Purpose and Nonprofit Enterprise

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For insightful comments, we thank Debadatta Bose, Ryan Bubb, Jill Fisch, Jeff Gordon, Joe Grundfest, Oliver Hart, Jay Mitchell, Peter Molk, Michael Oswalt, Julianna Pillemer, Elizabeth Pollman, David Pozen, Eric Talley, Emily Winston, and participants in the Berkeley Law School Faculty Workshop, Columbia Law School Faculty Workshop, the Duke Law Faculty Workshop, the FGV Faculty Seminar, the HLS Corporate Law Policy Seminar, the NYU Law and Economics Workshop, and the Wayne State University Law School Baiardi Endowed Lectureship in Corporate Law. Thanks to Claire Addinquy, JiHoon Ko, Sean Deresh Larin, Ashley Pennington, Shaurir Ramanujan, Claire Song, David Dah-Wei Yih, and Virginia McDaniels for excellent research assistance.

Abstract

Nonprofit enterprise is responsible for a large share of economic activity across the globe. And yet, leading theories fail to explain why nonprofit business survives and even thrives across a vast number of industries, ranging from artificial intelligence to beer brewing, despite an absence of shareholder control. Indeed, as shareholder ownership and intervention rights have become the core component of successful corporate governance, this success is all the more surprising.

We offer a novel "purposeful enterprise" theory to explain the puzzling success of nonprofit enterprises. Drawing on research in behavioral economics and organizational science, we argue that organizational purpose can serve as a substitute for shareholder control and monitoring, by mitigating managerial agency costs and aligning employee incentives. Nonprofit enterprise may also promote value creation by improving the stability of the entity. Our theory clarifies why nonprofit businesses and other related purposeful enterprises have thrived in certain industries and not others. It also sheds light on fundamental debates in corporate law, including that of the corporation's purpose in society. In particular, it suggests that shareholder ownership and control is not the only means of addressing agency costs and improving organizational efficiency.

Keywords: Nonprofits, benefit corporations, corporate governance, openAI, corporate purpose, enterprise foundations, dual class companies

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Purpose and Nonprofit Enterprise

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Abstract

Nonprofit enterprise is responsible for a large share of economic activity across the globe. And yet, leading theories fail to explain why nonprofit business survives and even thrives across a vast number of industries, ranging from artificial intelligence to beer brewing, despite an absence of shareholder control. Indeed, as shareholder ownership and intervention rights have become the core component of successful corporate governance, this success is all the more surprising.

We offer a novel "purposeful enterprise" theory to explain the puzzling success of nonprofit enterprises. Drawing on research in behavioral economics and organizational science, we argue that organizational purpose can serve as a substitute for shareholder control and monitoring, by mitigating managerial agency costs and aligning employee incentives. Nonprofit enterprise may also promote value creation by improving the stability of the entity. Our theory clarifies why nonprofit businesses and other related purposeful enterprises have thrived in certain industries and not others. It also sheds light on fundamental debates in corporate law, including that of the corporation's purpose in society. In particular, it suggests that shareholder ownership and control is not the only means of addressing agency costs and improving organizational efficiency.

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INTRODUCTION

Anthropic—the artificial intelligence company that created Claude—was founded in 2021 by former OpenAI employees concerned about AI safety.[3] With purpose in mind, the founders chose an innovative governance structure: they formed Anthropic as a benefit corporation and gave control of the business to a charitable "long-term-benefit trust." The founders populated the trust with independent trustees with experience in "AI safety, national security, public policy, and social enterprise," all of whom were duty-bound to advance the company's purpose of "responsible development and maintenance of advanced AI for the long-term benefit of humanity."[4]

Anthropic is one of many modern examples of "nonprofit enterprise."[5] Nonprofit enterprise—which we define as a nonprofit (or related charitable organization such as a trust, foundation, or enterprise foundation) that generates revenue primarily through business operations—looks and feels like for-profit business. Nonprofit enterprises are typically managed by high-powered and highly compensated managers and are not primarily engaged in charitable causes. And yet, they are organized as, or primarily controlled by, nonprofits.

Danish beermaker Carlsberg is another example: it is controlled by a nonprofit foundation.[6] British newspaper *The Guardian* is organized similarly: it has only one shareholder, which is a nonprofit charity.[7] Luxury retail conglomerate Rolex is owned by a Swiss charitable trust[8] and iconic American candymaker Hershey is controlled by the Hershey Trust Company, which also manages the endowment of a private school for low-income children.[9] Taking a look beneath the hood of Swedish furniture giant IKEA reveals that within its labyrinthian corporate organization, it, too, is owned by a set of nonprofits.[10] Civica, the generic drug maker, is organized as a non-profit,[11] alongside AAA, the

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[3] Billy Perrigo, *Inside Anthropic, the AI Company Betting That Safety Can be a Winning Strategy,* TIME (May 30, 2024), https://time.com/6980000/anthropic/.

[4] *The Long-Term Benefit Trust,* ANTHROPIC, https://www.anthropic.com/news/the-long-term-benefit-trust (last visited Oct. 22, 2024).

[5] We include within the term "nonprofit enterprise" both enterprise foundations (in which a nonprofit owns and controls a for-profit subsidiary), as well as pure nonprofit business, because both entities use governance to ensure that the nonprofit (and specifically, its self-perpetuating board) controls the business. Of course, there are important differences between these two organizational forms that we discuss in Part II.C.

[6] *Pursuit of Perfection Since 1876,* THE CARLSBERG FOUNDATION, https://www.carlsberggroup.com/who-we-are/the-carlsberg-family/the-carlsberg-foundation/ (last visited Aug. 24, 2024) ("The Carlsberg Foundation still holds the controlling interest in Carlsberg A/S").

[7] *Guardian Media Group*, THE GUARDIAN, https://www.theguardian.com/about/organisation (last visited Aug. 25, 2024) ("Guardian Media Group has only one shareholder - The Scott Trust. The Trust forms part of a unique ownership structure for the Guardian that ensures editorial interests remain free of commercial pressures").

[8] Th*e Man Behind the Crown*, ROLEX, https://www.rolex.org/perpetual/the-man-behind-the-crown (last visited Aug 26, 2026).

[9] *Over 100 Years of Strength, Heritage, and Stability*. HERSHEY TRUST COMPANY, https://www.hersheytrust.com/ (last visited Aug. 26, 2024).

[10] *This is Inter IKEA Foundation*, INTER IKEA FOUNDATION, https://www.interikeafoundation.com/ (last visited Aug. 26, 2024).

[11] Civica, https://civicarx.org/ (last visited Sep. 18, 2024).

national motoring association that funds its activities via its roadside assistance business[12] and ProPublica, the investigative news organization.[13]

Why does nonprofit enterprise exist? Fifty years ago, Henry Hansmann proposed the leading economic theory: contract failure.[14] In certain industries—hospitals, nursing homes, and education, for example—consumers cannot easily evaluate or bargain with service producers. For example, consumers often find themselves seeking hospital services during an emergency, making it hard for them to shop around for the best deal. This contract failure is ameliorated when the producer organizes as a nonprofit: the nonprofit form assures the consumer that they are purchasing services from a business that cares about healthcare, for example, rather than one that is primarily motivated by generating profits for shareholders.[15]

Hansmann's elegant theory anchors an important literature on nonprofit enterprise.[16] And yet, in the years that followed Hansmann's article, it has become clear that contract failure is not the whole story. Today, nonprofit enterprise proliferates across a broad spectrum of industries, beyond those with severe consumer information asymmetries. Indeed, nonprofits successfully run clothing

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[12] AAA, About AAA, https://exchange.aaa.com/about-aaa/ (last visited Sep. 18, 2024).

[13] ProPublica, About Us, https://www.propublica.org/about/ (last visited Sep. 18, 2024).

[14] Henry Hansmann, *The Role of Nonprofit Enterprise,* 89 YALE L.J. 835 (1980). It is one of the most cited law review articles in history. Fred R. Shapiro & Michelle Pearse, *The Most-Cited Law Review Articles of All Time*, 110 MICH. L. REV. 1483, 1489, 1492 tbl.1 (2012). Note that a deep theoretical literature considers this question of why nonprofits exist. For example, some scholars posit that the nonprofit sector responds to deficiencies in the private market and government when providing collective goods (the "market failure" theory); scholars also contend that the government responds to the limits of the nonprofit sector by subsidizing it with grants and other funding (the "voluntary failure" theory). See, e.g., Burton Weisbrod, *Toward a Theory of the Voluntary Nonprofit Sector*; Lester A. Salamon, *Of Market Failure, Voluntary Failure, and Third-Party Government*, 16 NONPROFIT & VOLUNTARY SECTOR Q. 22 (1987). Our question is different: we consider why some businesses organize as nonprofits, and whether that business would be better run if it had shareholders. Indeed, given the central role that shareholders play in theories about corporate governance, this question is all the more interesting. Simply put, our article does not focus on differences between business nonprofits and donative nonprofits, and instead considers the choice between nonprofit enterprise vs. for-profit enterprise. As such, Hansmann's contract failure theory is our starting point—it explains how nonprofit business can offer a competitive advantage relative to for-profit business.

[15] *Id.* at 845, 866-67. Note that enterprise foundations in particular make up a sizeable amount of economic activity in Nordic countries. For example, in Denmark, roughly 1,400 enterprise foundations account for 5–10% of the economic activity, more than 70% of stock market capitalization and roughly 50% of Danish research and development. Likewise, in Germany, over 50% of stock market value comes from companies in which foundations are the majority shareholders. https://www.intersentiaonline.com/publication/enterprise-foundation-law-in-a-comparative-perspective/8

[16] *See, e.g.*, Brian Galle & David I. Walker, *Nonprofit Executive Pay as an Agency Problem: Evidence from U.S. Colleges and Universities*, 94 B.U. L. REV. 1881 (2014); M. Todd Henderson & Anup Malani, *Corporate Philanthropy and the Market for Altruism*, 109 COLUM. L. REV. 571, 576 (2009); James R. Hines Jr. et al., *The Attack on Nonprofit Status: A Charitable Assessment*, 108 MICH. L. REV. 1179 (2010); Robert A. Katz, *Can Principal-Agent Models Help Explain Charitable Gifts and Organizations?*, 2000 WIS. L. REV. 1; Jonathan Klick & Robert H. Sitkoff, *Agency Costs, Charitable Trusts, and Corporate Control: Evidence from Hershey's Kiss-off*, 108 COLUM. L. REV. 749 (2008); Anup Malani & Guy David, *Does Nonprofit Status Signal Quality?*, 37 J. LEGAL STUD. 551 (2008); Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017 (2007); Avner Ben-Ner, *Who Benefits from the Nonprofit Sector? Reforming Law and Public Policy Towards Nonprofit Organizations*, 104 YALE L.J. 731 (1994); Peter Molk & D. Sokol, *The Challenges of Nonprofit Governance*, 62 B.C. L. REV. 1497 (2021); Ira Mark Ellman, *Another Theory of Nonprofit Corporations*, 80 MICH. L. REV. 1000 (1982); Henry Hansmann & Steen Thomsen, *The Governance of Foundation-Owned Firms*, 13 J. LEGAL ANALYSIS 172 (2021); Steen Thomsen & Henry Hansmann, *The Performance of Foundation-Owned Companies* (2013)*,* available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2406055; *See also* Edward L. Glaeser & Andrei Shleifer, *Not-for-Profit Entrepreneurs*, 81 J. PUB. ECON. 99 (2001).

manufacturers,[17] insurance companies,[18] beer breweries,[19] candy manufacturers,[20] furniture makers,[21] and more[22]—that is, industries where consumers can easily evaluate goods and services. Moreover, changes in the information environment undermine the existence of contract failure in Hansmann's paradigmatic examples. Consider higher education. Hansmann theorized that parents sending their children to college might not be able to evaluate such a "complex and subtle service," preferring to rely on nonprofits as an indication of quality. Of course, modern college rankings and college advisory services offer detailed descriptions of colleges, and therefore, it is difficult to attribute the success of nonprofit colleges to contract failure alone.

This Article therefore offers a new "purposeful enterprise" theory to explain the existence and persistence of nonprofit enterprise. This theory posits that corporate purpose can play an important role in both the selection of the nonprofit form at the outset and the success of the entity over time. Our theory also explains how nonprofit enterprise can flourish despite departing substantially from "good governance" practices thought to be responsive to the central problem in corporate law and governance—that of managerial agency costs.

Agency costs are inherent in many business entities—when the owners of an entity are not the managers of the business, managers have an incentive to behave self-interestedly and to the detriment of the business.[23] A complex corporate governance machine has risen to combat agency costs in for-profit business, with shareholder monitoring and control at its core.[24] Through the power to elect directors, make shareholder proposals, and review books and records (among others rights), shareholder monitoring and control is thought to ameliorate managerial agency costs.

An enduring puzzle of the nonprofit form is that nonprofits are, by definition, entities without shareholders.[25] As such, they should suffer from pronounced agency costs.[26] Without shareholder monitoring, who will monitor management and ensure that they pursue the organization's mission and not extract undue private benefits?

And yet, nonprofit enterprises not only exist, but thrive. Certain industries—such as hospitals and higher education—are dominated by nonprofit businesses, which outcompete their for-profit

[17] *Who Owns Patagonia?*, PATAGONIA, https://www.patagonia.com/ownership/ (last visited Aug. 26, 2024).

[18] Det Norske Veritas, *The Foundation Det Norske Veritas assumes full ownership of DNV GL and remains committed to Maritime headquarters in Hamburg*, DNV: NEWS FROM DNV (Dec. 14, 2017), https://www.dnv.com/news/the-foundation-det-norske-veritas-assumes-full-ownership-of-dnv-gl-and-remains-committed-to-maritime-headquarters-in-hamburg-105746/(last visited Aug. 26, 2024).

[19] *Who owns Carlsberg?*, CARLSBERG, https://www.carlsberg.com/en-be/better-answers/who-owns-carlsberg/ (last visited Aug. 26, 2024).

