFTING CULTURE OF BUSINESS AND CAPITAL

Over the past thirty years, as many of the problems endemic in a business culture focused on profit-maximization have become apparent, we have begun to see a culture shift towards using business as a force for good, not just to make a buck. In the U.S. alone, according to the American Sustainable Business Council, there are over 200,000 businesses and 325,000 business executives who identify themselves as being driven by a mission to use their business to create a more sustainable society.[6] These business leaders are, at least in part, responding to market trends.

To stay competitive, companies must meet the higher expectations of the next generation of consumers and employees who want to align their purchases with their values and to bring their whole selves to work every day.

Purpose has become a leading purchase trigger for global consumers. In fact, the importance of purpose as a purchase factor has risen 26 percent globally since 2010.[7] And to an increasingly sophisticated and skeptical public, lofty statements about corporate purpose are not enough. According to a survey by Cone Communications, 90 percent of Americans say that companies must not only say a product or service is beneficial, but they need to prove it.[8] In 2012, nearly half (47 percent) of consumers bought a brand at least monthly that supports a cause, representing

4 The authors of this paper are the co-founders of B Lab. Please see editor's note on page 1 for more on their role in the organization and the independence of the Brookings Institution.

5 All Certified B Corporations are required to complete the B Impact Assessment and achieve a minimum verified score of 80 out of 200 available points to meet the performance requirement for certification. Certified B Corporations and benefit corporations are often confused. They share much in common and are complementary, but have a few important differences. Both meet higher standards of accountability by expanding the fiduciary duty of their directors to consider stakeholder interests. Some companies use the benefit corporation legal structure to meet the legal requirement for B Corp certification — most benefit corporations are not Certified B Corporations. Benefit corporations are not required to meet a minimum verified level of overall social and environmental performance.

6 "Overview," *American Sustainable Business Council*, (http://asbcouncil.org/about-us).

7 "U.S. Consumers Feel Most Responsible to Help, Yet Involvement in Societal Issues Declines for the First Time; Look to Marketers to Bridge the Gap," *Edelman*, April 2012, (http://www.scribd.com/doc/90410268/Press-Release-2012-Edelman-goodpurpose-Study).

8 "2010 Cone Cause Evolution Study," *Cone Communications*, September 2010, (http://www.conecomm.com/stuff/contentmgr/files/0/6bc819050a7914fc99b99c205493d8bc/files/2010_cone_cause_evolution_study_report.pdf).

Gallup estimates disengaged employees cost US companies $450 billion to $550 billion in lost productivity annually.

a 47 percent increase from 2010.[9] A recent Brookings Institution report found, "Millennials overwhelmingly responded with increased trust (91 percent) and loyalty (89 percent), as well as a stronger likelihood to buy from those companies that supported solutions to specific social issues (89 percent)."[10]

This growing preference is true not only when choosing a product, but also when choosing a job. Millennials represent roughly 50 percent of the global workforce and want more than just a paycheck—they want a higher purpose.[11] Connection to higher purpose leads to more engaged employees, and research has shown that engaged employees are more profitable, because, among other things, they are more customer-focused, safer, and less likely to leave.[12] Within the U.S. workforce, Gallup estimates disengaged employees cost companies $450 billion to $550 billion in lost productivity annually.[13] An additional report from Hewitt Associates found that companies with high levels of engagement (65 percent or greater) out-performed the total stock market index and posted shareholder returns 19 percent higher than average in 2009.[14] Companies with disinterested employees (40 percent or less engagement) had a total shareholder return 44 percent below average.[15]

Capital markets are changing too. While the capital markets are likely to continue to lag the consumer and labor markets, we are in the early stages of a transition in investor expectations that will move impact from the margins to the mainstream. This is largely because of two trends. The first is a growing interest in what has been called "impact investing" among high net worth individuals, family offices, and foundations. The second is the growing recognition by the largest institutional investors that investing with an ESG (Environmental, Social, and Governance) lens creates more long-term value.

For 40 years, a growing community of socially responsible investors has been incorporating ESG factors in their investment decisions, or engaging companies in social issues through shareholder resolutions. The total U.S.-domiciled assets under management using Socially Responsible Investment (SRI) strategies expanded from $3.74 trillion at the start of 2012 to $6.57 trillion at the start of 2014, an increase of 76 percent.[16] These assets now account for more than one out of every six dollars under professional management in the United States.[17] There are 308 money managers and 880 community investing institutions that incorporate ESG issues into their investment

9 "U.S. Consumers Feel Most Responsible to Help, Yet Involvement in Societal Issues Declines for the First Time; Look to Marketers to Bridge the Gap"

10 Michael Hais and Morley Winograd, "How Millennials Could Upend Wall Street and **Corporate** America," *The Brookings Institution*, May 2014, (http://www.brookings.edu/~/media/research/files/papers/2014/05/millennials%20wall%20st/brookings_winogradv5.pdf).

