Does business structure influence social impact?

Early insights and practical implications for donor agencies

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Donors are engaging directly with the private sector, as partners in development. This represents a major shift in mode of operation, relative to the more traditional, bilateral model. One particular area of interest is how business form, governance and ownership influence social outcomes, a theme that has not received much attention until now.

This Briefing Note explores why form, governance and ownership matter, and reviews the evidence that they can influence outcomes for the poor. It is intended to support donors in enhancing the impact of future programming choices, when engaging with business. It is based on research and practical examples from both developed and developing countries, and is a joint initiative of Oxfam and DCED.

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Introductory remarks

Donors are increasingly engaging directly with the private sector, as partners in development. This Briefing Note explores why and how business form, governance and ownership may influence outcomes for the poor.

There are significant lessons to be drawn from the experience and evidence around business structures in developed countries. Much of this Briefing Note therefore draws from evidence in developed economies, with the aim of informing approaches to private sector development in developing countries. Additionally, donor partnerships with multinational companies can be shaped more effectively if they take into regard the structure of those companies and their supply chains

This joint DCED-Oxfam Note complements another DCED Paper, which explores how business environment reform can support 'inclusive business' - meaning those businesses that enable the poor to access jobs, higher incomes or better services. The literature on inclusive business often recommends that new legal forms or accreditation systems are created, to promote and support inclusive business.

This is a discussion paper, intended to provoke reflection and debate, and does not represent Oxfam policy positions.

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Why business structures are important to development

> "I am utterly convinced that our future depends on our ability to explore and invent new businesses and new types of enterprise."
> *Franck Roboud, CEO of Groupe Danone*

Businesses are diverse in the way they are owned and governed; that diversity matters for development. While profitability is one important determinant of benefits for employees and suppliers, there are also likely to be trades-off between a pure profit maximisation focus and social objectives. This is where the business structure can play a critical role. It determines which stakeholder has power over key decisions when there are trades-off between stakeholder interests. It is likely to influence the mission of the business, and the balance struck in practice between profit maximisation and broader social goals, the timescale for taking those profits, and how profits are distributed. Some business structures lend themselves to balancing different interests, while others may limit the ability of managers to shape decisions in favour of social goals.

The legal form, ownership structure and whether shares are publicly traded can also drive the kinds of requirements and regulations that apply to a business. For instance, tax policies can apply differently, and sustainability and financial reporting requirements can vary depending on structure, with companies listed on stock exchanges typically required to report more comprehensively.[1]

There are other factors that influence the way that businesses behave – such as leadership, culture, regulatory frameworks and public opinion. This Brief, however, only focuses on the specific role of business structure and governance. This is critical to enable informed programming choices by development practitioners in Private Sector Development.

Potential risks in promoting the traditional corporate structure

In the developed world, the ability of traditional, for-profit companies to share value with workers, farmers and communities has recently changed dramatically. Shareholders now expect much larger dividends; in the 1970s, for example, UK companies paid about 10% of their profits in dividends. That has increased to about 70% today, and this trend is mirrored across many developed economies.[2] This means that companies now invest correspondingly less of their profits in business expansion, hindering growth - as noted by Andrew Haldane, the Chief Economist at the Bank of England. According to Haldane, companies are now net savers, not net investors. A survey of chief financial officers of listed companies in 2006 found that 78% would destroy economic value to meet earnings targets.[3]

Oxfam's work with several companies has shown that a focus on short-term profits can also penalise suppliers, for example by pitting procurement objectives (including low prices) with sustainability objectives (particularly improving wages for workers). Oxfam's recent work with Unilever in its operations and supply chain in Vietnam highlighted that despite strong commitments by Unilever to improve working standards, there remained a significant tension between commercial and labour requirements for suppliers.[4] Indeed, the share of value going to farmers and workers has declined sharply globally. For example, cocoa farmers received 18% of the value of a chocolate bar in the 1980s; today, however, they receive below 6%. Overall, the decreasing returns to labour and increasing returns to capital have been

[1] http://www.sseinitiative.org/wp-content/uploads/2016/05/Carrots-Sticks-2016.pdf
[2] The Purpose of the Corporation Project, 2016
[3] Graham et al, Financial Analysts Journal, November/December 2006, quoted in UK Business What's Wrong? What's Next? Tomorrow's Company 2016.
[4] https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/rr-unilever-vietnam-progress-challenges-040716-en.pdf

linked to increases in inequality that experts at the IMF[5], World Bank[6] and Bank of England[7] have all expressed concerns around. The structures of business may be a key driver for how value is shared and, consequently, whether inequality continues to grow.

Understanding the role of business structures in influencing management decisions -- such as wages paid to workers, prices paid to farmers and level of aggressiveness of tax avoidance -- could allow development practitioners to focus on the kinds of businesses that share more value with workers and farmers.