[20] Press Release, Hershey Trust, History of Hershey Trust Company, https://www.hersheytrust.com/press-=]releases/History%20of%20Hershey%20Trust%20Company.pdf (last visited Aug. 25, 2024).

[21] *About Us*, IKEA, https://www.ikea.com/us/en/this-is-ikea/about-us/ (last visited Aug. 26, 2024).

[22] Erik Friesenhahn, *Nonprofits: a Look at National Trends in Establishment Size and Employment*, U.S. BUREAU OF LABOR STATISTICS: MONTHLY LABOR REVIEW (January 2024), https://doi.org/10.21916/mlr.2024.2 (last visited Aug. 26, 2024). Table A-3 (showing that nonprofits exist in the following industries: laundry services, repair and maintenance, waste management, retail trade, finance and insurance, construction, and wholesale trade).

[23] ADOLPH A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932) (coining the term "the separation of ownership and control").

[24] Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV 2563 (2021); see also Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 899-901 (2005).

[25] Seong J. Kim, *Hiding Behind the Corporate Veil: A Guide For Non-Profit Corporations With For-Profit Subsidiaries*, 5 HASTINGS BUS. L. J. 189, 205 (2009).

[26] Hansmann & Thomsen, *supra* note 16; Geoffrey Manne, *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227 (1999).

rivals.[27] Other industries, including technology,[28] retail trade,[29] and pharmaceuticals,[30] are seeing more and more productive activity conducted by nonprofits. What explains this expansion and success?

Our theory provides an answer. We argue that nonprofit enterprises can harness corporate purpose as a substitute for shareholder monitoring and intervention rights, mitigating agency costs in the process. In particular, we draw on insights from behavioral economics and organizational science to describe how an authentically communicated purpose can provide direction for management, serve as a powerful source of motivation across the organization, and empower stakeholders as enforcers. Indeed, because authenticity of purpose depends on the sacrifice of profits, nonprofits have a head start relative to for-profit enterprise because of their non-distribution constraint.[31] We further explain how purposeful enterprise can generate organizational efficiencies by increasing the resilience and stability of the organization over time, by eliminating an expensive stakeholder with powerful control rights that may undermine the organization's mission.

Moreover, our theory extends beyond nonprofits and sheds light on blended entities that pursue both purpose and profit, and particularly insulated benefit corporations, which cut off shareholder intervention rights using dual-class structuring and antitakeover provisions.[32] We show that these blended entities resemble nonprofit businesses when they use corporate governance to elevate purpose and cut off shareholder control.[33] In these ways, insulated benefit corporations offer similar advantages to enterprise foundations, which can use nonprofit ownership of a for-profit subsidiary to cut off shareholder intervention and elevate purpose.[34] Our purposeful enterprise theory sheds light on the success of each of these three entity types and helps us understand the tradeoffs presented by each form of social enterprise.

Although our theory explains why certain nonprofit enterprises may succeed over time and even outcompete for-profit competitors,[35] our analysis is largely descriptive. It does not suggest that all companies should become nonprofits or use purpose as a substitute for shareholder control—indeed, we suggest that calls for a mandatory corporate purpose[36] are misguided because they

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[27] Danielle Ofri, *Why Are Nonprofit Hospitals So Highly Profitable?*, THE NEW YORK TIMES (Feb. 20, 2020), https://www.nytimes.com/2020/02/20/opinion/nonprofit-hospitals.html (last visited Aug. 26, 2024); Friesenhahn, *Nonprofits: a Look at National Trends in Establishment Size and Employment*, *supra* note 22, at Table A-3 (showing that nonprofit hospitals and educational institutions are larger and employ more people than their for-profit counterparts).

[28] Notably, two of the largest artificial intelligence companies in the world have chosen to use an enterprise foundation structure. They join other household names like Mozilla and Wikipedia, who operate as pure nonprofits. See generally Joanna Glasner, *Nonprofit Tech Startups Are Neither Strange Nor Destined to Flame Out*, Crunchbase News (Nov. 22, 2023), https://news.crunchbase.com/startups/openai-nonprofit-tech-accelerators-yc-fast-forward/.

[29] Friesenhahn, *supra* note 22.

[30] Adetunji et al, *The Potential Role of The Nonprofit Pharmaceutical Industry in Addressing Shortages and Increasing Access to Essential Medicines and Low-Cost Medicines*, HHS: OFFICE OF THE ASSISTANT SEC'Y FOR PLANNING & EVALUATION (Jul. 8, 2024), https://aspe.hhs.gov/reports/potential-role-nonprofit-pharmaceutical-industry (last visited Aug. 26, 2024).

[31] See Part III.B, infra.

[32] Cf. Paul Miller & Andrew Gold, Fiduciary Governance, 57 William & Mary L. Rev. (discussing how benefit corporations "occupy a middle ground between a non-profit entity and the classic for-profit corporation").

[33] Of course, there are important differences as well. In particular, benefit corporations have shareholders, while nonprofits do not. We discuss these differences and how they affect our analysis throughout Part II and again in Part III.A.3.

[34] Nonprofits may use for-profit subsidiaries for non-purpose reasons as well, such as insulating themselves from liability or protecting their tax exemption. See, e.g., Jeffrey S. Tenenbaum, Forming and Operating Subsidiaries and Related Entities: Maximizing the Benefits and Minimizing the Risks.

[35] Hansmann & Thomsen, *supra* note 16; William H. Clark Jr. & Elizabeth K. Babson, *How Benefit Corporations Are Redefining the Purpose of Business Corporations*, 38 WM. MITCHELL L. REV. 817 (2012).

[36] COLIN MAYER, PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD (Oxford University Press, 2018), at 22, 24.

undermine the authenticity of purpose that is necessary to secure the benefits that we observe.[37] Instead, our theory helps us understand why purposeful enterprise has emerged and thrived in certain areas. In particular, our theory explains why companies ranging from artificial intelligence developers[38] to pasture-raised egg farmers[39] choose and succeed under a purposeful enterprise form.[40]

All in all, our purposeful enterprise theory represents an important development in how scholars and practitioners currently think about nonprofit and other purposeful enterprise. Specifically, it offers a serious critique of the economic disaggregation of purpose and profit. Common economic and legal understanding asserts that embracing a corporate purpose other than shareholder wealth maximization is inefficient and undermines profit incentives. Our analysis of nonprofit enterprise demonstrates that this assertion incorrect—corporate purpose may actually enhance profitability of certain organizations.

Our analysis also sheds light on fundamental debates in corporate law and governance, including that of a corporation's purpose in society. Conventional wisdom posits that corporations should be managed for the benefit of their shareholders, although advocates of alternative stakeholder governance theories have been gaining ground.[41] Shareholder primacy proponents have greeted this interest in stakeholderism with dismay, arguing that directing management pursue a purpose other than profit will undermine discipline and lead to runaway agency costs, to the detriment of all.[42] Our analysis of nonprofit enterprise shows a different picture in many places—not one of rampant organizational inefficiency, but prolonged economic success.[43] As such, our analysis provides an important counterweight to scholars that contend that accountability to shareholders is the only or best way to respond to agency costs and promote efficient business.[44]

We further provide practical guidance for entrepreneurs that wish to engage in purposeful enterprise. We describe how founders can elevate purpose and use it to provide discipline for motivation across the organization. Although we recognize that not all companies will be able to secure the benefits of purposeful enterprise, certain firms—and dual-class firms in particular—could potentially benefit from using purpose to respond to agency cost problems created by the governance structure, improving ongoing efficiency and profitability.

The remainder of this article proceeds as follows. Part I begins with an overview of the existing literature on the nonprofit business form. It focuses on Hansmann's pathbreaking contract failure theory—the leading economic explanation for the existence of nonprofit enterprise. Although this lens helps explain an important advantage of nonprofit enterprise, we show that it is imperfectly

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37 *See* Part III.B, infra.
38 *OpenAI LP*, OPENAI.COM, https://openai.com/index/openai-lp/ (last visited Aug. 26, 2024); *Company,* ANTHROPIC, https://www.anthropic.com/company (last visited Aug. 26, 2024).
39 *About Us,* VITAL FARMS, https://vitalfarms.com/about-us/ (last visited Aug. 26, 2024).
40 *See* Part II.C.
41 Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91 (2020); Cathy Hwang & Yaron Nili, *Shareholder-Driven Stakeholderism*, U. CHI. L. REV. ONLINE, Apr. 2020, at 3–4.
42 *Id.*
43 Susan Rose-Ackerman, *Altruism, Nonprofits, and Economic Theory*, 34 J. ECON. LITERATURE, 701 (1996) (summarizing a number of empirical studies on cost and quality differentials); Ofri, *supra* note 27; Hansmann & Thomsen, *supra* note 16 (showing the sustained profitability of enterprise foundations).
44 Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767 (2017) ("Many scholars—we refer to them as *agency-cost essentialists*—treat the reduction of agency costs as the essential function of corporate law and of related fields such as securities regulation. To reduce agency costs, the essentialists would mandate corporate-governance arrangements, such as proxy access, that allocate more control rights to shareholders. And they would ban arrangements that disempower shareholders, such as staggered boards").

explanatory. Part II introduces and elucidates our theory of purposeful enterprise. This Part centers on two major claims. First, by elevating corporate purpose, the business can mitigate agency problems by motivating management and lower-level employees, providing direction and promoting stakeholder enforcement. Second, the nonprofit form can create business value by eliminating an expensive stakeholder that can redirect the entity's mission over time. Importantly, this Part also explains that our theory is not universally applicable. Some businesses would benefit from a purposeful form of business, while others would not. Instead of offering a normative account, we conclude by explaining which types of business might be a good fit for purposeful enterprise. We further show how our theory has descriptive purchase over the types of businesses that have become nonprofits and related purposeful businesses. Part III then turns to implications for theory and practice, including implications for the ongoing debate about corporate purpose.

I. THE PUZZLE OF NONPROFIT ENTERPRISE

This Part first defines nonprofits, as well as our subcategory of interest—nonprofit enterprise. It then discusses existing theories about why nonprofit enterprise survives—and in some cases proliferates—despite a lack of shareholders. The leading theory of nonprofit enterprise, for instance, posits that such businesses exist where arms-length bargaining between consumers and businesses fails due to information asymmetries. But many nonprofit businesses exist outside of those circumstances, presenting a puzzle that we address in the next Part.

A. Nonprofit Enterprise

This Section defines nonprofits and their critical attributes, highlighting the potential for managerial agency costs. We then turn to nonprofit enterprise, which we define as nonprofits that primarily derive their revenues from business operations, rather than donations.

1. Nonprofits

In the United States, there are approximately 1.5 million "nonprofits": a big-tent category that includes nonprofit organizations like the Humane Society of the United States and the American Red Cross, as well as many universities, religious organizations, charities, social clubs, and more.[45] But while many organizations call themselves nonprofits, there is a great deal of diversity within that name. Some of the organizations in that grouping are legally formed—at the outset—under various state nonprofit incorporation statutes. In Virginia, for example, one can incorporate a "non-stock corporation," which the Commonwealth of Virginia notes is usually "formed for non-profit purposes, such as clubs, rescue squads, and religious and charitable organizations."[46] Others might use the nonprofit moniker to mean that they have received tax-exempt status from the Internal Revenue Service and state-level tax authorities.[47]

A few common threads run through all nonprofits, however. First, nonprofits are, at their core, entities that are "barred from distributing [their] net earnings, if any, to individuals who exercise control over it, such as members, officers, directors or trustees."[48] Of note, nonprofits are not barred from *generating* profit—they can and often do make more money than they spend. But they simply

[45] *What is a "Nonprofit"?*, NATIONAL COUNCIL OF NONPROFITS, *available at* https://www.councilofnonprofits.org/what-nonprofit (last visited Aug. 26, 2024), Hansmann, *The Role of Nonprofit Enterprise, supra* note 14.
[46] *Virginia Nonstock Corporations (including Nonprofits)*, STATE CORPORATION COMMISSION, *available at* https://scc.virginia.gov/pages/Virginia-Nonstock-Corporations-FAQs (last visited Aug. 26, 2024).
[47] Constantine et al, *The Difference Between Nonprofit and Tax-Exempt Status*, VENABLE LLP (1999), https://www.venable.com/insights/publications/1999/10/the-difference-between-nonprofit-and-taxexempt-sta.
[48] Hansmann, *The Role of Nonprofit Enterprise, supra* note 14, at 835.

cannot distribute those profits to shareholders (indeed, because they cannot have any shareholders) or to managers.[49]

This "non-distribution constraint" has two major related consequences that bear emphasis: a lack of shareholders and an attendant potential for agency problems. Because there are no shareholders to whom the organization can distribute profits, nonprofits generally plough their profits back into the business.[50] In theory, this can help the entity's growth and survival because money is being put back into the nonprofit's mission—caring for shelter animals, running blood drives, or whatever other activities support the non-profit's mission.

And yet, as others have noted, there are many problems inherent to the nonprofit form, such as difficulties in securing investment and potentially higher costs of goods and services.[51] But perhaps the largest potential problem is that of agency costs: because an entity without shareholders does not benefit from shareholder monitoring, management can use its control of the organization to secure private benefits or otherwise operate the entity inefficiently.[52]

Agency costs represent a major problem for all organizations, not just nonprofits. Indeed, for decades, corporate scholars have worried about the "separation of ownership and control"—a term coined in 1983 by Eugene Fama and Michael Jensen to describe how corporate shareholders (the owners) do not control the company they own.[53] While this separation has advantages, it also leads to agency problems: corporate managers, who are acting as the shareholders' agents in managing the corporation, may be motivated to act in their own interests rather than in the interests of the shareholders and the corporation.[54]

A rich web of corporate law, policy, and practice has arisen to address agency costs that arise from the corporate form.[55] Perhaps the most important guardrail against agency costs, however, is shareholder control. Shareholders have a variety of rights, including the right to elect directors, to sue directors and officers on behalf of the corporation, and to make and vote on shareholder proposals, for instance.[56] They are motivated to use those rights, because their own money is on the line—if an executive is paid too much, that means less for the shareholders to enjoy as dividends.