11 "The Deloitte Millennial Survey 2016: winning over the next generation of leaders," *Deloitte*, 2016, (http://www2.deloitte.com/global/en/pages/about-deloitte/articles/millennialsurvey.html).

12 Kevin Kruse, "Why Employee Engagement? (These 28 Research Studies Prove the Benefits)," *Forbes*, September 2012, (http://www.forbes.com/sites/kevinkruse/2012/09/04/why-employee-engagement/3/#2e1a4fcb26d7).

13 Keri Garman and Susan Sorenson, "How to Tackle U.S. Employees' Stagnating Engagement," *Gallup*, June 2013, (http://www.gallup.com/businessjournal/162953/tackle-employees-stagnating-engagement.aspx).

14 Courtney Rubin, "Why Happy Employees Are Good for Business," *Inc.*, September 2010, (http://www.inc.com/news/articles/2010/09/happy-employees-are-good-for-business.html).

15 *Ibid.*

16 "Report on US Sustainable, Responsible and Impact Investing Trends 2014," *US SIF*, November 2014, (http://www.ussif.org/Files/Publications/SIF_Trends_14.F.ES.pdf.)

17 *Ibid.*

decision-making, with a combined $4.8 trillion in assets under management.[18] This is 3.4 times the corresponding figure for 2012.[19] There are also 336 alternative investment vehicles—private equity and venture capital funds, responsible property funds, and hedge funds—engaged in sustainable and responsible investment strategies, with a combined total of $224 billion in assets under management.[20] In other words, each of the major asset categories has a growing component of ESG-driven investing.

As more investors have become interested in responsible ESG investing, a subset of them, including both high net worth individuals and institutions, has become focused on impact investing. Impact investing is an investment approach intentionally seeking to create both financial return and measurable positive social impact. These investors tend to seek deeper and direct social impact, rather than simply avoiding harm or investing in companies with responsible practices that may, as a result, create more long term financial value. They seek to create impact both in developed markets and for the world's most vulnerable people. This emerging investment approach has inspired many adherents and much buzz, with a 2010 report by J.P. Morgan and the Rockefeller Foundation stating that the impact investment sector could reach $400 billion to $1 trillion by 2020.[21] A more recent study shows approximately $60 billion already under management using impact investment strategies.[22]

While traditional investment practice is skeptical of these kinds of social and environmental considerations in the investment markets, a growing body of research makes a compelling case that these factors are directly responsible for positive financial performance over the long term. A recent meta-study by Arabesque Asset Management reviewing 190 research studies on responsible and ESG investing concluded that: 90 percent of the studies on the cost of capital show that sound sustainability standards lower the cost of capital of companies; 88 percent of the research shows that solid ESG practices result in better operational performance of firms; 80 percent of the studies show that stock price performance of companies is positively influenced by good sustainability practices; and based on the economic impact, it is in the best interest of investors and corporate managers to incorporate sustainability considerations into their decision making processes.[23] David Blood, former head of asset management at Goldman Sachs, and co-founder with former Vice President Al Gore of Generation Investment Management, a B Corp, is more pointed when he states that "the active decision to ignore sustainability factors may in fact be a breach of fiduciary duty."[24]

A recent study by McKinsey and the Canadian Pension Board, with the involvement of the world's largest asset manager, BlackRock, concluded that too many investors continue to seek returns on their strategies as quickly as possible.[25] Companies are missing out on profitable investments for fear of missing quarterly earnings guidance. Investors are missing out on potential returns because stock markets are penalizing companies that make long-term investments. Society is missing out on long-term growth and innovation because of underinvestment. The study indicates that senior executives today are seeing increased short-term pressure on financial performance,

18 *Ibid.*

19 *Ibid.*

20 *Ibid.*

21 "Impact Investments: an emerging asset class," *J.P. Morgan* and *Rockefeller Foundation*, November 2010, (http://www.ita.doc.gov/td/finance/publications/JPMorgan%20II%20Report.pdf).

22 "Eyes on the Horizon: The Impact Investor Survey," *J.P. Morgan* and *Global Impact Investing Network*, May 2015, (http://impactinvestingaustralia.com/wp-content/uploads/GIINJPMorgan-2015-impact-investor-survey.pdf).

23 "From the stockholder to the stakeholder: how sustainability can drive financial outperformance," *Arabesque Asset Management*, March 2015, (http://www.arabesque.com/index.php?tt_down=51e2de00a30f88872897824d3e211b11).

24 "Allocating Capital for Long-Term Returns: The Strengthened Case For Sustainable Capitalism," *Generation Foundation*, May 2015, (https://www.genfound.org/media/pdf-genfound-wp2015-final.pdf).