Categories of business structures and what we know about their social impact

Alternative structures of business have emerged that not only reinvest more into their business, but also benefit stakeholders other than shareholders. In order to explore these in more detail, we distinguish between: the statutory form; the internal governance; and ownership. Note that businesses can change their form, governance and ownership from time to time. Also, various hybrid forms are emerging; this Paper summarises the main, distinct categories for the sake of discussion.

Statutory form of a company

The statutory form of the company creates the parameters within which a company can operate, such as the definition of the duties of the directors. Examples of statutory form with varying emphasis on financial and social goals include:

- **Standard company form** (usually established through a Companies or Corporations Act), usually to prioritise the maximisation of profit and returns to shareholders. Some jurisdictions allow for 'enlightened shareholder value maximisation'[8]: In the UK, for example, this happened through an expanded definition of 'shareholder value' in the 2006 UK Companies Act, which includes (a) a longer-term view of shareholder value, and (b) the need to 'have regard to' a range of other stakeholder interest. Similar legislation exists in some US States.[9] Still, the standard company form encourages prioritisation of shareholder financial interests, as boards are ultimately accountable to shareholders.
- **Benefit Corporation** is a hybrid structure originating in the US in 2010 but spreading globally. It shield directors from liability so they may find it easier to prioritise a social mission over short-term shareholder interest. There are no tax advantages to being a Benefit Corporation.[10]
- The **BCorp certification** is a distinct service, available for businesses in jurisdictions where the form of Benefit Corporation is not available. This certification involves a score based on a 'B Impact Assessment', administered by B Labs. It is similar to the Benefit Corporation, in that directors are required to consider the interests of all stakeholders, not just those of shareholders.[11]

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[5] http://www.imf.org/external/pubs/ft/fandd/2016/06/ostry.htm
[6] http://www.worldbank.org/en/publication/poverty-and-shared-prosperity
[7] https://www.theguardian.com/business/2016/feb/10/bank-of-englands-recovery-policies-inequality-standard-and-poors
[8] Taylor, PN: Enlightened Shareholder Value and the Companies Act 2006. Birkbeck College PhD Thesis, 2010
[9] Underberg, M: Benefit Corporations vs. "Regular" Corporations: A Harmful Dichotomy. Harvard Law School Forum on Corporate Government and Financial Regulation, 2012.
[10] http://benefitcorp.net/faq
[11] See https://benefitcorp.net/businesses/benefit-corporations-and-certified-b-corps for more information on the differences between the two.

- **Other forms** that prioritise social benefit. Examples include Community Contribution Companies (3C, in Canada), Community Interest Company (CIC, in the UK) and Low-profit Limited Liability Company (L3C, in the US). These are sometimes referred to generically as social enterprises[12]. The South Korean Social Enterprise Promotion Act of 2007 also defines and legitimises businesses promoting a social mission.[13] Expanding the identification of businesses pursuing a social mission is on the agenda for the G20 meeting in China in 2016.[14] Businesses that demonstrate they are structured to prioritise a social mission (social enterprises) can get favourable tax treatment in multiple jurisdictions (e.g. UK[15] and Thailand[16]).
- **Cooperatives** are owned and run by their members, rather than by outside investors[17]. Members are often stakeholders, such as customers, employees, producers, community members, or service providers. Cooperatives have a specific statutory form in some countries (e.g. Finland, UK, Australia) but elsewhere may take the form of a standard company.

Some B-Corps have expanded reporting requirements, informing shareholders annually about whether it is achieving its stated purpose. While expanded reporting requirements might be a drawback for business,[18] it may be an asset for donors interesting in working with them.

Critics argue that the primary rationale for alternative statutory forms rests on the mistaken premise that existing law prevents boards of directors from considering the impact of corporate decisions on other stakeholders, the environment or society at large. According to them, there are no legal restrictions on directors' ability to consider the interests of other stakeholders, including the groups listed in the B Corp statutes, for the vast majority of corporate decisions. As such, corporate decision-making is seen largely as a function of corporate choice rather than corporate law.[19]

Similarly, some argue that the B Corp movement has not effectively engaged with existing standards on human rights. In particular, it has not addressed the potential contradiction between unlimited scaling - a key goal of B Corps - and the ability of large multinational corporations to respect human rights.[20]

Multi-stakeholder cooperative models also aim to balance the interests of various stakeholders, such as consumers and workers. These typically structure the governance to ensure that the interests of workers and consumers, or producers and buyers are balanced in key decisions, including on how profits are used. The Wisconsin Producers and Buyers Cooperative, Eroski in Spain, East Carolina Organics and the emerging structure of the Go-op train cooperative[21] are all examples of this model.