Nonprofit governance is different.[57] When management misbehaves, there are no shareholders to vote for their removal or to withhold approval in the next election.[58] Although nonprofit directors and officers owe fiduciary duties to the organization, there are few people with incentives to enforce

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[49] Nonprofit managers can only receive salaries and limited forms of performance-based compensation. *Compensation for Nonprofit Employees*, NATIONAL COUNCIL OF NONPROFITS, *available at* https://www.councilofnonprofits.org/running-nonprofit/employment-hr/compensation-nonprofit-employees (last visited Aug. 26, 2024).

[50] *See, e.g., OpenAI LP*, OPENAI.COM, https://openai.com/index/openai-lp/ (noting that after investors received their capped returns, all additional profits go to the nonprofit. The company also warns investors that it has no obligation to generate a profit for them.) (last visited Aug. 26, 2024).

[51] Armen A. Alchian & Harold Demsetz*, Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972); Manne, *Agency Costs and the Oversight of Charitable Organizations*, *supra* note 26.

[52] Peter Molk & D. D. Sokol, *The Challenges of Nonprofit Governance*, 62 B.C. L. REV. 1497 (2021).

[53] Eugene F. Fama, and Michael C. Jensen, *Separation of Ownership and Control*, 26 J. LAW & ECON. 301 (1983). But concept goes back to Berle and Means, *See* Berle & Means, *supra* note 23.

[54] Shane M. Shelley, *Entrenched Managers & Corporate Social Responsibility*, 111 PA. ST. L. REV. 107 (2006).

[55] Jeremy McClane, *The Agency Costs of Teamwork*, 101 CORNELL L. REV. 1229 (2016); Lund & Pollman, *supra* note 24.

[56] Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407 (2006).

[57] Molk & Sokol, *supra* note 16, at 1509; Manne, *Agency Costs and the Oversight of Charitable Organizations*, *supra* note 26.

[58] Molk & Sokol, *supra* note 16, at 1509.

them.[59] In lieu of shareholder monitoring, nonprofits are officially monitored by state attorneys general, but these offices generally lack the resources and incentives to monitor nonprofits carefully.[60] In theory, donor-supported nonprofits are also monitored by their donors, but donors may fail to devote sufficient attention to the business to control managerial self-dealing.[61]

Therefore, we might expect that an organization without shareholders would be run inefficiently. Instead of investing in the business, management could pay themselves high salaries without reprisal.[62] The organization might be slower at meeting consumer demand or they may use inputs less efficiently.[63] Over time, we might predict that for-profit enterprise would outcompete nonprofit rivals. Yet, as the next Section highlights, nonprofit enterprise exists, and even flourishes, across the globe. And therefore, the puzzle as to how nonprofits manage these agency problems remains.

2. *Nonprofit Enterprise*

Nestled within the big-tent definition of nonprofit entities in general is the *nonprofit enterprise*—the type of nonprofit with which this article is concerned.[64] Nonprofit enterprise includes nonprofits that primarily derive their revenues from business operations, rather than from donations.

Here, we draw on Henry Hansmann's seminal 1980 article on nonprofit enterprise, which differentiates between "donative" and "commercial" nonprofits.[65] The former are "[n]on-profits that receive most or all of their income in the form of grants or donations."[66] Commercial nonprofits, by contrast, "are those that receive the bulk of their income from prices charged for their services."[67]

This Article's definition of nonprofit enterprise encompasses commercial nonprofits, but with two further wrinkles. First, like Hansmann, we recognize that enterprises may not be fully donative or commercial. Rather, these definitions exist on a continuum. Hansmann notes that the Salvation Army, known for its holiday-time bell-ringing donation drives, would be an example of a donative non-

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[59] Molk & Sokol, *supra* note 16; Brian Galle, *Valuing the Right to Sue: An Empirical Examination of Nonprofit Agency Costs*, 60 J.L. ECON. 413 (2017); see also David I. Walker & Brian D. Galle, *Nonprofit Executive Pay as an Agency Problem: Evidence from U.S. Colleges and Universities* (arguing that president pay in higher education rises when there are fewer external constraints). The IRS also polices nonprofit, but its focus is on enforcing the code provisions that relate to the organization's tax-exempt status. Molk & Sokol, *supra* note 16; Henry Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 601-606 (1981).

[60] Susan N. Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law,* 21 U. HAW. L. REV 593 (1999); *Regulating Nonprofit Health Care: Insights from State Attorneys General*, MCDERMOTT, WILL & EMERY, https://www.healthlifesciencesnews.com/2018/08/regulating-nonprofit-health-care-insights-state-attorneys-general/ (last visited Aug. 26, 2024). The same limitations plague the IRS, which monitors tax-exempt entities to ensure compliance with the tax code. Molk & Sokol, *supra* note 16.

[61] Donor influence may also present its own costs, as we explore in Part II.A.4.

[62] Many nonprofit executives do indeed pay themselves large salaries. *See, e.g., Nonprofit Compensation Packages of $1 Million or More*, CHARITY WATCH, https://www.charitywatch.org/nonprofit-compensation-packages-of-1-million-or-more (last visited Aug. 26, 2024).

[63] Hansmann, *The Role of Nonprofit Enterprise, supra* note 14, at 844.

[64] In this way, we differ from others who focus on the effectiveness of purely donative organizations, such as NGOs. Ofer Eldar, *The Organization of Social Enterprise* (June 09, 2024), European Corporate Governance Institute – Finance Working Paper No. 987/2024, https://ssrn.com/abstract=3217663; Ofer Eldar, *The Role of Social Enterprise and Hybrid Organizations*, 2017 COLUM. BUS. L. REV. 92-194 (2017); BURTON A. WEISBROD, AN AGENDA FOR QUANTITATIVE EVALUATION OF THE NONPROFIT SECTOR: NEED, OBSTACLES, AND APPROACHES (Springer, 2001), at 273-290 (measuring the impact of the nonprofit sector); MARY KAY GUGERTY AND DEAN KARLAN, THE GOLDILOCKS CHALLENGE: RIGHT-FIT EVIDENCE FOR THE SOCIAL SECTOR (Oxford University Press, 2018).

[65] Hansmann, *The Role of Nonprofit Enterprise*, *supra* note 14.

[66] Id. at 835.

[67] Id.

profit.[68] And yet, it surely derives income from its many thrift stores, too. The Salvation Army is mostly donative, but a bit commercial. Hospitals, on the other hand, might generate most of their income from services rendered—but, as the portraits that line hospital hallways attest, they are not above accepting the largesse of the wealthy, either. As a result, hospitals are mostly commercial, but a bit donative. Again, our analysis encompasses entities like hospitals that regenerate revenue primarily from operations, rather than donations (and excludes the Salvation Army, for which the business is less central to the entity's operations).

Second, unlike Hansmann, our analytical scope sweeps in enterprise foundations.[69] Enterprise foundations are nonprofits (or equivalent entities, such as trusts or foundations) that own and control for-profit businesses.[70] As a result, the nonprofit is required to exercise its control of the entity pursuant to the nonprofit's purpose. Of course, the for-profit businesses that it controls can (and often does) have shareholders that take profits out of the business. But the enterprise foundation structure ensures that those shareholders have limited influence.[71]

An enterprise foundation's key characteristic is that the nonprofit controls the business, under the watchful eye of a self-perpetuating board that is duty-bound to promote the nonprofit purpose.[72] This control can manifest because the nonprofit is the sole owner of the business (as is true of Norske Veritas, a Norwegian logistics company[73]); at the other end of the spectrum, the nonprofit may own a minority stake in the business but exercise control via a dual-class voting structure (as is true of Hershey's, the American candy company, and Novo Nordisk, the most profitable pharmaceutical company in Europe[74]).[75] The punchline, however, is that the enterprise foundation blends both non-profit and for-profit elements, but gives the nonprofit entity control over the for-profit one.

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[68] Id.

[69] Although Hansmann's 1980 article did not include enterprise foundations, in later co-authored work, Hansmann stated that his theory offered descriptive purchase in the context of enterprise foundations as well. See Hansmann & Thomsen, *supra* note 16.

[70] Steen Thomsen & Nikolaos Kavadis, *Enterprise Foundations: Law, Taxation, Governance, and Performance*, 6 ANNALS OF CORP. GOV., 227 (2022).

[71] Enterprise foundations are essentially the upside-down version of the traditional structure involving a for-profit corporation with a charitable arm that is controlled by the corporation. Oil and gas giant Exxon Mobil Corporation, for instance, has a "philanthropic arm," the ExxonMobil Foundation, that "has a strategic focus supporting education with an emphasis on math and science in the United States, promoting women as catalysts for economic development and ending deaths from malaria." *Worldwide Giving*, EXXONMOBIL FOUNDATION, https://corporate.exxonmobil.com/who-we-are/corporate-giving/worldwide-giving (last visited Aug. 26, 2024). In these organizations, the for-profit is often intimately engaged with the nonprofit's activities, and the nonprofit engages in activities that help the for-profit, such as improving the for-profit's public image. Michael E. Porter & Mark R. Kramer, *The Competitive Advantage of Corporate Philanthropy,* HARV. BUS. REV., (Dec. 2020).

[72] The level of effective control exercised by the non-profit over the business varies, however. Some nonprofits, like Anthropic's Long-Term Benefit Trust, exhibit substantial control over the business (and indeed, this is the point of the structure). Others take a stance of zero interference in the business—for example, the Pierre Fabre foundation (which controls the for-profit French consumer goods company) states that it "does not get directly involved in the operational management of the company," despite holding a majority stake in the consumer products company.

[73] Hansmann & Thomson, *supra* note 16.

[74] *Ownership*, HERSHEY, https://hershey.gcs-web.com/static-files/db1ce4c6-2737-42ee-94bf-b011f50a69cf (last visited Aug. 26, 2024); *Ownership*, NOVO NORDISK FONDEN, https://novonordiskfonden.dk/en/who-we-are/ownership/ (last visited Aug. 26, 2024).

[75] The level of effective control exercised by the non-profit over the business also varies. Some nonprofits, like Anthropic's Long-Term Benefit Trust, exhibit substantial control over the business (and indeed, this is the point of the structure). Others take a stance of zero interference in the business—for example, the Pierre Fabre foundation (which controls the for-profit French consumer goods company) states that it "does not get directly involved in the operational management of the company," despite holding a majority stake in the consumer products company. *Our company ownership*, THE PIERRE

B. The Puzzle of Proliferation

With the definitional elements squared away, we now turn our core question: how does nonprofit enterprise survive, and in some cases flourish, despite having no shareholders to monitor management and intervene when problems arise?

"Private nonprofit institutions account for a sizable and growing share of our nation's economic activity."[76] So begins Hansmann's seminal 1980 article on non-profit law, *The Role of Non-Profit Enterprise*. Hansmann's article was not only area-defining, but prescient. In 1980, non-profit business was growing in economic importance.[77] Nonprofit activity continues to be significant, accounting for "over a trillion dollars . . . of the U.S. gross domestic product [and] employ[ing] twelve million people."[78] And given heightened interest from consumers, employees and even shareholders in business as a force for good, we expect that more and more economic activity will be undertaken by nonprofit or blended enterprise in the coming years.

While nonprofit enterprises can exist in just about any industry, they dominate several. Of the United States' 6,120 hospitals, for instance, only 1,219 are for-profit.[79] Nonprofits also dominate in the post-secondary education sector. Of the approximately 4,000 post-secondary institutions listed by the National Center in Education Statistics, only about 700 are for-profit; the rest are non-profit or government-run.[80] For many non-profit hospitals and non-profit schools—and numerous other nonprofit enterprises like these, which generate much or most of their revenue from business operations—the nonprofit form is a choice.

In this Section, we first discuss the leading answer to the puzzle of why non-profit enterprise exists—an answer provided by Hansmann's 1980 article. We then evaluate how Hansmann's theory has fared in the subsequent years. To preview, although his theory remains an important part of the nonprofit enterprise puzzle, it does not explain why nonprofits exist and proliferate in certain areas. And this lack of explanatory power leaves room for new theories to explain why nonprofit business can survive and even thrive.

1. Contract Failure Theory

Hansmann's theory focuses on the idea of "contract failure."[81] At the core of Hansmann's theory is that old economic chestnut of supply and demand, and the consumer's ability (or inability) to accurately gauge the quality of goods and services being sold. As he notes, "[e]conomic theory tells us that, when certain conditions are satisfied, profit-seeking firms will supply goods and services at the quantity and price that represent maximum social efficiency."[82] Among the most important of those

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FABRE GROUP, https://www.pierre-fabre.com/en-us/our-group/our-shareholder-scheme (last visited Aug. 26, 2024); *The Foundation*, FOUNDATION PIERRE FABRE, https://www.fondationpierrefabre.org/en/the-foundation/dna/ (last visited Aug. 26, 2024).

[76] Hansmann, *The Role of Nonprofit Enterprise, supra* note 14, at 835.

[77] *Id.*

[78] Molk & Sokol, *supra* note 16, at 1498.

[79] Fast Facts on U.S. Hospitals, 2024, AMER. HOSPITAL ASS'N., https://www.aha.org/statistics/fast-facts-us-hospitals. (noting that about 1,100 are federal, state, and government hospitals, and almost all of the rest are organized as non-profits) (last visited Aug. 26, 2024). *Id.*

[80] *A Guide to the Changing Number of U.S. Universities*, U.S. NEWS, https://www.usnews.com/education/best-colleges/articles/how-many-universities-are-in-the-us-and-why-that-number-is-changing (last visited Aug. 26, 2024).

[81] Hansmann, *The Role of Nonprofit Enterprise, supra* note 14, at 844.

[82] *Id,* at 843.

conditions is consumers' ability to compare market products, negotiate clearly for products and prices, and to figure out if the producer has held up its end of the bargain in supplying the goods or services.[83] In other words, consumers must have enough information to contract effectively.