25 "Perspectives On The Long Term," *Focusing Capital on the Long Term*, 2015, (http://www.fclt.org/en/ourthinking/perspectives.html).

notwithstanding their belief that a long-term approach to business decisions is a key driver of company performance. Forty-six percent of respondents said that the pressure to deliver strong short-term financial performance stemmed from their board and executive team, while also pointing to their institutional shareholders.[26] As a follow up to this report, BlackRock and Ceres published a report providing guidance to investors on how to engage with companies on ESG issues to drive better performance and create more benefit for these investors' beneficiaries.[27]

BARRIERS TO IMPACT GOVERNANCE AND MANAGEMENT

Increased attention to ESG issues indicates a change in what is driving markets. However, businesses that attempt to harness these opportunities still face significant institutional and normative barriers. Those barriers include the existing laws of fiduciary duty for companies and for investors that limit flexibility and accountability, and the lack of credible, comprehensive, and transparent standards that would allow the market to effectively and efficiently measure, manage, and reward companies and investments that create positive social impact.

FIDUCIARY DUTY LAWS

If everyone wants companies to behave differently, but the laws that govern those companies and their investors don't allow for it, even the best intentions and the most visionary and fearless business leaders won't get very far. The evolution of capitalism requires an evolution in corporate law, one that allows company directors to serve all stakeholders and creates mechanisms so that investors can hold them accountable.

According to the Delaware Chancery Court, under existing Delaware corporate law, the only legitimate purpose of a corporation is, in the end, to maximize value for its shareholders.[28] Some argue that changes in corporate law are unnecessary and excessive, as Delaware Supreme Court Chief Justice Leo Strine has said in his essay "The Dangers of Denial: The Need for Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law." But these skeptics are failing to address the reality of the law,[29] as well as the real implications of the perception of the law on corporate decision-making in the boardroom, and the short term demands of the capital markets.

If the law does not allow for a company to make an explicit trade-off between financial and social value, it is hard to imagine how business can play the positive role in society that so many people desire. However, according to the corporate law of Delaware, a corporation must be able to tie its actions to financial value maximization at some point in the future. While corporate leaders may make decisions taking into account ESG considerations that they believe can be tied to long term shareholder value, if a company is explicit about trade-offs that favor society, the directors have liability for a breach of fiduciary duty. This conflict recently played out in Delaware courts in the 2010 case Ebay v. Craigslist. Ebay claimed (and the courts affirmed) that a corporate mission that "seeks not to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders"[30] is an invalid corporate

26 Dominic Barton and Mark Wiseman, "Focusing Capital on the Long Term," *Harvard Business Review*, February 2014, (https://hbr.org/2014/01/focusing-capital-on-the-long-term).

27 "21 Century Engagement: Investor Strategies for Incorporating ESG Considerations into Corporate Interactions," *BlackRock* and *Ceres*, May 2015, (https://www.blackrock.com/corporate/en-us/literature/publication/blk-ceres-engagementguide2015.pdf).

28 *Ebay Domestic Holdings Inc., v. Craig Newmark et al.*, 16 A.3d 1 (Del. Ch. 2010); David Yosifon, "The Law of Corporate Purpose," *Berkeley Business Law Journal*, 2014, (http://scholarship.law.berkeley.edu/bblj/vol10/iss2/1).

29 Leo E. Strine, "The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law," *Wake Forest Law Review*, March 2015, (ttp://ssrn.com/abstract=2576389).

30 16 A.3d 1 (Del. Ch. 2010)

purpose and inconsistent with directors' fiduciary duties, further stating that "promoting, protecting or pursuing non-stockholder considerations must lead at some point to value for stockholders."[31] An increasing community of companies and their investors believe that there are real and explicit trade-offs that are worth making so that business can best serve society.

Hope is not a good strategy for the investor who makes her investment with the intent to create a positive social and environmental impact.

Further, for shareholders who seek to achieve both financial return and social impact, even in the case of ESG-related decisions that do not negatively affect financial value, under existing corporate law, investors are not able to hold companies accountable for having a greater purpose than simply making money. Management has the option to consider ESG interests, but it also has the option not to consider such interests. Hope is not a good strategy for the investor who makes her investment with the intent to create a positive social and environmental impact. This growing class of investors wants the legal standing to hold management accountable to make a meaningful return and a measurable impact.

