Silicon Flatirons

A Center for Law, Technology, and Entrepreneurship at the University of Colorado

*Roundtable Series on Entrepreneurship, Innovation, and Public Policy**

Encouraging Social Impact Through Private and Public Sector Leadership

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I. Introduction

The social impact space is changing and growing rapidly. There is an increasing demand from global consumers for products and services provided by companies committed to positive social and environmental impact.[1] In response, there are a growing number of companies seeking to meet this demand, as well as an increased investment interest in these spaces. For example, JP Morgan reported that last year, 146 of the world's largest impact investors reported $10.6 billion in commitments to impact investments, with plans to commit 16% more in 2015.[2]

Responding to the consumer interest in companies committed to a positive social impact, there are a number of emerging legal and policy issues. Consider, for example the rise of new corporate forms available to social entrepreneurs, such as benefit corporations,[3] flexible purpose corporations,[4] and L3Cs.[5] Notably, last year, Delaware—home to more than half of America's publicly traded businesses— joined 19 other states as it enacted benefit corporation legislation into law. As companies adopt these new corporate forms, many also have chosen to become B Corps as certified by B Lab. As of May 2015, 1,297 companies, including public companies such as Etsy and Natura, in 41 countries have become B Corps.[6] New social enterprise business models and vehicles, such as social impact bonds, are also emerging.

The implications of this movement remain open to debate. Some commentators argue that social and environmental responsibility simply responds to market demand and is simply good business, meaning that no new form is necessarily and the creation of special rules for so-called "social impact" is a recipe for mischief. In terms of implementing benefit corporation laws, a crucial question remains of whether, when, and why a for-profit entity can prioritize goals other than maximizing shareholder returns, particularly when achieving social objectives are difficult to measure.

On May 7, 2015, leaders in impact investing, social entrepreneurship, and academia came together for a roundtable discussion organized by the Silicon Flatirons Center for Law, Technology and Entrepreneurship. The participants in that discussion are listed in Appendix A.

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[1] Fifty-five percent of global online consumers across 60 countries say they are willing to pay more for products and services provided by companies that are committed to positive social and environmental impact, according to a new study by Nielsen. http://www.nielsen.com/us/en/press-room/2014/global-consumers-are-willing-to-put-their-money-where-their-heart-is.html

[2] *Eyes on the Horizon: The Impact Investor Survey*, May 2015. http://www.thegiin.org/cgi-bin/iowa/resources/research/662.html

[3] A type of for-profit corporate entity, legislated in 28 U.S. states, that includes positive impact on society and the environment in addition to profit as its legally defined goals.

[4] Also known as social purpose corporations, a type of for-profit entity in some U.S. states that enables corporations to consider social or environmental issues in decision making instead of relying only on profit-maximizing goals.

[5] A for-profit, social enterprise venture that has a stated goal of performing a socially beneficial purpose, not maximizing income. It is a hybrid structure that combines the legal and tax flexibility of a traditional LLC, the social benefits of a nonprofit organization, and the branding and market positioning advantages of a social enterprise. The L3C is obligated to be mission-driven so there is a clear order of priorities for its fiduciaries.

[6] https://www.bcorporation.net/community/find-a-b-corp

The discussion, which followed the Chatham House Rule, explored the emerging legal and policy issues in the social impact space. This report highlights the key areas of discussion.

II. B Lab Certification

Currently, a range of companies are opting to be certified as B Corps by B Lab.[7] Nonetheless, the relative value and necessity of certification remains open to debate, mirroring the debate noted above with regard to alternative statutory corporate forms. The certification option is approaching its tenth anniversary (it dates back to 2006); the statutory corporate forms, however, are relatively new, vary by state, and are less tested.[8]

Many proponents of certification assert that certification provides a valuable signaling mechanism to future clients, consumers, and employees. Moye White, a B Lab Certified law firm in Denver, chose to become certified to attract a different kind of client, says Moye White Partner Trish Rogers. Rogers argued that B Lab certification has been an important differentiator and has brought in clients and employees who share their values. This, she believes, ultimately will lead to increased profitability. On the attracting employees front, the value of certification is not a hypothetical. Jonathan Milgrom, a 2015 Colorado Law graduate, praised Moye White's decision to become a B Corp, explained that the certification signaled to him that Moye White shared his values, and was one aspect that attracted him to the firm (where he will start this fall as an associate).