When consumers are unable to contract effectively for certain goods and services—*i.e.*, when there is a contract failure—consumers can turn to nonprofits. Nursing care is one of Hansmann's paradigmatic examples: "patients who receive the services are often too enfeebled to be able to judge effectively the quality of care they receive, or to press complaints against managers or seek out an alternative institution."[84] Moreover, the payer of the services is often an insurer—not the recipient of the services—and has less stake in the quality of the care provided.[85] A similar story applies to hospital care and, to a lesser extent, daycare.[86]

In these situations, "the advantage of a nonprofit producer is that the discipline of the market is supplemented by the additional protection given the consumer by another, broader 'contract,' the organization's legal commitment to devote its entire earnings to the production of services."[87] Because nonprofits have no shareholders to cater to, consumers are assured that the nonprofit is less likely to cut corners in service of a profit-maximizing goal.

And yet, Hansmann does not challenge the classic view that "without a profit motive," nonprofit businesses may operate inefficiently. Hansmann argues, however, that in some circumstances, the advantages that the nonprofit form provides in assuring consumers of product quality will outweigh these shortcomings.[88]

2. The Limits of Contract Failure

In the almost half-century since Hansmann's article was published, much of his contract failure theory remains relevant. And yet, as Hansmann himself has since recognized,[89] the theory has proven to be imperfectly descriptive.[90]

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[83] *Id,* at 843.
[84] *Id,* at 864.
[85] *Id.*
[86] *Id.*
[87] *Id.* at 844.
[88] *Id.* Although this theory was initially developed in the context of a pure nonprofit, Hansmann and Thomsen subsequently recognized that "[t]he theory applies easily to [enterprise] foundations," but for a different reason. Hansmann and Thomsen, *supra* note 16, at 12. The authors explain that the enterprise foundation structure allows the founder to ensure that control of their company will perpetuate "beyond the grave." Id. In other words, the contract failure narrative changes to respond to a founder's inability to secure perpetual control via contract. However, this theory does not explain the ongoing success of these entities, as the authors recognize. Id. (arguing that this structure should result in agency costs but does not seem to).
[89] See, e.g., Hansmann & Thomsen, *The Governance of Foundation-Owned Firms,* note 16.
[90] See Hansmann & Thomsen, *The Governance of Foundation-Owned Firms,* note 16, at 180 ("To be sure, the goods and services that Danish FOFs typically produce – such as beer, container shipping, and hearing aids – are not characterized by unusual degrees of asymmetric information between the company and its customers. Consequently, reassurance to consumers can have little to do with the motives for putting these companies under the control of nonprofit foundations,"); see also Vladislav L. Valentinov, *Explaining Nonprofit Organisation: The Social Value Approach*, 38 J. COOPERATIVE STUD. 22 (2005) (arguing that "the major existing economic theories of nonprofits, in spite of their important complementarities, still do not offer equally convincing explanations for every possible structural and organisational types of these organisations"); Ofer Eldar, *The Organization of Social Enterprise, supra* note 64 ("The proliferation of both for-profit and nonprofit social enterprises necessitates a new explanation regarding the function and choice of organizational forms").

One imperfection that has become especially apparent is that nonprofits now flourish in industries where Hansmann's theory predicted they would not, such as those producing standardized goods that are to compare.[91]

And yet, consider the following examples. German automotive supplier Mahle, for example, is 99.9% owned by the Mahle Foundation, a non-profit foundation formed in the 1960s by the founders of the company.[92] Automotive supplies are a quintessential example of standardized goods—consumers have no trouble evaluating and comparing them before purchasing, rendering Hansmann's theory irrelevant in this context. Likewise, furniture giant IKEA is owned by a complex web of for-profit and nonprofit companies, with the result being that all of its profits flow to the nonprofits.[93] Again, given the ease by which consumers can evaluate and compare furniture, contract failure does not explain why this structure has worked for the company. And in the U.S., the Hershey Trust Co., a Pennsylvania chartered trust, has the explicit goal of "advanc[ing] the legacy and vision of Milton and Catherine Hershey in perpetuity through excellence in asset management and trust administration."[94] Although it is the minority owner of the Hershey Company—a publicly traded candy company—the Trust owns the majority of the company's voting stock.[95] This structure means that although the Hershey Company is a for-profit, it is controlled by an entity which has the explicit purpose of preserving the Hershey family's legacy. Given the nature of the business—producing candy for consumer consumption—contract failure cannot help us understand why the business has persisted for decades in spite of this structure that has all of the hallmarks of bad corporate governance.[96]

Many more examples of nonprofit enterprise exist across the globe, in industries that produce standardized goods in competitive markets in which consumers can compare products and ensure that the manufacturer abides by their deal. Moreover, nonprofits have begun to proliferate in industries that Hansmann's theory did not contemplate or anticipate—such as the pharmaceutical and technology sector. Indeed, in his 1980 article, Hansmann suggested that even though consumer information asymmetries are present in the pharmaceutical industry, these "small and discrete"

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[91] Hansmann, supra note 14 at 843. A related theory is that nonprofits allow stronger consumer control over firms, which may be necessary to guarantee product quality. *See* Ira Mark Ellman, *Another Theory of Nonprofit Corporations*, 80 MICH. L. REV. 999 (1982). However, this theory has limited empirical and explanatory support. Valentinov, *supra* note 91, at 24.

[92] *Engagement of the MAHLE Foundation*, MAHLE, https://www.us.mahle.com/en/sustainability/mahle-foundation/.

[93] Jules Gray, *Does IKEA truly deserve its non-profit status?*, WORLD FINANCE, https://www.worldfinance.com/markets/does-ikea-truly-deserve-its-non-profit-status.

[94] *Our Vision and Mission*, HERSHEY TRUST COMPANY, https://www.hersheytrust.com/vision-and-mission.html (last visited Aug. 26, 2024).

[95] Masaaki Yoshimori, *Looking a Gift Horse in the Mouth: A Reassessment of the Impact of the Hershey Trust*, 6 SOCIOECONOMIC CHALLENGES 87, 96 (2022).

[96] Note that the Hershey's example shows one complication of nonprofit enterprise—State AG enforcement, though rare, can threaten economic value. In 2001, the Trust announced that it was contemplating a sale of its controlling interest in the company "to protect the financing for its main beneficiary, the Milton Hershey School." https://www.nytimes.com/2002/09/18/business/hershey-trust-halts-auction-despite-offer-of-12-billion.html. On the day of the announcement, the company's stock price rose 25% in a day. Id. Eventually, the Trust negotiated a $12.5 billion offer for the trust's stake (representing a 42% premium for shareholders) to Wrigley, who promised to keep local factories open after the sale. Although shareholders welcomed this news, the community was outraged and began putting pressure on the company to abandon the sale. https://www.theguardian.com/business/2002/sep/18/money1. Eventually, Pennsylvania's Attorney General sought to block the sale in the Dauphin County Orphan's court, contending that the sale "could devastate the town, where about 6,200 people work for the company." Id. A judge eventually granted a temporary injunction in a sharp opinion that criticized the trustees. Ny T. Eventually, Hershey's abandoned the plan, and the board was overhauled after the Orphans' Court judge criticized it for becoming too detached from the candy company's philanthropic mission. Id.

transactions" with low switching costs reduced the hazards of any given transaction, and thus explained why pharmaceutical nonprofits did not exist.[97] Today, however, there are several successful pharmaceutical companies that operate as nonprofits or enterprise foundations, again suggesting weaknesses in Hansmann's theory.

More fundamentally, changes in search and information technology environment have further undermined Hansmann's claim. For example, consider education, one of Hansmann's paradigmatic examples. When choosing a school, the child's parents may struggle to evaluate the "complex and subtle service." Moreover, the parents may not get a fair and thorough evaluation from the child.[98] As such, the nonprofit school provides an additional layer of assurance about quality to the parent.[99] In modern times, however, schools are evaluated in a number of ways, on online ranking and review sites, in guidebooks, and in consultation with educational professionals. This abundance of information undermines the argument that nonprofit status is necessary to convince parents of educational quality. A similar level of information exists about nursing homes and hospitals—they are evaluated by non-profit and for-profit ratings providers, and also third-party accreditation agencies. More important, we doubt that individuals searching for a nursing home or hospital pay much attention to nonprofit vs. for-profit status: far more important are factors such as proximity to the customer's home, the facility's affiliation with familiar doctors, and accepted insurance.[100]

Therefore, the ensuing years have begun to tug the weave of Hansmann's contract failure theory.[101] As such, we return to the original question and ask—are there additional considerations that can explain why businesses survive and even flourish as nonprofits?[102]

II. A THEORY OF PURPOSEFUL ENTERPRISE

This Part describes our theory of purposeful enterprise and argues that it helps to explain the existence and persistence of nonprofit enterprise. Drawing on insights from organizational science and behavioral economics, we posit that organizational purpose can play a role in not just the selection of the nonprofit form, but also the success of the business.[103] We first show how purpose can help

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[97] Hansmann, supra note 14 at 869.
[98] Id. at 866.
[99] Id.
[100] See, e.g., *Choosing a Hospital*, N.Y. STATE DEPT. OF HEALTH, https://profiles.health.ny.gov/hospital/pages/choosing_a_hospital (last visited Oct. 22, 2024). *See also* Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457 (1996) ("Patients cannot simply check into their local trustworthy nonprofit hospital; rather, they must have a doctor with staff privileges admit them.").
[101] *See also* Brody, *Agents Without Principals*, supra note 100 (providing additional arguments about the limits of the contract failure theory); Salamon, *Of Market Failure, Voluntary Failure, and Third-Party Government,* supra note 14 (arguing that if contract failure was the explanation for nonprofit goods, we would "expect more reliance on government agencies than nonprofit ones").
[102] As discussed in note 14, other theoretical accounts also provide explanations for the existence of nonprofits. In particular, Weisbord theorized that nonprofits exist to deal not with contract failure, but government failure (this became known as the "public goods" theory). Lee, A., Weisbrod, B. 1977; Collective goods and the voluntary sector: the case of the hospital industry; BURTON WEISBROD, THE VOLUNTARY NONPROFIT SECTOR: AN ECONOMIC ANALYSIS (1977); BURTON WEISBROD, THE NONPROFIT ECONOMY (Harvard University Press, 1991). As discussed, our scope is narrower and considers simply why people who wish to do good in the world choose to do so through a business, and whether that business would be better run if it had shareholders. As such, Hansmann's contract failure theory is our lodestar—it not only explains why nonprofits exist, but also why nonprofit business can offer a competitive advantage relative to for-profit business.
[103] This account relates to work by Valentinov, who posits that donative nonprofits allow people to realize their social values, something that cannot be done using the for-profit form. We sharpen and deepen this point by showing how the

the nonprofit enterprise address agency costs. Specifically, purpose can act as a substitute for shareholder monitoring enforcement by creating a clear directive for management, aligning incentives across the organization, and promoting enforcement. Second, the nonprofit form can also promote value creation by eliminating an expensive stakeholder and better ensuring long-term stability.

Our purposeful enterprise theory helps us understand the aspects of nonprofit governance that can help the organization survive and thrive. Importantly, it does not contend that nonprofits are more efficient than for-profit business. Examples of inefficient business and managerial misconduct exist in the nonprofit world,[104] just as they do in the for-profit world.[105] Instead, as we discuss in Section D, our analytical framework helps us understand why nonprofits have emerged and thrived in certain industries and not others.[106]

A. Purpose and Agency Costs

Agency costs plague both for-profit and nonprofit enterprise: corporate management may slack, make misguided choices, or pursue their own self-interest, all at the expense of business value.[107] In for-profit enterprise, corporate governance scholars generally offer two solutions, both rooted in financial rewards (or punishments) for managers. Ex ante, companies can tie management's compensation to performance of the company. Specifically, stock options, bonuses, and other incentive-based compensation structures will help to align managements' incentives with those of shareholders.[108] Ex post, shareholders can be expected to monitor management, ousting inept directors through regular elections or proxy fights.[109]

Of course, these incentives are not available in the nonprofit context due to lack of shareholders. And we posit that for many nonprofit businesses, purpose can fill the gap left by a lack of shareholders, financial incentives, and the other agency-cost curbing mechanisms.[110] In this Section, we highlight three specific ways that purpose can serve as a substitute for shareholder monitoring and

realization of social values can improve organizational efficiency and respond to agency costs in enterprise nonprofits. Valentinov, *supra* note 91.

104 For a recent example, *see* https://www.nytimes.com/2024/08/01/business/glaad-ceo-spending.html.

105 *See, e.g.*, Michael Peregrine & Charles Elson, *Twenty Years Later: The Lasting Lessons of Enron*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE, https://corpgov.law.harvard.edu/2021/04/05/twenty-years-later-the-lasting-lessons-of-enron/.

106 Like Hansmann, we do not think tax benefits offer a full explanation for the success of nonprofit enterprise. This is because not all nonprofits secure tax-exempt status, and even those that do may not be exempt from income taxation. Nonprofit business, like for profit businesses, are also subject to a host of other taxes, including payroll, local, real estate, property, and sales tax. *See* George E. Constantine, et al., *The Difference Between Nonprofit and Tax-Exempt Status*, VENABLE (1999), https://www.venable.com/insights/publications/1999/10/the-difference-between-nonprofit-and-taxexempt-sta. As such, while tax law may encourage the creation of nonprofits in some jurisdictions (because it allows the donor to escape wealth taxes), these exemptions should not materially improve the ongoing performance of nonprofit enterprise and therefore explain their success. *See also* Hansmann & Thomsen, *supra* note 16, at 9.

107 This recognition goes back to Berle and Means, who observed that top corporate executives, "while in office, have almost complete discretion in management." *See* Berle & means, *supra* note 23, at 139. Since Jensen and Meckling, the problem of managerial power and discretion has been analyzed in modern finance as an "agency problem." *See* Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3(4) J. FINANCIAL ECONOMICS (1976).

108 *See, e.g.*, LUCIAN A. BEBCHUK & JESSE M. FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (Harvard University Press, 2004).