Delaware Supreme Court Chief Justice Leo Strine, in many ways the final arbiter of these questions, states:

> Advocates for corporate social responsibility pretend that directors do not have to make stockholder welfare the sole end of corporate governance within the limits of their legal discretion, under the law of the most important American jurisdiction—Delaware. … If we wish to make the corporation more socially responsible, we must do it the proper way. If we believe that other constituencies should be given more protection within corporation law itself, then statutes should be adopted giving those constituencies enforceable rights that they can wield… But lecturing others to do the right thing without acknowledging the actual rules that apply to their behavior, and the actual power dynamics to which they are subject, is not a responsible path to social progress. Rather, it provides an excuse for avoiding the tougher policy challenges that must be overcome if we are to make sure that for-profit corporations become vehicles for responsible, sustainable, long-term wealth creation.32

Separate from these issues of corporate law, the laws that govern investment fiduciaries are equally challenging and also require a clear-eyed look at how to allow for investments that meet the long term interests of retirees and other institutional asset owners, as well as the demands of a new class of investor with an explicit objective to create social value beyond a financial return with their investment capital.

COMMON STANDARDS

If it is true that we manage what we measure, then we ought to measure what matters.

The second major barrier to fulfilling the promise of capitalism is the lack of generally accepted standards to measure and manage impact, and thus to drive behavior change. A marketplace lacking common impact metrics and credible data prevents consumers, workers, companies, investors, policymakers, and other stakeholders from rewarding those companies that can demonstrate that they are creating a material positive impact on society.

31 *Ibid.*

32 Strine. op cit.

While many entrepreneurs and business leaders want their companies to act as a positive force for social and environmental change, it is hard to know where to start and how to benchmark progress against meaningful and comparable data points. Furthermore, there are few tools that all businesses can use to access best practices for building a better business for their workers, community, or environment. Such tools would not only reduce the barriers to participation for mainstream businesses, but also accelerate the shift in corporate culture to make measuring and managing impact as normal as measuring and managing profit.

A lack of transparent standards also makes it difficult for individuals to differentiate between good companies and just good marketing. An ever increasing number of people want to work for and support companies aligned with their values, but don't trust what companies say about themselves. A generally accepted set of standards, especially when coupled with credible third-party validation, would empower individuals to vote with their dollars and their talent to drive further behavior change.

> If we manage what we measure, then we ought to measure what matters.

Investors also need credible and comparable impact metrics to make informed investment decisions that meet their evolving investment objectives. As stated by the G8 Social Impact Investing Task Force, "To solve problems on a global scale, we need global capital pools to respond. … Impact measurement is central to the practice of impact investing and vital to the growth of the impact investing market."33 Recent studies state there is up to $1 trillion of demand for impact investment capital from high impact businesses.34 Enabling infrastructure would help unleash this pent up demand. By demonstrating social impact in a concrete manner, capital can be mobilized, transparency and accountability increased, and the movement to use business as a force for good accelerated.

CURRENT PUBLIC AND PRIVATE APPROACHES ARE NECESSARY YET INSUFFICIENT TO FULFILL THE PROMISE OF CAPITALISM

Many approaches have been tried to help capitalism create a shared and durable prosperity. A brief look at some of these suggests that all are likely needed, but none alone are likely to prove sufficient.

- Government regulation and incentives to enforce or encourage behavior change by business have been the traditional carrots and sticks in determining the role of business in society. However, while necessary, the government's role has limits in effectiveness, at least in the U.S. Political gridlock makes smart regulation or incentives unlikely, a globalized economy without state walls limits the power of any one country to change the system, and many regulations and incentives are often co-opted or made less effective by bad actors or bad design.

- Citizen activism in business and the capital markets has some capacity to uncover misdeeds and to drive behavior change that is critical to protecting vulnerable workers, communities, and the environment, and to raising public consciousness about important social issues. However, it is often focused on reducing harm, not creating positive impact, and it tends to focus on specific bad actors rather than reforming the system.

33 "Measuring Impact: Subject paper of the Impact Measurement Working Group," *Social Impact Investment Taskforce*, September 2014, (http://www.socialimpactinvestment.org/reports/Measuring%20Impact%20WG%20paper%20FINAL.pd).

34 "Impact Investments: an emerging asset class"

- Constructive engagement through partnerships and shared value initiatives between business and civil society is also useful. However, these efforts are often relegated to the margins of the core business, susceptible to changes in leadership, and limited in aspiration to reducing harm or in efficacy by a need for a relatively short-term return on investment or good press.

- Traditional CSR, SRI, ESG,[35] and sustainability efforts that focus on responsible behavior as a better path to profitability have begun to catalyze this culture shift among large corporations and institutional investors. However, too much of the market's focus has been on proving the business case—to minimize risk and maximize long term value—missing the opportunity to engage the majority of people motivated by meaning more than money. Culture will have shifted when business leaders and investors don't feel the need to apologize for prioritizing impact, even if doing so does not maximize profits, even in the long term.