Certification also provides a structure and accountability mechanism that otherwise is lacking in this space, said Andrew Kassoy, one of B Lab's Founders. Kassoy explained that B Lab provides valuable infrastructure and guidance to firms committed to making a social impact. Kassoy went on to highlight that since its founding, B Lab has strived to provide this infrastructure by helping consumers differentiate between good companies and good marketing. In particular, B Lab offers a mechanism for shareholders of companies who purport to have both a profit and socially oriented purpose to assess if and how their firms are actually meeting the social objectives. In that sense, B Lab seeks to replicate the role played by LEED Certification, which provides guidance for what constitutes a "green building."

[7] B Lab certifies companies as B Corps, if they meet certain social and environmental standards. Become a certified B Corp is distinct from incorporating as a B Corporation under a particular state's statutes. Different states have a variety of statutory schemes. However, most statutes – including many traditional corporate statutes – generally allow companies to pursue social goals along with maximizing shareholder value. Companies can be both B Lab certified and incorporated as a B Corp, be one or the other, or neither.

[8] Though businesses with an eye towards social impact have a variety of corporate structures and tools at their disposal, this Roundtable focused on B Lab given its tenure in the space, the nature of the ongoing debate, and the composition of Roundtable attendees. This focus does not serve as an endorsement of the model, but only reflects the nature of the conversation of the Roundtable.

The relevance and need for certification may change as the regulatory space changes. Stephanie Gripne, Executive Director of the Impact Finance Center at the University of Denver, suggested that certification has catalyzed much of the social enterprise movement, but ultimately may struggle to keep up with regulatory and social changes. She turned the LEED Certification example around to note that this certification program risks being eclipsed as local government regulations (such as those in Boulder, Colorado) demand more than the LEED Certification requires. B Lab's Kassoy agreed that, in an ideal world, certification would not be required because the necessary capital market demand and legal infrastructure would allow every business to have a social impact. However, in the meantime, B Lab strives to stay ahead of the market by constantly tweaking its requirements to always be a "gold standard." He noted that, as of now, certification continues to stay ahead of regulations.

Others argued that the availability of certification may undermine the goals of the social impact movement. For example, Steve Bachar, Co-founder of Empowerment Capital Management, posited that the availability of certification signals to the market that socially oriented businesses function outside of the normal rules of capitalism. Others have pointed out that certification reinforces the idea that companies must make compromises between social concerns and profit, which he says is often a false tradeoff. These concerns may explain why some companies choose not to become certified despite their social orientation. For example, the Colorado Impact Fund, a private equity fund supporting local companies with a social or environmental impact, is not a B Corp. Carly Abrahamson, Principal and General Counsel at the Colorado Impact Fund, echoed Bachar when she explained that Colorado Impact Found chose not to become certified because they wanted to show social good can be achieved with private equity-appropriate returns and traditional structure and approach.

An open question is whether certification results in smaller returns (along with the associated social responsibility). Some argue that the required focus on social or environmental returns and the capital outlay required to become and remain certified minimizes profit. Participants agreed that certification requires at least an initial increase in costs, but disagreed as to whether the costs pay off in the end. Some participants highlighted the resource constraints of some companies prevents them from becoming B Corps in the first place noting that they would rather put their resources into making their company better and did not have time for certification. However, Rogers of Moye White believes the initial investment will generate increased profit in the end. She says that, though there are some upfront costs, these expenditures increase employee retention as well as sales.

Beyond concerns with whether the initial investment pays off, debate remains on the long-term profitability impact of certification. For some larger institutions such as banks a focus on social returns may not comport with client's goals and may distract from profit generation.

Many may see their responsibility as needing to maintain and grow the savings and investments of their clients, many of whom may be pensioners focused on maximizing returns to their retirement savings. This responsibility often requires that they single-mindedly pursue financial profit. David Haynes, Managing Director of Greenmont Capital Partners, on the other hand, believes that looking beyond financial profit ultimately increases financial returns; many consumers want to know the impact of the products or investments they are buying.

An interesting dimension of this discussion is that consumer segments may well have differing purchasing and investment priorities. Millennials, more than any other generation, are increasingly focused on the social aspect of their financial decisions. As David Brooks pointed out, "Today more people want to blend these minds. Typically a big client, or a young heir, will go to his or her investments adviser and say, "I want some socially useful investments in my portfolio." If the adviser has nothing on offer, the client leaves the firm."[9] Companies serving this generation may see increased profitability from prioritizing social and financial returns, while companies serving older generations may not.