109 Lucian Arye Bebchuk & Jesse M. Fried, *Executive Compensation as an Agency Problem*, 17 J. ECON. PERSPECTIVES 71 (2003); Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021 (2007).

110 Lund & Pollman, *supra* note 24.

enforcement by providing direction for management, serving as an incentive alignment device, and finally, promoting stakeholder enforcement.

1. Purpose as Direction

A higher organizational purpose can reduce agency costs by inverting the purpose/profit relationship, providing direction to corporate management about the organization's goals in the process.

In a typical for-profit organization, management maximizes value for shareholders by pursuing profit. In practical terms, this means that in for-profit enterprises, profit drives purpose. Even companies that take steps to delineate a higher purpose will find it subsumed by the pursuit of profit, due to legal and institutional realities. It is black letter Delaware corporate law that fiduciaries must manage the corporation "in the best interests of the corporation's stockholders."[111] Perhaps more important, as one of us has written elsewhere, there is a "corporate governance machine" that puts extra-legal pressure on corporate management to pursue shareholder gains.[112]

The legal and cultural ascendance of shareholder primacy is based on the belief that without the directive to pursue profit, management would be lost. Corporate management chosen for their business acumen lack the expertise needed to promote social responsibility or some other goal; faced with broad discretion that travels with purpose, management would fail or use their discretion to benefit themselves.[113] And yet, note that the directive to maximize shareholder value is not terribly clear either. For example, any business decisions have tradeoffs—between long-term value and short-term value, between risk and reward, between different values that different shareholders hold..[114]

Unlike for-profit business, the nonprofit form tends to elevate purpose over profit. If a nonprofit enterprise incorporates under a nonprofit statute, for example, founders are required to identify a charitable purpose.[115] If the entity seeks federal tax-exempt status (as most do), the IRS will also require the specification of a specific charitable purpose.[116]

Moreover, the legal and institutional environment facing nonprofits facilitates a focus on the entity's social purpose. Nonprofit directors and officers owe fiduciary duties, but these duties are viewed through the prism of the entity's mission. Like directors of for-profits, nonprofit directors owe

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[111] *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010).
[112] Lund & Pollman, *supra* note 24.
[113] Friedman, Social Responsibility of Business; N. Gregory Mankiw, C.E.O.s Are Qualified to Make Profits, Not Lead Society, N.Y. TIMES: BUS. (July 24, 2020), https://www.nytimes.com/2020/07/24/business/ceos-profits-shareholders.html.
[114] Dorothy S. Lund, *Enlightened Shareholder Value, Stakeholderism, and the Quest for Accountability*, RES. HANDBOOK ON CORP. PURPOSE & PERSONHOOD (Elizabeth Pollman & Robert Thompson eds.) (2021). It can also lead to agency cost issues. *Id.*
[115] *Nonprofit Purpose and Tax-Exempt Status*, SCORE, https://www.score.org/resource/blog-post/nonprofit-purpose-and-tax-exempt-status (last visited Aug 31, 2024).
[116] *Charitable hospitals – general requirements for tax-exemption under Section 501(c)(3)*, INTERNAL REVENUE SERVICE, https://www.irs.gov/charities-non-profits/charitable-hospitals-general-requirements-for-tax-exemption-under-section-501c3. (There are more specific requirements for hospitals). *See also*: *Social welfare organizations*, INTERNAL REVENUE SERVICE, https://www.irs.gov/charities-non-profits/other-non-profits/social-welfare-organizations; Daniel J. Hemel, *Tangled Up in Tax: The Nonprofit Sector and the Federal Tax System*, NONPROFIT SECTOR: A RESEARCH HANDBOOK (Patricia Bromley & Water Powell eds.) (forthcoming 2019).

a duty of care and a duty of loyalty to the organization.[117] Unlike corporate directors, however, nonprofit fiduciaries owe a duty of obedience to carry out the nonprofit's mission.[118] In addition, the lack of shareholders means that nonprofit fiduciaries will not be subject to shareholder intervention or annual referendums on the organization's conduct—a difference we discuss in Part III.C.

In other words, for nonprofit enterprise, the purpose/profit relationship is inverted: purpose drives profit, rather than profit driving purpose. And this purpose not only dictates the organization's activity, it helps management resolve tradeoffs.[119]

Enterprise foundation Patagonia provides one example of the purpose/profit inversion. The company espouses the purpose of "saving our home planet."[120] But the company's growth and expansion began to jeopardize this core value. As the head of the company's sportswear division put it, "Making products creates a huge mess, with horrible impacts around carbon waste, water, biodiversity, social justice—what can we do to try to address that?"[121]

Patagonia's business faced a classic tradeoff between growth (and profit) and environmental harm. Contrary to conventional wisdom, a shareholder value maximization directive did not necessarily give a clear answer: pursuit of growth would generate revenue, but could undermine the brand and therefore create unforeseen risks. It might also disappoint shareholders who increasingly invest as a manifestation of their "values."[122]

By contrast, through the lens of purpose, management had a clear directive. As CEO Ryan Gellert stated, "I want us…taking responsibility for [our] product and ultimately create as closed of a loop as possible for the materials that we use."[123] The company is now looking at regenerative agriculture for its products and growing its used and repair programs, with full awareness that this would cannibalize product sales.[124]

In other words, purpose can provide direction and guidance to management forced to confront difficult decisions. At the same time, elevation of purpose does not necessarily neuter the nonprofit's profit motive, as Hansmann and others have claimed.[125] Managers of nonprofit enterprise,

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[117] Ryan T. Murphy, *Fiduciary Duties of the Ultimate Fiduciaries – Directors and Officers of Nonprofits*, FREDRIKSON (Feb. 12, 2024), https://www.fredlaw.com/the-restructuring-report/fiduciary-duties-of-the-ultimate-fiduciaries-directors-and-officers-of-nonprofits.

[118] *Id.*

[119] Note that disagreements over purpose can lead to bitter clashes. David M. Schizer, *Enhancing Efficiency at Nonprofits with Analysis and Disclosure*, 11 COLUM. J. TAX L. 76-134 (2020) ("Even when nonprofit stakeholders agree on the mission, they still might disagree on how to advance it. These disputes can be hard to resolve…"). Specificity of purpose (which we discuss in Part XX), as well as more rigorous analysis and disclosure, can help provide clarity and minimize these inefficiencies. *Id.*

[120] Interview with Yvon Chouinard, founder, Patagonia (Apr. 20, 2023), https://www.mckinsey.com/industries/agriculture/our-insights/patagonia-shows-how-turning-a-profit-doesnt-have-to-cost-the-earth.

[121] Lauren Aratani, '*We've lost the right to be pessimistic': Patagonia treads fine line tackling climate crisis as for-profit* company, THE GUARDIAN (Mar. 12, 2023), https://www.theguardian.com/business/2023/mar/12/patagonia-climate-crisis-for-profit-company.

[122] *Id.*

[123] *Id. See also*, Interview with Yvon Chouinard, Patagonia (Apr. 20, 2023), https://www.mckinsey.com/industries/agriculture/our-insights/patagonia-shows-how-turning-a-profit-doesnt-have-to-cost-the-earth.

[124] *Id.*

[125] Non-profits are generally evaluated based on the assets they accumulate and the amount they spend in relation to them. Kaitlin Cashwell et al., *Using Ratio Analysis to Manage Not-For-Profit Organizations*, THE CPA JOURNAL (June 2019) https://www.cpajournal.com/2019/06/05/using-ratio-analysis-to-manage-not-for-profit-organizations/; Thad D.

just like managers of for-profits, seek to run a profitable business.[126] But for nonprofit enterprise, management seeks to generate profits to advance the organization's mission, and not to satisfy shareholders' need for profits.

2. Purpose as Motivation

Research in behavioral and identity economics suggests that purposeful enterprise offers another advantage: motivating employees to work hard to advance the organization's mission. This advantage can serve as a substitute for stock-based compensation. Indeed, the existence of shareholder control and performance-based pay can actually undermine this positive incentive effect.

The core attribute of a nonprofit is its lack of shareholders. Law and economics scholars view this feature skeptically, because the lack of shareholders (and shares) means that the company cannot award performance-based compensation to its employees.[127]

However, management—and employees—are not homo-economicus, as evidenced by decades of research in behavioral economics and organizational science.[128] And focusing on motivation from a behavioral standpoint leads to many insights. First, managerial motivation is complex and can actually be undermined by contingent monetary rewards.[129] Motivation consists of both intrinsic motivation, or the desire to work hard because it is inherently satisfying, and extrinsic motivation, which is the desire to work to gain a reward or avoid punishment.[130] Indeed, external rewards can actually crowd out intrinsic motivation, leading to detrimental effects on overall effort.[131] This is especially true if the benchmarks are perceived to be set by outside individuals,[132] such as activist shareholders. And because nonprofits face fewer forms of extrinsic motivation—they do not worry about shareholder activists or performance-based compensation—nonprofit managers may actually reap the rewards of intrinsic motivation more readily.

Moreover, the lack of shareholders may also increase nonprofit employee motivation for another reason: the nonprofit status provides a commitment that the employee's work will go toward

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Calabrese, *The Accumulation of Nonprofit Profits: A Dynamic Analysis*, 41 NONPROFIT & VOLUNTARY SECTOR Q. 300 (Apr. 15, 2011).

126 This is contrary to Hansmann, who posited that nonprofit managers lack a profit motive. *See* Hansmann, *The Role of Nonprofit Enterprise, supra* note 14.

127 *See, e.g.*, Manne, *Agency Costs and the Oversight of Charitable Organizations*, *supra* note 26.

128 Richard H. Thaler, *The Evolution of Economics and Homo Economicus,* CHI. BOOTH REV. (June 17, 2015), *https*://www.chicagobooth.edu/review/the-evolution-of-economics-and-homo-economicus; Alexander Pepper & Julie Gore, *Behavioral Agency Theory: New Foundations for Theorizing About Executive Compensation*, 41 J. MGMT. 1045 (2015).

129 See Hansmann & Thomsen, *supra* note 16 (discussing how incentive compensation can be distorting in the enterprise foundation context: "It is the distortion of this intrinsic motivation by over-incentivizing certain tasks, and thereby inducing neglect of other important tasks, that renders incentive compensation inefficient in these models.").

130 Anjan v. Thakor & Robert E. Quinn, *Higher Purpose, Incentives and Economic Performance* (European Corporate Governance Institute – Finance Working Paper 706/2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3350085. Glaeser and Shleifer focus on a different aspect of employee motivation theory in their contract failure model—they posit that "[e]mployees may invest more in specific human capital at not-for-profit firms because these firms have less financial incentive to cut wages or perquisites ex post." In other words, nonprofits are likely to treat workers better, causing them to work harder. Our argument is different. It is not that nonprofits pay workers work harder because they are paid more (in fact, the opposite is true)—they work harder because furthering the purpose is highly motivating.
Not-for-Profit Entrepreneurs, 81 J. PUB. ECON. 99 (2001

131 Bruno S. Frey & Reto Jegen, *Motivation Crowding Theory: A Survey of Empirical Evidence* (Institute for Empirical Research in Economics, Working Paper No. 26, 1999), https://clivespash.org/speer/iewwp026.pdf ("many laboratory experiments support this motivational effect"); Richard Koestner et al., *Autonomous Motivation, Controlled Motivation, and Goal Progress*, 76 J. PERSONALITY 1201 (2008).

132 Bruno Frey, *Policy consequences of pay-for-performance and crowding-out*, 1 J. BEHAVIORAL ECON. 55 (2017).

advancing the purpose, rather than being converted by the firm into profit that can be drained by shareholders.[133] By contrast, workers in a for-profit firm may work less hard knowing that their effort will go toward profit and not the mission.[134]

The second insight is related to the first, but it is more fundamental: research shows that that setting a "higher purpose" for a firm or nonprofit can be motivating and lead to economic benefits.[135] A higher purpose differs from a corporate vision and strategy, which exist across all companies. The typical corporation will generally have a vision for where it would like to go, and a strategy for how it would like to get there. The higher purpose does something different—it explains *why the business exists*.[136] And theoretical and empirical research suggests that a credible higher purpose encourages employee effort and dissipates managerial agency costs.[137] One study—which used a sample of nearly 500,000 people across 429 firms—found that a clear and authentic higher purpose improved operating financial performance and stock performance.[138] Another interview-based study found that when company leaders embrace an authentic higher purpose, employes work harder and more creatively.[139] Other studies have similarly concluded that organizations feature better performance when they identify a higher purpose and appear to pursue it authentically.[140]

Although for-profit businesses can also reap the rewards of higher purpose, it is a more difficult task. Behavioral research on for-profit enterprise suggests that higher purpose does the best job of bringing about positive effects if it is perceived as authentic, which depends on the extent to which the firm uses profits to implement its purpose.[141] Of course, nonprofits cannot distribute profits, meaning that authenticity is easier to come by. In other words, importance of the non-distribution constraint goes beyond consumer signaling[142]—it assures employees that their efforts are furthering the business' mission.

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[133] Cf. Brian Galle, *Keep Charity Charitable*, Texas L. Rev. at 1223 ("Warm glow changes the incentives of a charity's employees. Just as giving to charity produces a warm glow, so too may working for one."); Usha Rodrigues, *Entity and Identity*, Emory L J 1285 (discussing how nonprofits offer works the prestige of "not being part of the for-profit world").

[134] Cf. P Francois, Not-for-Profit Provision of Public Services, The Economic Journal 113 (2003).

[135] See also Hansmann & Thomsen, *supra* note 16 ("identity economics assumes that participants in an organization can, through appropriate experiences and framing, be induced to identify their personal goals more closely with those of the organization, and hence to serve the organization more effectively").

[136] Thakor & Quinn, *Higher Purpose, Incentives and Economic Performance, supra* note 126; Rebecca Henderson & Eric Van den Steen, *Why Do Firms Have "Purpose"? The Firm's Role as a Carrier of Identity and Reputation,* 105 AM. ECON. REV. 326 (2015) (defining purpose as a concrete goal or objective for the firm that reaches beyond profit maximization").