BEST PRACTICE IN IMPACT GOVERNANCE AND MANAGEMENT: THE B CORP MOVEMENT

The B Corp Movement has arisen as a result of the dynamics explored in the discussion above. In contrast to the short-term, profit-maximization vision that has dominated capitalism in past decades, the vision of the B Corp Movement entails an inclusive economy that creates a shared and durable prosperity. The goals of the movement are a society with reduced inequality, lower levels of poverty, a healthier environment, stronger communities, and more high quality jobs. In this vision, business (not investors or consumers) is the lead agent of change. It is business that creates the actual products and services and the potential investments among which we must choose; and it is business that creates the high quality jobs that both drive economic growth and uplift personal dignity. Business channels capital to human need.

B Lab, a nonprofit organization started in 2007, is the certification body for B Corporations, which are meant to serve as a concrete manifestation of the ideals of effective impact governance and management. B Lab's mission is to serve a global movement of people using business as a force for good—the B Corp Movement—so that one day all companies compete not only to be best in the world, but best for the world. B Lab does this in two ways:

> First, B Lab builds a global community of leaders through a certification process. These leaders are called Certified B Corporations. They meet the highest standards of overall corporate social and environmental performance, public transparency, and legal accountability.
>
> Second, B Lab creates paths for others to follow. These paths include impact governance tools, like the benefit corporation legal structure, and impact management tools, like the B Impact Assessment and B Analytics.

Below, we discuss in more detail the B Corp certification, as well as the role that the B Corp community and B Lab have played in creating pathways for all businesses to access powerful impact governance and management tools.

35 CSR: Corporate Social Responsibility; SRI: Socially Responsible Investing; ESG: Environment, Social, and Governance factors

CERTIFIED B CORPORATIONS

More than 1,700 Certified B Corporations, certified by the nonprofit B Lab, act as the leaders of this movement. They set the gold standard for "good" business and are driving behavior change in the businesses around them. B Corps serve as a vanguard to lead and inspire a race to the top.

B Corp Certification is much like the "fair trade" identification for coffee, "organic" label for food products, or "LEED" certification for green buildings, but it is a certification for the whole company. To become certified, companies must first meet a minimum bar of overall social and environmental performance. This is achieved by earning a minimum verified score of 80 out of 200 on the B Impact Assessment, an analysis of a company's impact on its workers, community, and the environment. It is customized by company size, industry, and location. The B Impact Assessment is independently governed, and it is updated biennially to ensure accuracy and rigor. Companies must recertify every two years on the updated standard, and all B Corps pay an annual certification fee based on their revenues. Companies are also required to make the results of their assessment transparent by publishing their B Impact Report on bcorporation.net (please refer to Appendix B for more detail).

The B Corporation certification process also has a legal requirement to expand fiduciary duty to the extent possible within existing law, which: 1) gives legal protection to directors and officers to consider the interests of all stakeholders, not just shareholders, when making decisions, 2) creates additional rights for shareholders to hold directors and officers accountable to consider these interests, and 3) limits these expanded rights exclusively to shareholders. This step was created to address some of the largest gaps in current corporate law, ensuring that Certified B Corps not only meet a performance standard at a given moment in time, but that they are built with a governance structure that allows them to maintain mission over time as they scale, access third party capital, and plan for sale or succession. As discussed below, the B Corp community has played a leadership role in successfully advocating for changes to existing corporate law to make this step possible in many jurisdictions where it wasn't prior to the movement's advent.

The exact required legal change is dependent on legal structure (e.g., Corporation, LLC, or Partnership), and the state or country of incorporation. As discussed below, for U.S. corporations, the best way to institutionalize stakeholder interests is through incorporation as a registered benefit corporation because it is purpose-built to create an enforceable expansion of fiduciary duty.

The community is growing in size and reach. Since 2007, it has expanded from 20 B Corps to over 1,600, from a U.S.-focused certification to a global movement with B Corps in 42 countries. Found in over 121 industries, B Corporations include well-known brands like Ben & Jerry's, Method Products, Honest Company, and Warby Parker; high-impact social enterprises like Cooperative Home Care Associates, Roshan and d.light designs; tech-startups like Kickstarter, Change.org, and HootSuite; and sustainable business icons like Seventh Generation, Patagonia and Triodos Bank. B Corporations are establishing a presence in the public market as well. Etsy and Natura, a multibillion dollar Brazilian cosmetics company, are publicly traded Certified B Corporations; Laureate, the largest for-profit provider of post-secondary education, is a Certified B Corporation that recently filed an S-1 to go public; and Campbell's Soup, P&G, and Unilever have subsidiaries that are B Corporations (Plum Organics, New Chapter, and Ben & Jerry's respectively).

Below we describe the catalytic role that the B Corp community has played in getting the larger market ecosystem to adopt higher standards of impact governance and impact management.