Ultimately, there is agreement that the social enterprise and impact investing industry is growing quickly. As Monisha Merchant, Managing Director of Lotus Advisory said, the industry no doubt benefits from policies and standards such as B Lab Certification. As Jed Emerson, Senior Advisor for Gary Community Investments noted, the industry is still in a transitional, early stage, and therefore requires certification among other support mechanisms. However, the point at which certification may fail to stay relevant as policy changes gain momentum will likely remain a lively source of debate.

III. Measuring Impact

With the rise of alternative corporate forms, organizations such as B Lab, and the focus on social responsibility generally, there is frequent conversation about what metrics should be used to measure the impact organizations are purporting to make. Ultimately, there is broad agreement that metrics on a whole make the social impact space meaningful because, without metrics, impact would simply be a marketing tool. The example was raised that currently it is often hard to tell if an advertisement is for a socially conscious company like Whole Foods or for BP. Thus, what the company actually does and the impact they actually have requires quantifiable metrics.

Taking exception with the call for metrics, Emerson suggested that there may be an overemphasis on metrics in the social impact space. He explained that, in reality, the financial

[9] David Brooks, *How to Make a Mark*, January 2015, http://www.nytimes.com/2015/01/27/opinion/david-brooks-how-to-leave-a-mark.html?_r=1.

decisions of any company, particularly in investing, are never based entirely on metrics. These decisions involve leaps of faith. He emphasized that conversations about metrics in businesses focused on social impact must be placed in this context. Ultimately, he suggested that metrics are simply ways for a company to demonstrate both that it is taking social impact into account and that running a business in a socially-minded way is just better business. Research suggests, however, that measuring social impact is helping businesses be more effective because considering impact often leads to increased profit in the long term.[10] To be sure, if impact does lead to more profit, it becomes harder to make the case that these positive externalities need to be rewarded through any special regulatory or legal treatment.

With the rise of alternative legal structures, such as statutes authorizing "public benefit corporations" (Colorado and Delaware) and "benefit corporations" (elsewhere) which hardwire social objectives into the firm's purposes and corporate governance, the question arises as to whether courts will invoke metrics in derivative suits against corporations that availed themselves of these alternative structures. Dean Weiser commented that this is possible because the authorizing statutes provide additional protection to directors, so therefore it is likely that if directors want to invoke that protection, courts may require directors to prove they are making an impact. However, Professor Mark Lowenstein of Colorado Law disagreed. He noted that the law is already deferential to directors under the business judgment rule, and the statutes simply provide additional protection if directors are acting in good faith. Dean Weiser brought up the research of Herrick Lidstone, who believes that as socially minded companies get bigger, they likely will face scrutiny and have to substantiate their focus on impact.[11]

There are many available metric systems that courts and organizations could use to evaluate impact. B Lab, for example, uses a 200-point system to determine which companies earn the certification. They have a detailed assessment that each company completes, which attempts to measure objectively a company's impact. Other organizations may use a combination of tools, including IRIS, PULSE, and GIIRS, to measure their impact.[12] Some organizations, such as Gary Community Advisors, use different metrics based on the preference of a particular investor. Governments who have adopted a social impact bond scheme often measure impact by estimating the amount of money a program is saving the government.

[10] Nielsen research shows that there was an average annual sales increase of two percent for products with sustainability claims on the packaging and a lift of five percent for products that promoted sustainability actions through marketing programs in comparisons to products that did neither. http://www.nielsen.com/us/en/press-room/2014/global-consumers-are-willing-to-put-their-money-where-their-heart-is.html.

[11] *See* Herrick K. Lidstone, Jr., The Long and Winding Road to Public Benefit Corporations in Colorado, Colo. Law., January 2014.

[12] "IRIS serves as the taxonomy, or set of terms with standardized definitions, that governs the way companies, investors, and others define their social and environmental performance. PULSE is a portfolio management tool, administered by Application Experts, and is widely available to clients and comes pre-loaded with IRIS metrics. GIIRS is an impact ratings tool and analytics platform that assesses companies and funds on the basis of their social and environmental performance. It is based on IRIS definitions, and generates data that feed industry benchmark reports." http://www.ssireview.org/blog/entry/impact_investings_three_measurement_tools.

With so many available options, it can be challenging to choose an appropriate metric framework. However, Erik Gerding argued that for laws and policies to promote socially responsible business or investing, policymakers must have a way of determining what constitutes a social impact and then measuring that impact. Emerson noted, however, that because social enterprise and impact investing are so new, it remains unsettled as to which metrics are important. Ultimately, different programs and policies will likely choose different options, and time will tell which perspective provides the clearest picture of actual impact.