[137] Thakor & Quinn, *Higher Purpose, Incentives and Economic Performance* , *supra* note 127; Beiting Cheng et al., *Corporate Social Responsibility and Access to Finance*, 35 STRATEGIC MGMT. J. 1 (2014); *see also* Rose-Ackerman, *Altruism, Nonprofits, and Economic Theory, supra* note 40, at 126 ("An organisation with committed founders and managers has two possible benefits: the 'quality control' advantage and the 'product differentiation' advantage. Ideological founders will seek to hire managers and employees who share their vision. Because these employees want the services they provide to reflect these values, they will need little monitoring. Committed employees may be easier to attract if the firm is a non-profit.").

[138] Claudine Gartenberg et al., *Corporate Purpose and Financial Performance*, 30 ORG. SCI. 1 (2019).

[139] Robert E. Quinn & Anjan V. Thakor, *Creating a Purpose-Driven Organization*, HARVARD BUSINESS REVIEW (2018), https://hbr.org/2018/07/creating-a-purpose-driven-organization.

[140] Daniel Hedblom et al., *Toward an Understanding of Corporate Social Responsibility: Theory and Field Experimental Evidence* (National Bureau of Economic Research, Working Paper 26222, 2019), https://www.nber.org/papers/w26222 (conducting a field experiment that shows "when a firm convinces its workers that their efforts make the world a better place (as opposed to purely making money)" output increases and wage costs decrease); Adam M. Grant et al., *Impact and the Art of Motivation Maintenance: The Effects of Contact with Beneficiaries on Persistence Behavior*, 103 ORG. BEHAVIOR AND HUMAN DECISION PROCESSES 53 (2007) (conducting a field experiment in which call center employees performed significantly better in fund raising when given a higher purpose).

[141] Thakor & Quinn, *Higher Purpose, Incentives and Economic Performance, supra* note 126; Gartenberg et al., *supra* note 134.

[142] Hansmann, *The Role of Nonprofit Enterprise, supra* note 14.

Taken together, these insights suggest that the nonprofit form may actually reduce managerial agency costs by elevating the entity's purpose. Specifically, crowding out theory suggests that paying management for the company's stock performance, as is common in many for-profit corporations, may diminish motivation and lead to the very issue it seeks to address—managerial slack and self-dealing.[143] Instead, by authentically elevating a purpose other than profit, the nonprofit may provide a substitute for pay-for-performance compensation that is highly motivating and can actually increase the company's profitability over time.[144] The channel for these economic benefits is unclear, but has something to do with the increased effort and creativity of management, as well as a reduction in wage costs.[145] This leads to another documented efficiency inherent in purpose-driven firms—because individuals tend to work for purpose-driven firms that align with their values, the firm can pay employees less (an insight that we return to in the next Section).[146]

Indeed, the efficiency benefits that come from purpose extend beyond the C-suite and across the entire organization: several studies have found that an authentic higher purpose leads to greater employee motivation and engagement in their work.[147] This is especially true in circumstances where work becomes a place for self-expression and self-realization.[148] When employees identify with the organization's mission (and indeed, find that their sense of self and identity is strengthened by their work[149]), motivation can increase, along with productivity and efficiency.[150]

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143 *See* Adam J. Wowak, *Inducements and motives at the top: A holistic perspective on the drivers of executive behavior*, 11 THE ACAD. MGMT. ANNALS 669 (2017) (surveying executive compensation studies that "underscore the idea that executive pay-performance sensitivity can come at a cost").

144 *See* Part II.A.2. Note that organizational success can be harder to measure if the company lacks equity, complicating efforts to measure an individual's success to the organization. David M. Schizer, *Enhancing Efficiency at Nonprofits with Analysis and Disclosure*, 11.2 COLUMBIA J. TAX L. 76-134 (2020). Therefore, a business with a market for shares may offer some advantages to a nonprofit in terms of accountability and external monitoring.

145 Cait Brumme & Brian Trelstad, *Should Your Start-up Be For-Profit or Nonprofit?*, HARV. BUS. REV. (2023), https://hbr.org/2023/05/should-your-start-up-be-for-profit-or-nonprofit.

146 Timothy Besley & Maitreesh Ghatak, *Competition and Incentives with Motivated Agents*, 95 AM. ECON. REV. 616 (2005) ("When customers and/or investors care about the firm's higher purpose, the equilibrium wages of employees decline and higher purpose investments by firms increase"); George A. Akerlof & Rachel E. Kranton, *Identity and the Economics of Organizations*, 19 J. ECON. PERSPECTIVES 9 (2005) (arguing that organizations shape the self-images of their workers leading to lower labor and agency costs); Susan Rose-Ackerman, *Altruism, ideological entrepreneurs and the non-profit firm*, 8 INT'L J. VOLUNTARY & NONPROFIT ORGS. 120 (1997); Myron J. Roomkin & Burton A. Weisbrod, *Managerial Compensation and Incentives in For-Profit and Nonprofit Hospitals,* 15 J.L. ECON. & ORG. 750 (arguing that employee actions are influenced by their identification with other employees and the organization); DAVID SCHIZER, HOW TO SAVE THE WORLD IN SIX (NOT SO EASY) STEPS: BRINGING OUT THE BEST IN NONPROFITS (2023) at 13 ("employees usually earn less at nonprofits than at for-profit firms, while volunteers work for free. Usually, both groups are there because of their passion for the cause.").

147 Lars van Tuin et al., *A Corporate Purpose as an Antecedent to Employee Motivation and Work Engagement*, 11 FRONTIERS IN PSYCH. (2020); *Cf.* Daniel Hedblom et al., *Toward an Understanding of Corporate Social Responsibility: Theory and Field Experimental Evidence*, *supra* note 136 (using a field experiment to document that CSR increases employee effort and output); Oege Dijk & Martin Holmen, *Charity, Incentives, and Performance*, 66 J. BEHAV. EXP. ECON. 119 (2012). (finding that CSR generates a "warm glow" in employees that makes them work harder); DAVID SCHIZER, HOW TO SAVE THE WORLD IN SIX (NOT SO EASY) STEPS: BRINGING OUT THE BEST IN NONPROFITS (2023) at 24 ("At nonprofits, the mission is a key motivation, which can impel professionals and volunteers to go the extra mile.").

148 JOANNE B. CIULLA, THE WORKING LIFE: THE PROMISE & BETRAYAL OF MODERN WORK (2000); *see also* Stuart Albert & David A. Whetten, *Organizational Identity*, 7 ORG. BEHAV. 263 (1985) (exploring the concept of organizational identity)

149 Christopher P. Niemiec & Gordon Spence, *Optimal Motivation at Work*, *in* THE WILEY BLACKWELL HANDBOOK OF THE PSYCHOLOGY OF POSITIVITY & STRENGTHS-BASED APPROACHES AT WORK (2016); Akerlof & Kranton, *supra* note 142.

150 *See* Lars van Tuin et al., *supra* note 143 ("An appealing corporate purpose serving a broader interest in the pursuit of a greater good may thus support individuals to identify with that purpose and integrate it with their sense of self, which then nourishes high-quality motivation"); Henderson & Van den Steen, *supra* note 132 (developing a model of higher organizational purpose and argues that purpose creates value when it contributes to employee identity and reputation);

3. Purpose and Stakeholder Enforcement

Purpose can also reduce agency costs by promoting stakeholder enforcement. Previous scholarship has focused on a lack of third-party enforcement as a reason to doubt that non-profits will be run efficiently or further their mission.[151] However, stakeholder commitment to the mission and engagement in the business can also lead to internal enforcement that can operate as a substitute for shareholder enforcement.[152]

Consider, for example, the boardroom coup at OpenAI. OpenAI was founded as a nonprofit in December 2015 by a group of entrepreneurs, including Sam Altman and Elon Musk. The company was able to recruit top employees away from higher-paying Silicon Valley stalwarts like Facebook and Google because of the company's lofty mission:[153] to "build general-purpose artificial intelligence that safely benefits humanity" and "develop and responsibly deploy safe AI technology."[154]

By 2019, the company's need for capital warranted a rethinking of the organization's structure. It created a for-profit subsidiary, but warned investors that they should not count on returns at all, and that any eventual profits would be capped at 100 times their investment.[155] The company partnered with Microsoft, which invested a billion dollars in the for-profit company.[156] And yet, the enterprise foundation model limited Microsoft's influence: the nonprofit board (composed of mostly independent directors without equity in the for-profit entity) would govern and oversee the company's activities, pursuant to its mission, and Microsoft had no formal power to change that.[157]

A few years later, the capital infusion had paid off for OpenAI. In December 2022, OpenAI previewed ChatGPT, an AI chatbot that received over a million signups in the first five days.[158] The model became "the talk of the AI community within days and a global cultural phenomenon within

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Frederick J. Slack et al., *Effects of Commitment to Corporate Vision on Employee Satisfaction with Their Organization: An Empirical Study in the United States*, 27 INT'L J. MGMT. 421 (2010).

151 Molk & Sokol, *supra* note 16; Manne, *Agency Costs and the Oversight of Charitable Organizations, supra* note 26.

152 *See also* Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose?*, 99 TEX. L. REV. 1309, 1312 (2021) ("Critically and distinctively, under our framing, purpose is a means not an end; a means that allows corporate participants to signal, monitor, and manage their expectancy interests. Purpose identifies the metrics by which managers are to be held accountable.").

153 Michal Czerwonka, *Inside OpenAI, Elon Musk's Wild Plan to Set Artificial Intelligence Free,* WIRED (Apr. 27, 2019), https://www.wired.com/2016/04/openai-elon-musk-sam-altman-plan-to-set-artificial-intelligence-free/ ("a Google employee said he was willing to leave Google for OpenAI '…because of its mission.'…OpenAI co-founder Wojciech Zaremba stated that he turned down 'borderline crazy' offers of two to three times his market value to join OpenAI instead.").

154 OpenAI, Inc., Form 990, No. 81-0861541 (2022) (on file with author). https://openai.com/our-structure/. This structure had the added benefit of allowing employees to receive equity awards and thus share in the company's gains over time (but again, potentially at a lower level than they could expect from a for-profit competitor, given the capped profit structure).

155 For Microsoft's $13 billion investment, the actual cap was lower than 10x—below the goal of the typical VC investment. *See* Jerry Vance, *12 Things Venture Capitalists Look For In An Investment Opportunity*, PREFERRED CFO (Dec. 13, 2023), https://preferredcfo.com/12-things-venture-capitalists-look-for/#:~:text=Since%20venture%20capitalists%20are%20investing,more%20than%20their%20original%20investment. ("Since venture capitalists are investing in companies that are higher risk, they're usually looking for 10X exit multiples."); https://sacra.com/c/openai/ (explaining that Microsoft would recoup its principal and then get $92 billion in profits before hitting its cap).

156 *Id.*

157 *Our Structure*, OPENAI, https://openai.com/our-structure/

158 Kevin Rose, *The Brilliance and Weirdness of ChatGPT*, N.Y. TIMES (Dec. 5, 2022), https://www.nytimes.com/2022/12/05/technology/chatgpt-ai-twitter.html.

weeks."[159] The success of the chatbot was a boon for the company, which predicted that revenue would exceed $1 billion by 2024.[160] And this early success ultimately paved the way for a high-stakes boardroom dispute about the company and its leadership, leading to the board's surprise ouster of CEO and co-founder Sam Altman a few years later.

The media generally described the coup as a crisis over the entity's mission: Altman prioritized profits and the roll-out of ChatGPT over safety, and the board was the last bastion to protect the company's goals.[161] But a closer look revealed that personality dynamics were responsible for the rift, and that the board's actions may have been self-interested and not necessarily aligned with the company's mission.

In the weeks leading to the boardroom ouster, tensions were simmering across the organization. The board felt that it had been cut out of key discussions after Altman held a meeting with investors in the Middle East.[162] One of the directors, AI pioneer Ilya Suskever, viewed the promotion of another OpenAI employee to his same level as a slight and threatened to quit.[163] Another director published an academic paper that praised OpenAI rival Anthropic for avoiding the "frantic corner-cutting that the release of ChatGPT appeared to spur."[164] Beyond the propriety of a fiduciary taking a dig at her own company in an academic work, there was another issue: Altman was concerned that the statement could have negative antitrust implications for the company.[165] Altman sought an apology; the board believed that he was pitting directors against each other.[166]

In a stunning move, the board of directors determined that the best course of action for the company—which, by all accounts, was on a positive trajectory—was to fire Altman. The idea of a group of directors firing an innovative and productive CEO for a lack of candor (the only explanation they offered)[167] is unthinkable in a typical corporation. And yet, the entity's governance structure allowed them to act unilaterally to take a move justified by little more than their bruised egos.

As the chips fell, the world panned the misguided decision, but the board stuck to its guns. In a board call with OpenAI executives, Jason Kwon, the company's chief strategy officer, accused the board of violating their fiduciary duties, stating: "it cannot be your duty to allow the company to die." One of the directors responded that "the destruction of the company could be consistent with the

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[159] Sharon Goldman, *ChatGPT launched six months ago. Its impact – and fallout – is just the beginning,* VENTUREBEAT (May 30, 2023), https://venturebeat.com/ai/chatgpt-launched-six-months-ago-its-impact-and-fallout-is-just-beginning-the-ai-beat/

[160] Jeffrey Dastin et al., *Exclusive: ChatGPT owner OpenAI projects $1 billion in revenue by 2024*, REUTERS (Dec. 15, 2022, https://www.reuters.com/business/chatgpt-owner-openai-projects-1-billion-revenue-by-2024-sources-2022-12-15/.

[161] There is some truth to this narrative: in 2021, a group of employees left OpenAI out of concern that the company had gotten too commercial, and founded Anthropic, a rival "AI Safety lab." Kevin Rose, *Inside the White-Hot Center of A.I Doomerism*, N.Y. TIMES (July 11, 2023), https://www.nytimes.com/2023/07/11/technology/anthropic-ai-claude-chatbot.html.