THE ROLE OF B CORPS IN PROMOTING EFFECTIVE IMPACT GOVERNANCE

Certified B Corporations have been a driver of policy change to create effective impact governance structures available to all businesses. As discussed above, the culture shift to redefine success in business requires laws of fiduciary duty that allow for an accountable and transparent balancing of social and environmental interests with those of shareholders. In a relatively short period of time, due to the effective advocacy of the community of Certified B Corporations, laws have been passed in two-thirds of U.S. states to create a new corporate structure called a benefit corporation. Importantly, Delaware passed benefit corporation legislation in 2013, creating a pathway to effective impact governance in the public capital markets. The then-chair of the Corporations Law Council of the Delaware State Bar Association called the benefit corporation a "seismic shift in U.S. corporate law."[36]

In other words, there is now a new form of corporate governance, the benefit corporation, available to any U.S. business that wants it. You don't have to be certified by B Lab to register as a benefit corporation, opening the market to the whole universe of companies that want the freedom to pursue social impact alongside profit. In the short period of time in which these new laws have been in effect, there are already more than 3,000 U.S. businesses that have registered as benefit corporations, a number that outpaces the 1,700 Certified B Corps globally. We expect adoption of this legal form of accountable governance to continue to grow faster than B Corp certification because it meets the broader needs of companies focused on creating long-term value for all stakeholders, many of whom might not want to wear it on their sleeves or might not meet as high a performance standard as the Certified B Corps (although many will likely become B Corps). These benefit corporations range from Silicon Valley startups (like AltSchool, Ello, and Farmigo) funded by leading venture capital firms (like Founders Fund, Andreesen Horowitz, and Benchmark) to recognizable national brands (like Patagonia, Method, and King Arthur Flour), and subsidiaries of Fortune 500 companies (like Plum Organics, a subsidiary of Campbell's Soup Company).

Benefit corporation statutes address current corporate law's greatest deficiencies by 1) requiring a corporate purpose to create a material positive impact on society and the environment; 2) creating an explicit duty to pursue that public benefit and treating that public benefit as in the best interests of the corporation; 3) creating accountability that gives shareholders the ability to hold directors responsible for pursuing the public purpose even when it may involve an explicit trade off with financial value; and 4) requiring transparent reporting of overall social and environmental performance against a credible, independent third party standard.

Benefit corporations laws are opt-in—they do not impose any new regulatory regime on businesses that choose to operate under traditional corporate law—giving business leaders and investors more freedom to choose the corporate structure that meets their needs. Importantly, shareholders of benefit corporations retain all of their traditional governance rights, and benefit corporation directors have the same duties of care and loyalty that they have in traditional corporations.

As state policymakers responded to meet the needs of a growing community of businesses seeking to adopt corporate structures that support effective impact governance, federal policymakers have begun to remove similar impediments for investors who seek to invest in those businesses.

36 Quote by Norman Monhaight, Co-Chair of the Corporations Law Council of the Delaware Bar, on Tuesday, February 5, 2013 at a meeting held with the Chancellor Leo Strine and the DE Bar Association, held at the New Castle County Courthouse in Wilmington, DE.

One important step in this direction took place in late 2015, when the U.S. Department of Labor issued new Employee Retirement Income Security Act (ERISA) guidance giving institutional investors explicit permission to invest in businesses that have adopted ESG best practices like expanded fiduciary duties. This new guidance was the result of a multi-year effort led by a coalition of investors, labor, and business leaders, including the B Corp community. Based on prior ERISA guidance, those pension plans, some of the country's largest institutional investors, often felt discouraged from investing in companies and funds that took non-financial factors into consideration.

The new ERISA guidance states that:

> ...in some cases ESG factors may have a direct relationship to the economic and financial value of the plan's investment. In such instanc-es, the ESG issues are not merely collateral considerations or tie-breakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices.[37]

THE ROLE OF B CORPS IN PROMOTING EFFECTIVE IMPACT MANAGEMENT

Trust is the bedrock of strong relationships with all of a company's stakeholders. Transparency is the necessary first step to build trust; verification is the best practice. Skeptical and increasingly sophisticated stakeholders want the whole story and they want to know that this story is true—not self-reported—but verified by an independent, credible third party.

The B Corp Movement is creating and promoting tools for all businesses and investors to measure and manage their impact. The B Impact Assessment is a way for businesses globally to assess, compare, and improve their impact. Just like the number of companies using the benefit corporation legal form already outpaces the number of Certified B Corps, there are already more than 40,000 users of the B Impact Assessment. In other words, thousands of companies are choosing to use this free impact assessment tool to create their own assessment and roadmap for impact. This large number of businesses around the world using the B Impact Assessment is likely a testament to the credibility of the 1,600 Certified B Corporations to inspire others to follow their lead.