IV. Impact Investing Policy Initiatives

Impact investing is a fast growing sector and often results in promising returns. Governments around the world are experimenting with policy initiatives that continue to spur growth of this space. One policy discussed was Program Related Investments (PRIs)—investments made by foundations to support charitable activities that involve the potential return of capital within an established time frame.[13] PRIs are underutilized by foundations, although it is unclear precisely why this is the case. Gripne suggested that they are underutilized in part because foundations and individuals have not been introduced to the concept, educated on how to use them, nor connected to intermediary resources to help them effectively used the structure. Dean Weiser also pointed out that the tax policy around PRIs is not as clear as it could be. The 2014 report issued by US National Advisory Board on Impact Investing argues that the IRS should "provide greater clarity to its definition of charitable purpose in order to provide greater comfort to foundations seeking to address new or emerging challenges."[14]

Social impact bonds (SIBs) represent another policy tool increasingly used by states and local governments to mobilize private capital to fund, and non-profits to implement social programs that state and local governments are increasingly struggling to afford. Paul Tosetti, Chief Financial Officer of Nurse Family Partnership, explained that SIBs provide a way for the government to transfer the costs and risks associated with social issues that they otherwise cannot afford to address. Governments, in his view, buy outcomes, and the SIB model allows them to only pay if their preferred outcome is realized. Nurse Family Partnership provides an example of an organization that is a good candidate to receive SIBs here in Colorado. Nurse Family Partnership is a maternal and early childhood health program that fosters long-term success for first-time mothers, their babies, and society. Tosetti described how the program is a ripe candidate for SIB's because it is evidence-based and can provide certain metrics to justify its

[13]http://grantspace.org/tools/knowledge-base/Grantmakers/pris
[14] US National Advisory Board on Impact Investing, Private Capital, Public Good: How Smart Federal Policy Can Galvanize Impact Investing and Why It's Urgent (2014).

programs. For example, the Partnership has statistics that can show that women in its program have fewer premature births than those not in this program. This has a direct dollar impact on the amount Medicaid needs to spend for maternal and pediatric care. If a SIB program uses a decrease in Medicaid expenditures as the preferred outcome, Nurse Family Partnerships could apply for the SIB dollars. However, Rebecca Jackson, Independent Consultant & Coach, noted that, there is a risk that in tying SIBs to specific outcomes as correlation is not necessarily causation, and multiple causal factors may contribute to an outcome. The metric chosen (such as reduced premature births) is simply one potential cause of the outcome, and an assumption is made that this particular outcome saves money. There are often also many different possible causal factors that contribute to the outcome.

There is no doubt that these current policy initiatives will continue to evolve and new policies will develop as governments and consumers' interest in meaningful social impact grows. Critical conversations amongst industry leaders remain important in order that these policies best address important social causes while also meeting the political and popular demands.

APPENDIX A

Carly Abrahamson - Colorado Impact Fund, Principal and General Counsel

Steve Bachar - Moye White LLP, Attorney; Empowerment Capital Management, Co-Founder

Jill Dupre - ATLAS, Associate Director

Jed Emerson - Colorado Impact Fund; Gary Community Investments; Community Funds, Senior Advisor

Erik Gerding - Colorado Law, Associate Professor

Stephanie Gripne - University of Denver, Impact Finance Center, Executive Director and Founder

Andrea Guendelman - Colorado Law, Adjunct Professor

David Haynes - Greenmont Capital Partners, Managing Director

Rebecca Jackson - Independent Consultant & Coach

Andrew Kassoy - B Lab, Founder

Shalyn Kettering - Colorado Law, Student

Shannon Liston - Colorado Law, Student

Mark Loewenstein - Colorado Law, Professor and Associate Dean for Faculty Development

Monisha Merchant - Lotus Advisory Ltd., Managing Director

Jonathan Milgrom - Colorado Law, Student

Amber Nystrom - Social Fusion, Founder; Colorado B Corp Leadership Council, Member

Trish Rogers - Moye White, Vice-Chair – Business Section

Ashton Seip - Colorado Law, Student

Nancy Stevens - First Western Trust, Chairman - Boulder

Paul Tosetti - Nurse-Family Partnership, Chief Financial Officer

Adrian Tuck - Tendril, Chief Executive Officer

Phil Weiser - Colorado Law, Dean; Silicon Flatirons Center, Executive Director

Stephanie Wilson - Angels ROAR & World Impact Investing Institute, Founder