[162] Tripp Mickle, et al., *Inside OpenAI's Crisis Over the Future of Artificial Intelligence*, N.Y. TIMES (Dec. 9, 2023), https://www.nytimes.com/2023/12/09/technology/openai-altman-inside-crisis.html.

[163] Cade Metz, *OpenAI's Chief Scientist and Co-Founder is leaving the Company,* N.Y. TIMES (May 14, 2024), https://www.nytimes.com/2024/05/14/technology/ilya-sutskever-leaving-openai.html.

[164] Andrew Imbrie et al., *Decoding Intentions*, *Artificial Intelligence and Costly Signals*, CSET (Oct. 2023), https://cset.georgetown.edu/publication/decoding-intentions.

[165] Cecilia Kand & Cade Metz, *F.T.C. Opens Investigation Into ChatGPT Maker Over Technology's Potential Harms*, N.Y. TIMES (July 13, 2023), https://www.nytimes.com/2023/07/13/technology/chatgpt-investigation-ftc-openai.html.

[166] Mickle et al., *supra* note 158.

[167] *OpenAI announces leadership transition*, OpenAI, (Nov. 17, 2023), https://openai.com/index/openai-announces-leadership-transition/.

board's mission."[168] The executives insisted that the board resign, threatening to quit if they remained.[169]

By Monday, 730 employees (out of a total of 770) had signed an open letter threatening to leave unless the board resigned and Altman was reinstated as CEO.[170] The letter stated: "The process through which you terminated Sam Altman and removed Greg Brockman from the board has jeopardized all of this work and undermined our mission and company."[171] It accused the board of "negotiating in bad faith" and not carrying out their fiduciary duties.

On the same day, director Ilya Sutskever, who had initially spearheaded the coup, posted, "I deeply regret my participation in the board's actions."[172] Hours later, Microsoft announced that it would be hiring Altman, as well as any OpenAI employees who wanted to join him.[173]

Faced with the prospect of losing most of its staff, the board re-grouped and brought Altman back.[174] The board was then reconstituted after several of the dissident directors quit. Microsoft was given a non-voting board observer seat.[175] After the dust settled, the company was saved and went on to continue to develop innovative AI models, under the supervision of a mostly independent board.

In the case of OpenAI, employee engagement and motivation not only made the company successful, but also served as a check against misguided board action. Specifically, employee alignment with the company's mission and purpose encouraged them to take action to prevent an outcome that could potentially jeopardize the business' mission.

This example also reveals that although a company's mission and purpose are subject to many different interpretations[176]—indeed, the board justified its destruction of the company as potentially consistent with the mission—employees are positioned to play an important role in interpreting the mission and promoting alignment in purposeful companies.

Moreover, this example is not an isolated one. Consider how in 2024, the CEO of Mozilla, the nonprofit behind the Firefox browser, stepped down after employees argued that his stance on LGBTQ rights rendered his leadership incompatible with the mission of promoting an open and inclusive internet.[177] Likewise, Patagonia employees forced out CEO Rose Marcario in 2020, arguing that her values did not align with the company's environmental and social justice initiatives.[178] These examples provide an important counterargument to scholars who believe that a purpose other than profit will leave executives with too much discretion.[179] As these examples reveal, when mission drift

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[168] Mickle et al., *supra* note 158.
[169] Nitasha Tiku et al., *OpenAI future in chaos as most workers threaten to leave for Microsoft*, WASHINGTON POST (Nov. 20, 2023, 7:08 PM), https://www.washingtonpost.com/technology/2023/11/20/microsoft-openai-sam-saltman-fired/.
[170] Will Knight & Steven Levy, *OpenAI threatens to quit unless board resigns*, WIRED (Nov. 20, 2023, 10:13 AM), https://www.wired.com/story/openai-staff-walk-protest-sam-altman/.
[171] *Id.*
[172] Ilya Sutskever (@ilyasut), X (Nov. 20, 2023, 8:15 AM), https://x.com/ilyasut/status/1726590052392956028
[173] Knight & Levy, *supra* note 166.
[174] Cade Metz, et al., *Sam Altman Is Reinstated as OpenAi's Chief Executive*, N.Y. TIMES (Nov. 22, 2023), https://www.nytimes.com/2023/11/22/technology/openai-sam-altman-returns.html.
[175] It eventually gave it up due to antitrust concerns. Agence France Presse, *Microsoft Gives Up OpenAI Board Seat Amid Regulator Scrutiny,* BARRON'S (July 10, 2024), https://www.barrons.com/news/microsoft-gives-up-openai-board-seat-amid-regulator-scrutiny-c63d6cd3
[176] *See also* Schizer, supra note 115.
[177] Jon Swaine, Mozilla CEO Brendan Eich resigns in wake of backlash to Prop 8, The Guardian (April 3, 2024).
[178] Madeline Stone, Patagonia CEO Rose Marcario is stepping down, Business Insider (June 11, 2020).
[179] Manne, *Agency Costs and the Oversight of Charitable Organizations, supra* note 26; *see* also Bebchuk & Tallarita*, The Illusory Promise of Stakeholder Governance*, *supra* note 41.

occurs in purposeful enterprise, the company's employees will have powerful incentives and tools to reign in management. Of course, employee enforcement can be beneficial or it can represent a form of principal cost—a point we return to later on. But the important point remains that management of nonprofit enterprise need not be bereft of accountability.

Moreover, although employee enforcement is possible in for-profit organizations, it can achieve only limited effect when it is inconsistent with profit-maximization. Consider what happened at Amazon after employees responded negatively to the company's sale of its facial recognition software to law enforcement agencies in 2018.[180] In the aftermath of the sale, 450 Amazon employees signed an open letter to CEO Jeff Bezos and other executives titled "We Won't Build It."[181] The letter demanded that Amazon cease selling the software to law enforcement and to implement employee oversight for "ethical decisions."[182] Amazon refused to meet these demands, noting that "[t]here's a lot of value being enjoyed from Amazon Rekognition."[183] Because nonprofits elevate purpose and lack shareholder influence, they may better preserve pathways to employee enforcement of the entity's mission.

But employees are not the only stakeholders of interest in nonprofits: members and donors can also play a monitoring role.[184] In some nonprofits, for example, members who can elect directors and vote on significant organizational decisions.[185] These nonprofit members—who may or may not be donors—serve a similar role as shareholders in a for-profit, without receiving any right to the residual. In other nonprofits, donors can also potentially mitigate agency costs. Ex ante, the organization will need to prepare financial reports that disclose financial details, including the organization's spending revenue to income and assets.[186] It will also need to establish that it is succeeding in advancing its mission to attract donor funding. Ex post, donors may monitor the organization to ensure that the funds are being used appropriately.[187]

But although donor monitoring can help reduce agency costs, donor engagement, like employee or member engagement, can be a double-edged sword.[188] Donors may have a competing

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180 Jennifer Fan, *Employees as Regulators: The New Private Ordering in High Technology Companies,* 5 UTAH L. REV. 973, 1003 (2019).
181 Id.
182 Id.
183 Id.
184 In addition, employees can also serve as enforcers. Consider, Kiva, a microfinance nonprofit platform through which donors provide loans to entrepreneurs in underserved communities. The nonprofit faced a strike from its lenders in 2021 after its stakeholders noted a concerning lack of transparency in Kiva's loan interest rates and executive compensation, as well as an increasing focus within Kiva on making positive returns on loans, a focus that the strikers saw as antithetical to Kiva's founding principles. The lenders particularly opposed the profit focus that the involvement of outside investors such as Google had introduced to the nonprofit organization. Following the strike, Kiva has made changes to its website and implemented more detailed reporting practices in an attempt to address the lenders' concerns. Mara Kardas-Nelson, What happened to the microfinance organization Kiva?, MIT Technology Review (August 14, 2023). https://www.technologyreview.com/2023/08/14/1077351/microfinance-money- making/.
185 Lawyers Alliance for New York, *FAQs: Understanding Membership Structure* (April 20, 2022), https://lawyersalliance.org/userFiles/uploads/legal_alerts/Understanding_Membership_Structure_FAQs_Legal_Alert.pdf.
186 David M. Schizer, *Enhancing Efficiency at Nonprofits with Analysis and Disclosure*, 11 COLUM. J. TAX L. 11 76 (2020). Note that the need to appeal to donors may also change the investment priorities of the business. For example, many nonprofits underinvest in infrastructure because donors are wary to donate to support IT, HR systems, facilities, and etc.
187 But see Manne, *Agency Costs and the Oversight of Charitable Organizations, supra* note 27 (arguing that donor monitoring is expensive and cannot be depended on).
188 *See also* Brody, *Agents Without Principals*, supra note 100 ("A nonprofit organization dependent on a concentrated or organized donor base might be forced to make poor choices….[T]he nonprofit sector [] can behave more paternalistically

view of how the entity advances its mission that can undermine employee morale and productivity if it causes the entity to veer too far from its initial mission. As just one example, consider how the University of Pennsylvania's Faculty Senate issued a statement arguing that the University's commitment to freedom of thought, inquiry, and speech were being undermined by a donor campaign against the administration and faculty.[189] Therefore, although donor funding can help a low margin nonprofit business survive over the long-term, it can lead to organizational inefficiencies if donor influence undermines the entity's purpose and mission. We develop both of these points in further detail in the next Part.

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This Section formalizes within the legal academic literature what organizational scientists have been saying for years: that a genuine higher purpose can respond to managerial agency costs and otherwise improve productive efficiency by providing direction for management, motivating employees, and securing stakeholder enforcement. Moreover, our analysis suggests that certain firms will be better positioned to take advantage of these benefits. In particular, nonprofits, by virtue of the non-distribution constraint, will be ahead of the game in demonstrating the authenticity of purpose. Of course, this authenticity is not guaranteed—for example, in some enterprise foundations, the nonprofit form is used to keep control with a founder's family, rather than to elevate purpose.[190] Likewise, many for-profit firms (and even enterprise foundations) will struggle to communicate a credible and authentic higher purpose because of shareholder influence; by the same token, paying management for stock performance may actually undermine the engagement benefits that come from purpose. For purpose to motivate effectively, employees must identify with the purpose—which is typically the case for nonprofits, whose employees typically select the organization (and take a lower salary) because of the entity's purpose.[191] As a result, the nonprofit form may promote efficient business operations and overall profitability simply because it has elevated and guarded a higher purpose other than profit.

B. Value Creation

Thus far, this Article has shown how the nonprofit form can mitigate agency cost issues despite its lack of shareholders. This Section describes additional efficiencies created by the nonprofit form. We focus on two paths: thrift and stability.[192]

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and conservatively. Because donors often do not consume the services they donate, donor control can lead to inefficient overproduction of what particular donors want to support.").

[189] Jared Mitovich (@jmitovich), X (Oct. 19, 2023, 9:26 AM), https://x.com/jmitovich/status/1715177700321558816.

[190] For example, the enterprise foundation Rolex's nonprofit board is populated by members of the Wilsdorf family (who are descendants of Rolex's founder, who chose the structure at the end of his life) and their friends; the founder chose this structure to ensure "independence from external influences. The company could not be sold [or divided into separate entities…" Alexander A. Bove Jr. & Melissa Langa, *The Perpetual Business Purpose Trust: The Business Planning Vehicle for the Future, Starting Now,* 47 ACTEC L.J. 3 (June 1, 2021).

[191] This could be one reason why forcing banks to become nonprofits failed in the 19XXs. Hansmann & Thomsen, *supra* note 16.

[192] We exclude tax savings in this analysis, despite the fact that many nonprofits (but not all) have federal and/or state tax-exempt status. For those nonprofits that do have tax-exemption, tax is another (and obvious) source of savings for companies, however, it is smaller than one might think, given the low (and sometimes negative) tax rate borne by many for-profit companies. *See, e.g.*, Ryan Koronowski, Jessica Vela & Zahir Rasheed, *These 19 Fortune 100 Companies Paid Next to Nothing—or Nothing at All—in Taxes in 2021,* AMERICAN PROGRESS, https://www.americanprogress.org/article/these-19-fortune-100-companies-paid-next-to-nothing-or-nothing-at-all-in-taxes-in-2021 (last visited Oct. 22, 2024).

1. *Cost Savings*

It is a common saying in finance that "equity is expensive."[193] This phrase comes from the fact that entrepreneurs can fund corporate activity two different ways: through debt or through equity. Debtholders bear minimal risk—barring corporate bankruptcy, they will be paid back even if the borrowing company has a poor financial performance. Shareholders who provide equity are different. Because shareholders bear greater financial risk when the company does poorly, they also demand a higher return than debtholders. As a result, shareholders will soak up capital from the business over time in the form of dividends or share repurchases.[194] Shareholders also expect that the company will make decisions—such as cost cutting and continued dividend payments[195]—that will increase the value of the stock price over time. Indeed, shareholder intervention rights are often used to push companies to undertake these decisions—a point that we return to in the next Section.

Nonprofits, of course, lack shareholders. And while much has been written about how the lack of shareholders can lead to inefficiencies in nonprofits, we identify an overlooked benefit: nonprofit businesses do not have to pay out periodically to a class of investors hungry for returns.[196] Instead, profits can be reinvested in the business, leading potentially to higher product quality, employee benefits, product development, R&D, resilience, and growth.[197] This benefit supplements another cost savings discussed in the previous Section—the fact that the entity can pay employees less salary when it becomes a nonprofit.

These cost savings help to explain why many low-margin businesses, including educational institutions,[198] restaurants,[199] and generic drug manufacturers,[200] operate as nonprofits. Hospitals can also fall into this category—although there are a handful of profitable hospitals that operate with healthy margins, the vast majority are low-margin (or zero margin) businesses.[201] By eliminating shareholders' need for returns, low-margin businesses can survive and grow over time. Therefore, the

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193 Anat R. Admati, et al., *Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity Is Not Expensive,* (Stanford Graduate School of Business, Working Paper No. 2065, 2013), https://www.gsb.stanford.edu/faculty-research/working-papers/fallacies-irrelevant-facts-myths-discussion-capital-regulation-why

194 Amarjit Gill et al., *Determinants of Dividend Payout Ratios*, 3 OPEN BUS. J. 8 (2010).

195 *Id.* Empirical evidence has generally contradicted the Modigliani & Miller view that dividend decisions do not affect firm value—instead, companies that declare dividends are generally viewed favorably by the market.