In addition to individual businesses, institutional action is also needed to drive broad market adoption of effective impact management. Without effective impact management being pushed by market-shaping institutions, even robust adoption by individual businesses will not be sufficient to shift business culture. The broad adoption of green building practices offers a good example. According to a former chair of the board of US Green Building Council that oversees LEED certification, the primary driver of broad market adoption of green building standards was when the General Services Administration – the agency that oversee all federal procurement—incorporated LEED certification into all RFPs for new construction projects over a certain size.

Creating similar drivers of more wholesale adoption, more than 100 partners are using the B Impact Assessment (and its sister B Analytics data platform) to increase the positive impact of the businesses with whom they work.

37 "Economically Targeted Investments (ETIs) and Investment Strategies that Consider Environmental, Social and Governance (ESG) Factors," *U.S. Department of Labor*, October 2015, (http://www.dol.gov/ebsa/newsroom/fsetis.html).

These partners include corporate supply chain managers, investors, fund managers, credit providers, business associations, and, like happened in green building, government agencies.

In one example, the New York City Economic Development Corporation (NYCEDC) has joined with the Mayor's Office of Workforce Development and a group of New York City community organizations to launch "Best for NYC," Using a customized version of the B Impact Assessment, the city has challenged all local businesses to measure and improve their social and environmental impact. In the first few months of the campaign, more than 1,000 businesses are beginning to do so, and many are changing their behavior in ways that impact the lives of their workers—like raising all salaries to a living wage.

ACCELERATING THE CULTURE SHIFT

The B Corp Movement is a potentially disruptive innovation. However, even with 40,000 businesses taking the first steps toward effective impact management using the B Impact Assessment and 3,000 businesses using an effective impact governance tool like benefit corporation registration, these companies remain a tiny fraction of the millions of businesses in the U.S., and of course many millions more around the world.[38] For effective impact governance and management to become the norm, for capitalism to fulfill its unique promise, all elements of the market ecosystem must engage. This includes policymakers, investors, consumers, workers, academia, and the media.

Credible research and compelling storytelling are both needed to accelerate this culture shift to redefine success in business. Credible research is needed to test the hypotheses that effective impact governance and management lead to better financial and social outcomes. Compelling storytelling is needed to inspire millions of people that that can use business as a force for good.

For an impact economy to attract capital and talent to scale, a rigorous research agenda is needed to inform policymaking, investment strategies, business planning, and grant making for a broad range of players in this market ecosystem. Below are a few examples of questions and research topics that could be useful to these players:

- How does the financial performance of companies with effective impact governance and management compare to that of their traditional counterparts? How do specific practices factor into that comparison? How does this differ by size, sector, and region? How do we factor in changed risk in these businesses to look at risk-adjusted returns?

- What are the norms of performance for companies in terms of impact (analyzed by size, sectors, and geographies, impact intent, and legal structures)? For example, how does employee satisfaction correlate to a company's social and environmental impact? How does this affect retention rates? Does this differ by size, sector, and region?

- How do funds with effective impact governance and management perform in the long term and in relation to their traditional counterparts?

- Do companies with impact governance structures maintain levels of impact performance post-transaction (sale, financing, initial public offering)?

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- How can funds effectively marry financial and social performance in their incentive structures?
- Does verification make a difference in impact management over time?
- Which stakeholders have the most influence in moving the needle on impact (consumer preference, employee engagement, investors, government incentives, supply chain management)?
- Are new investors entering the impact investing market actually measuring impact? What are they measuring? How do returns and impact correlate? Can we categorize which investors are using common metrics and which investors are influencing companies to behave differently?
- What is the answer to each of these questions over a longer period of time? What kinds of engagement are most likely to lead to sustained improvement in corporate impact and improved lives of their workers and others affected by the business?
- What are the policy implications of the data? Are there specific incentives or regulatory changes that would recognize the measurable value for society created by these businesses or the stakeholders supporting them?

Lastly, no social movement can succeed without media. Until now, this culture shift to redefine success in business has not had its own media platform to serve as a center of gravity and a hub for inspiring stories, practical tools, credible insights, and contextual perspectives. Existing media coverage is sporadic and places these issues at the periphery rather than at the center of a public conversation about the role of business in society. Rolling Stone captured the moment when music became an emblem of identity and an instrument of social change; B the Change Media, a new company launched by B Lab strives to capture this turning point for business.

CONCLUSION

Fulfilling the promise of capitalism to create a shared and durable prosperity requires the acceleration of a nascent cultural shift. The B Corp Movement is playing a leadership role in making the shift meaningful and lasting by demonstrating and creating pathways for others to adopt effective impact governance structures and management systems.