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[12] The term 'social enterprise' is used in a variety of ways. Depending on the jurisdiction, it may refer to a for-profit statutory form incorporating a social mission, a non-profit statutory form that still earns some or all of its revenue, or a statutory form where a for-profit statutory form is associated with a non-profit statutory form by way of ownership, contracts or donations (Haigh, Dowin Kennedy and Walker, 2015)

[13]Lyons, T: Social Entrepreneurship: How Businesses Can Transform Society, Volume 1, 2013,ABC-CLIO

[14] http://www.g20inclusivebusiness.org

[15] https://www.gov.uk/government/publications/social-investment-tax-relief-factsheet/social-investment-tax-relief

[16] https://www.pioneerspost.com/business-school/20160616/building-social-economy-asia

[17] www.uk.coop/about/what-co-operative

[18] Bend and King: Why Consider a Benefit Corporation? Forbes, 2014.

[19] Underberg op. cit.

[20] Bauer and Umlas. Making Corporations Responsible: The Parallel Tracks of the B Corp Movement and the Business and Human Rights Movement. Social Science Research Network, 2015.

[21] http://www.go-op.coop

While the cooperative form has stood the test of time, there are also examples (including in the developing world) of cooperatives being ineffective[22], corrupted or politicised, resulting in poor outcomes for cooperative members and society more broadly.

Donors may note that business can change its statutory form. Research into 48 social enterprises in developed and developing countries found that half of the businesses included in the study had changed their statutory form in order to better fit the mission of the organisation, to raise capital and to increase their legitimacy with stakeholders[23].

Internal corporate governance

Businesses determine their structure through documents such as Company Constitution, Articles of Association or Memorandum of Association. These can determine the mission of the business and its internal governance. The form of governance of the company can determine who sits on the board (e.g. workers on boards can change how businesses decide), how key decisions are made (e.g. committees that decide remuneration of senior management, or the prices that enterprises pay to farmers they buy from), and more broadly, drive which stakeholders have more or less power over critical decisions.[24] The size, composition and influence of boards are also important factors influencing the governance of businesses.

Many social enterprises exist in countries where there are no specific legal forms for social enterprises. In such situations, they can be incorporated as standard companies, cooperatives, or as a non-profit or non-governmental organisation (NGO).[25] Yet, laws are appearing or being proposed in multiple jurisdictions (e.g. Vietnam, Philippines[26] and Thailand) that set out to define criteria for social enterprises that allow governments to support the growth of such enterprises (e.g. through tax breaks). Such laws typically look for specific internal governance characteristics in order to identify if an enterprise is mission-led.

One example of the importance of governance is again John Lewis' employee-owned business model. In fact, employees only 'own' a specific right to a minimal level of dividend, but they control managerial decision-making through an elaborate governance structure: Employees elect 80% of the 'John Lewis Partnership Council' which ultimately enables them to influence strategy as well operational decisions - or even to remove the Chairman. It is this governance arrangement, more than their property rights as shareholders, that provide employees with this power.[27]

Ownership models

Which stakeholders own the company usually drives who has power over key decisions, and who gets the profits. Cooperatives are one form of stakeholder ownership, already discussed above under statutory forms; they may be employee owned.

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[22] Mondal. Failure of the Cooperative Movement in India.

[23] N. Haigh, E. Dowin Kennedy, and J. Walker, "Hybrid Organizations as Shape-Shifters: Altering Legal Structure for Strategic Gain," California Management Review, 57/3 (Spring 2015).

[24] Mair, J., Mayer, J.m and Lutz, E (2015). Navigating Institutional Plurality: Organizational Governance in Hybrid Organizations in *Organization Studies* Vol. 36(6) pp713–739

[25] https://cdn.odi.org/media/documents/8877.pdf

[26] https://www.aidfi.org/documents/4/Social-Enterprise-Bill_HB-6085___1.pdf

[27] Paranque and Willmott. Cooperatives—saviours or gravediggers of capitalism? Critical performativity and the John Lewis Partnership. Organization Journal, 2016.

Employee-owned businesses, such as John Lewis, have become more numerous worldwide, particularly in the professional services, health and social care, retail and manufacturing sectors.[28] The form of ownership varies, covering shares owned in trust for workers, shares owned directly by employees, and sometimes a combination of both. Some sources suggest that employee-owned businesses outperform other forms of business on sales and employment growth[29], and have become the fastest growing form of business in the UK[30]. More broadly, academic studies on employee ownership also find that they generate more employment growth[31] and to significantly higher pay for their employees[32].