There are important roles for every player in the market ecosystem to accelerate this culture shift. Through supportive public policy, an investment community aligned around long-term value creation, an engaged citizenry that recognizes its power as customer, worker, investor, and voter, credible research from academia, and compelling storytelling from the media, we can complete the transformation from shareholder capitalism to stakeholder capitalism and fulfill the promise of capitalism to create a shared and durable prosperity.

APPENDIX A

Impact governance: Proper alignment and good process drives good decisions

Expanded purpose and fiduciary duty of Benefit Corporations

Section 201 of Benefit Corporation Model Statute

Corporate purposes.

(a) General public benefit purpose. – A benefit corporation shall have a purpose of creating a material positive impact on society and the environment, taken as a whole, assessed against a third-party standard, from the business and operations of a benefit corporation.

(b) Optional specific public benefit purpose. – The articles of incorporation of a benefit corporation may identify one or more specific public benefits that it is the purpose of the benefit corporation to create in addition to its purposes under [cite section of the business corporation law on the purpose of business corporations] and subsection (a). The identification of a specific public benefit under this subsection does not limit the purpose of a benefit corporation to create general public benefit under subsection (a).

(c) Effect of purposes. – The creation of general public benefit and specific public benefit under subsections (a) and (b) is in the best interests of the benefit corporation.

Section 301 of Benefit Corporation Model Statute

Standard of conduct for directors.

(a) Consideration of interests. – In discharging the duties of their respective positions and in considering the best interests of the benefit corporation, the board of directors, committees of the board, and individual directors of a benefit corporation:

(1) shall consider the effects of any action or inaction upon:

(i) the shareholders of the benefit corporation;

(ii) the employees and work force of the benefit corporation, its subsidiaries, and its suppliers;

(iii) the interests of customers as beneficiaries of the general public benefit or a specific public benefit purpose of the benefit corporation;

(iv) community and societal factors, including those of each community in which offices or facilities of the benefit corporation, its subsidiaries, or its suppliers are located;

(v) the local and global environment;

(vi) the short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the benefit corporation; and

(vii) the ability of the benefit corporation to accomplish its general public benefit purpose and any specific public benefit purpose; and

(2) may consider:

[(i) the interests referred to in [cite constituencies provision of the business corporation law if it refers to constituencies not listed above]; and

(ii)] other pertinent factors or the interests of any other group that they deem appropriate; but

(3) need not give priority to a particular interest or factor referred to in paragraph (1) or (2) over any other interest or factor unless the benefit corporation has stated in its articles of incorporation its intention to give priority to certain interests or factors related to the accomplishment of its general public benefit purpose or of a specific public benefit purpose identified in its articles.

APPENDIX B

Impact management: Good questions drive good business

Sample questions from the B Impact Assessment

WORKER IMPACT

Is an hourly living wage paid to all full-time, part-time and temporary workers and independent contractors?

Does the company offer, whenever feasible, in writing and in practice:

- Parental leave
- Part-time or flex-time work schedules
- Telecommuting or job-sharing

What % of the Company is owned by full time workers (excluding founders/executives)?

COMMUNITY IMPACT

What % of management and suppliers are from underrepresented populations? (e.g. women, people of color, people with disabilities, and/or individuals living in low-income communities)

What % of materials or products purchased from Significant Suppliers have third-party social or environmental certification or approval?

Are employees given paid time off to volunteer in their communities?

ENVIRONMENTAL IMPACT

What % of energy is used from renewable sources at your corporate facilities?

By what % have your greenhouse gas emissions been reduced on a per unit basis over the last fiscal year?

Does the Company monitor, record and set targets to reduce universal waste production?

GOVERNANCE

Has the Company adopted an impact governance structure?

What portion of Company management is evaluated in writing with regard to social and environmental performance targets?

Has the Company worked to develop social and environmental standards for your industry?

APPENDIX C

Difference between Certified B Corporations and benefit corporations

Issue	Certified B Corporations	Benefit corporations
Accountability	Directors required to consider impact on all stakeholders	Same
Transparency	Must publish public report of overall social and environmental performance assessed against a third party standard	Same*
Performance	Must achieve minimum verified score on B Impact Assessment. Recertification required every two years against evolving standard.	Self-reported
Availability	Available to every business regardless of corporate structure, state, or county of incorporation.	Available for corporations only in 30 U.S. states and D.C.**
Cost	B Lab certification free from $500 to $50,000/year, based on revenues	State filing fees from $70-$200
Role of B Lab	Certifying body and supporting 501(c)3, offering access to certified B Corporation logo, portfolio of services, and vibrant community of practice among B Corps.	Developed model legislation, works for its passage and use, offers free reporting tool to meet transparency requirement: No role in oversight

* Delaware benefit corps are not required to report publicly or against a third party standard
** Oregon and Maryland offer benefit LLC options

GOVERNANCE STUDIES

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