However, other research concluded that 'ownership by employees, individuals, and firms is associated with relatively poor corporate social policies of the firms they invest in. In contrast, the holdings by banks and institutional investors as well as those by the state appear to be neutral in this respect.'[33] Performance of employee-owned businesses is better when combined with employee participation. A 1987 study by Harvard Business Review[34] found that employment and sales grew 5% faster on average, considering all companies which had employee stock ownership plans (ESOPs). However, those that also featured employee participation in decision making grew three to four time faster than employee-owned companies that did not encourage participation.[35]

Farmer-owned businesses such as Divine Chocolate and Cafe Direct (which was co-founded by Oxfam in 1991) are structured to benefit the people who grow the cocoa and coffee. They do this by providing farmers with equity holdings, giving them representation on the board. The Kenyan Tea Development Agency is owned by 550,000 small-scale tea farmers with 66 tea processing factories; it enables farmers to receive over 75% of the final tea price.[36] Meanwhile, tea farmers in nearby Rwanda operating through more traditional business structures, only earn 25%.[37]

While employee-owned businesses may have many potential benefits, they are also subject to criticism. For example, employee-ownership models have struggled to attract capital, and have performed best only in certain sectors.[38] A critical assessment of John Lewis notes that, while the shareholder and worker interests are no longer inherently opposed, employee bonuses may function in a similar way to dividends paid to shareholders, as each encourages the generation of surplus in a manner that does not 'accommodate or fulfil other, non-financial objectives (e.g. sustainability).' [39]

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[28] http://employeeownership.co.uk/wp-content/uploads/Top-50-A6-Booklet.pdf

[29] Key Facts: Employee Ownership Top 50 2016, Employee Ownership Association

[30] Davie, Gary, Employee Ownership: Another way of doing business, HR Magazine, 2015

[31] Blasi, Joseph, Douglas Kruse, James Sesil, Maya Kroumova, and Ryan Weeden. 2000. Stock Options, Corporate Performance, and Organizational Change. Oakland, CA: National Center for Employee Ownership.

[32] Kardas, Peter; Adria L. Scharf; and Jim Keogh. 1998. "Wealth and Income Consequences of ESOPs and Employee Ownership: A Comparative Study from Washington State," Journal of Employee Ownership Law and Finance. Vol. 10, No. 4, Fall.

[33] Dam and Scholtens, Does Ownership Type Matter for Corporate Social Responsibility? Corporate Governance: An International Review, 2012.

[34] Rosen and Quarrey, Sept. 1987. How well is employee ownership working?

[35] Profit data were not used because they were not publicly available for some companies.

[36] Inclusive Business Case Study: Kenya Tea Development Agency Ltd. (KTDA). IFC 2014.

[37] www.gatsby.org.uk/africa/programmes/rwandan-tea-sector

[38] Key Facts: Employee Ownership Top 50 2016, Employee Ownership Association

[39] https://journals.sagepub.com/doi/abs/10.1177/1350508414537622

Conclusion and recommendations for donor agencies

In summary, business structure can influence the social impact of a company; some formats require or encourage more reporting on social issues, which donors may find helpful in their own processes. But there is no perfect structure, and each option has pitfalls. Even in opting to work with a particular business structure, it can be important to assess the particular history of a company.

For example, researchers have proposed that donors partnering with hybrid social enterprise should understand first the reasons that the owners or founders chose that form over others. They suggest that businesses whose initial statutory form was chosen for personal reasons (e.g. it fitted with the founder's values) were more likely to have a stable structure than those businesses where the statutory form was chosen for strategic reasons, such as ensuring the ability to raise capital or fit with the product.[40]

Meanwhile, many companies have taken steps to address a lack of value and low margins in their supply chains, to reduce risks of instability and lack of sustainability. There is a need for holistic research into how corporate structures, alongside other factors, influence the pursuit of sustainability objectives, in order to inform the design of effective donor strategies. Answering the following research areas could represent a useful starting point for future initiatives by the DCED and its members on this issue:

I. Collaborative research into understanding which business structures and other factors are most likely to encourage pro-poor business decisions; specifically:
   a. What causes some companies to operate in a sustainable and pro-poor manner with a traditional structure? This could include investigating structure-related drivers as well as other factors at play in companies which are regarded as sustainability leaders (e.g. Olam IKEA, Walmart).
   b. Why are some cooperatives seen as a clear success whereas others are considered to have failed in producing benefits for their members?

II. Based on the findings about key drivers, above, research what policies would encourage pro-poor business:
   a. How can economic governance and PSD policies be used to favour business structures that are the most pro-poor (if any) or to influence corporate decision-making in other ways (e.g. through tax policy, public procurement, credit guarantee facilities)?
   b. How can donors use partnerships with global companies to incentivise pro-poor business models in their supply chains?

[40] N. Haigh, E. Dowin Kennedy, and J. Walker, "Hybrid Organizations as Shape-Shifters: Altering Legal Structure for Strategic Gain," California Management Review, 57/3 (Spring 2015).