196 Note that nonprofits generally experience a higher cost of capital than for-profits, leading to substantial fundraising costs. For this reason, businesses with large capital needs will likely choose a blended structure. But businesses that can accomplish their fundraising via debt and donor financing will benefit from the nonprofit structure over time, as the absence of shareholders will allow the business to invest a greater share of profit back into the business.

197 Of course, nonprofits may also inefficiently squander these profits, rather than re-invest them. *See* Brody, *Agents Without Principals*, supra note 100 at 535 ("The absence of shareholders demanding profits enables the organization to relax into productive inefficiencies, or to cross-subsidize activities the patron would not want to pay for (could she only observe them.")

198 Jono Landon, *How to Increase Your Profit Margin Per Child*, HUBBLI (Dec. 11, 2017), https://hubbli.com/how-to-increase-your-profit-margin-per-child/#:~:text=You%20may%20run%20a%20school,student%20if%20they're%20lucky.

199 *Non-Profit Restaurants Across America*, USA TODAY (Mar. 3, 2017), https://www.usatoday.com/picture-gallery/travel/experience/food-and-wine/2017/03/02/non-profit-restaurants-across-america/98658096/.

200 *See, e.g., Ensuring Quality Generic Medications Are Available and Affordable to All*, CIVICA, https://civicarx.org/(last visited Aug. 31, 2024).

201 Madeline Ashley & Alan Condon, *From -6.8% to 12.2%: 43 Health Systems Ranked by Operating Margins*, BECKER'S HEALTHCARE (Apr. 10, 2024), https://www.beckershospitalreview.com/finance/from-6-8-to-12-2-34-health-systems-ranked-by-operating-margins.html.

lack of shareholders may partially explain why so many hospitals have maintained their nonprofit form over time.[202]

This insight further suggests that capital-intensive, high-risk businesses with low marginal costs of production (such as technology, news, or pharmaceutical companies) may see an advantage in forming as a nonprofit, because profits could be invested back in the business rather than squeezed out by shareholders.[203] And yet, nonprofits also struggle to fund growth, as lenders can be irrationally hesitant to lend to the business.[204] As a result, capital intensive businesses have typically employed a blended enterprise foundation model in which the nonprofit controls a for-profit subsidiary. For example, Novo Nordisk, the most profitable pharmaceutical company in Europe, employs this structure—the for-profit business is wholly owned by the Novo Nordisk Foundation, a Danish foundation primarily engaged in grantmaking.[205] Recall further that OpenAI employs an enterprise foundation model that allows it to raise capital within the for-profit subsidiary of the non-profit parent company. Open AI goes even further than Novo Nordisk by informing its investors that any profits will be capped, and that they should expect that most will be reinvested into the business.[206]

As a result of the blended structure, OpenAI and Novo Nordisk investors can invest in the for-profit business, but they do so with the knowledge that the business is controlled by a nonprofit entity with lofty goals—from sustainability to increased innovation—that will require reinvestment of profits.[207] All in all, these entities are able to raise money from equity shareholders while also dampening investor expectations for outsized profits, adopting attributes of the non-profit form in ways that are advantageous. In particular, the nonprofit form offers founders a fundamental efficiency—that profits can be invested back into the business, rather than simply paid out to shareholders.

2. Resilience and Long-Term Focus

The nonprofit form can sometimes offer greater stability than for-profit business forms. There are two ways that this can happen: the nonprofit form can enhance financial resilience and promote a long-term focus.

Financial resilience. First, as the previous sub-Section explained, many nonprofits retain unrestricted net assets. As a result, they may be better equipped to weather a bad month of sales or a spike in inflation.[208] Nonprofits also have multiple streams of income; donations can also cover a period of negative operational revenue, enhancing a nonprofit entity's resilience. And, of course,

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202 Hansmann also provides an important historical explanation for the persistence of the nonprofit form in the hospital industry. Hansmann, *supra* note 14, at 867.

203 Some news outlets also benefit from this structure.
See, e.g., About Us, PROPUBLICA, https://www.propublica.org/about/ (last visited Aug. 31, 2024).

204 William Foster & Gail Fine, *How Nonprofits Get Really Big*, STAN. SOC. INNOVATION REV. (2007), at 46, 48; *cf.* Emilie Aguirre, Pairing Purpose with Profit 69–70 (Apr. 30, 2021) (Ph.D. dissertation, Harvard University), https://dash.harvard.edu/handle/1/37368454 (noting how for-profit startups that also pursue objectives beyond profit may struggle to appeal to traditional investors).

205 *Ownership*, NOVO NORDISK FOUNDATION, https://novonordiskfonden.dk/en/who-we-are/ownership/; *What Do We Support?*, NOVO NORDISK FOUNDATION, https://novonordiskfonden.dk/en/what-we-support/.

206 *Our Structure*, OPENAI, https://openai.com/our-structure/ (last visited Dec. 15, 2024).

207 *See also* Andrew Jack, *A Model for Healthier Profits*, FIN. TIMES (Dec. 5, 2011), https://www.ft.com/content/658bcbea-1f33-11e1-ab49-00144feabdc0 ("It's an ideal model for the pharmaceutical industry, where there will be ups and downs, and you need to be left in peace to do the development work.").

208 *Cf.* Calabrese, *supra* note 125 at 315 (showing that nonprofits tend to retain unrestricted net assets to reduce financial vulnerability).

nonprofit businesses that satisfy Sections 501(c)3-6 of the tax code are exempt from paying federal and state corporate tax on income that is generated.[209]

Long-term focus. Under some circumstances, nonprofits may also benefit from the freedom to focus on the mission over the long-term. For example, nonprofits lack a market for corporate control, one of the longest-standing tugs of war in corporate governance.[210] When shareholders of for-profit firms believe that management is responsible for the business' poor performance or that assets are not being well-utilized, shareholders can attempt to take over the company to unlock value. Management, however, has long argued that these actions by shareholders—especially in modern times, when they are spearheaded by activist shareholders or private equity firms—disrupt the company's long-term trajectory.[211] Today, even as the threat of hostile takeovers has largely abated, for-profit firms face the ever-present threat of shareholder proxy fights.

Unlike directors of a for-profit company, the nonprofit board is typically self-perpetuating, meaning that the typical mechanisms for outside influence via proxy fights or takeovers do not exist. State attorneys general may be able to affect the board, but they are typically underfunded and lacking in resources needed to provide genuine oversight.[212] As such, nonprofits generally police themselves, under the direction of self-governing boards. This structure can allow management to focus on their long-term strategy without much fear of external interventions. And nonprofit management argue that this is a chief benefit of their governance structure—that the entity is free from short-term market pressure.[213] In sum, the absence of shareholder ownership can enhance organizational stability and allow managers to focus on the business' long-term vision, promoting value creation under the right circumstances.

And yet, this freedom from takeover markets and shareholder activism can also lead to inefficiencies. Shareholders' ability to force changes over the objections of entrenched management is often thought to be highly desirable and a necessary means of limiting agency costs.[214] As a result, not all businesses would benefit from an absence of shareholder discipline. In particular, certain businesses, such as those with high fixed costs for research and development over a long time period, such as pharmaceutical companies and early-stage technology companies, may benefit from reduced pressure from shareholders to provide returns.[215] This reality is especially true for purpose-driven businesses, for the reasons we discussed in the previous Part. Likewise, nonprofit businesses that experience robust product and labor market competition may suffer less from agency cost problems,

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209 I.R.C. § 501(c)(3)–(6). Again, we do not think this tax benefit fully explains the persistence and success of nonprofit enterprise. See supra note 192.

210 Hwang & Yaron Nili, *Shareholder-Driven Stakeholderism*, supra note 41.

211 John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 592 (2016).

212 Molk & Sokol, *supra* note 16, at 1509, 1522–23.

213 Jack, *supra* note 207; *see also* Emilie Aguirre, *Beyond Profit*, 54 U.C. DAVIS L. REV. 2077, 2084 (2021) (arguing that the corporate form does not allow stability of purpose).

214 Zohar Goshen & Reilly S. Steel, *Barbarians inside the Gates: Raiders, Activists, and the Risk of Mistargeting*, 132 YALE L.J. 411, 422 & n.38 (2022).

215 This may be why such firms often choose to go public with dual class structures or other insulation from shareholders—because such insulation provides benefits. Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 590 (2016). Note that these benefits may recede over time. Robert J. Jackson, Jr., Comm'r, U.S. Sec. & Exch. Comm'n, Address at Univ. Cal. Berkeley Sch. of Law: Perpetual Dual-Class Stock: The Case Against Corporate Royalty (Feb. 15, 2018), https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-againstcorporate-royalty; Lucian A. Bebchuk & Kobi Kastiel, The Untenable Case for Perpetual Dual-Class Stock, 103 VA. L. REV. 585, 631 (2017) (showing that the benefits of dual class stock decrease over time).

because those market forces will further motivate and discipline management for inefficient operations.

And yet, the financing limitations that nonprofits experience render the form an unattractive choice for businesses that need substantial capital infusions to launch or grow. Such businesses might consider opting for a blended governance form (an enterprise foundation or even an insulated benefit corporation) in an attempt to have the best of both worlds—a mission-driven business with equity investment. But blended entities come with their own challenges. In particular, the presence of shareholders, even with limited control rights, can undermine the stability that may be necessary to see the mission through.[216] We return to this point in Part III.

Likewise, although nonprofits are not subject to a market for corporate control or influence, they may be vulnerable to pressure from another class of stakeholders—their donors. As the previous Section discussed, donor influence can mitigate managerial agency costs because nonprofits must compete for donor dollars[217]; however, this influence can also serve to redirect the nonprofit entity's mission, in ways that undermine management's focus on the mission over the long-term.

Donor influence has been a live issue in higher education recently. Many colleges and universities rely on a combination of donations and operations for income. But donor influence can undermine the very conditions that are necessary for the university to function. Indeed, the protection of faculty tenure came about after the eponymous donor to Stanford University, Jane Stanford, forced out a socialist economist on the faculty in 1900.[218] This event led to a departure of 10% of Stanford's faculty and a full-blown university crisis.[219] When the chips fell, some of the dissenting faculty authored the founding document for academic freedom in the United States—the "Declaration of Principles on Academic Freedom and Academic Tenure" which stated, among other things, that faculty scholarship and opinions should not be constrained by political pressure.[220]

And yet, despite the protection of tenure, universities are subject to considerable donor pressure—to admit their relatives or friends' children as students, or, as recent events have illustrated, change their administration. Harvard University President Claudine Gay was recently ousted from her role after powerful donors threatened to withhold money.[221] The same result befell Liz Magill, the University of Pennsylvania president, who resigned in the face of hefty donor pressure and in the wake of Congressional testimony.[222] This donor influence threatens academic freedom, one of the critical pillars of higher education in the U.S. For another example, consider how in 2019, the University of

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216 Kobi Kastiel, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 2016 COLUM. BUS. L. REV. 61 (2016).

217 *See, e.g.*, Galle, *Valuing the Right to Sue: An Empirical Examination of Nonprofit Agency Costs*, *supra* note 59.

218 Brian Eule, *Watch Your Words, Professor*, STANFORD MAGAZINE (Jan./Feb. 2015), https://stanfordmag.org/contents/watch-your-words-professor.

219 *Academic freedom's origin story*, STANFORD GRADUATE SCHOOL OF EDUCATION (May 1, 2023), https://ed.stanford.edu/news/academic-freedom-s-origin-story?print=all.

220 Nicholas Dirks, *Higher Education's Donor Problem,* TIME (2024, https://time.com/6554359/university-donor-problem-essay/; *Academic freedom's origin story*, STANFORD GRADUATE SCHOOL OF EDUCATION, supra note 219. ("In the institutions of higher education the board of trustees is the body on whose discretion, good feeling, and experience the securing of academic freedom now depends. There are boards which leave nothing to be desired in these respects; but there are also numerous bodies that have everything to learn with regard to academic freedom. These barbarous boards exercise an arbitrary power of dismissal. They exclude from the teachings of the university unpopular or dangerous subjects. In some states they even treat professors' positions as common political spoils.")

221 Eileen McNamara, *Ousting Claudine Gay from Harvard was always about the money,* WBUR (Jan. 3, 2024), https://www.wbur.org/cognoscenti/2024/01/03/harvard-claudine-gay-resigns-president-eileen-mcnamara.

222 *Id.*; Nicholas Dirks, *Higher Education's Donor Problem,* TIME (Jan. 11, 2024, 2:02 PM), https://time.com/6554359/university-donor-problem-essay/.

Alabama law school engaged in a very public tango with the university's largest donor, Hugh Culverhouse.[223] Culverhouse had committed over $20 million in donations to the law school, gaining naming rights to the law school in the process. Soon after, however, Culverhouse apparently wrote testy emails to the dean about hiring decisions, asked to be allowed to wander the halls and sit in on classes. Eventually, the university returned the money and removed Culverhouse's name from the law school.[224]

In sum, although nonprofits are protected from shareholder influence, they must navigate a different set of concerns that come from the potential for donor interference. The next Part returns to this issue.

C. The Descriptive Power of Purposeful Enterprise Theory

The previous Sections described our purposeful enterprise theory and discussed how nonprofits and other blended entities can offer genuine efficiency advantages relative to for-profit businesses. We do not suggest that all business should be conducted through nonprofits, nor do we predict that nonprofits will outcompete for-profit business across all industries. Instead, purposeful enterprise theory provides an explanation for why certain nonprofit enterprises and blended entities manage to succeed and thrive without shareholder intervention and control.

Our theory of purposeful enterprise also sheds light on the different categories of nonprofit enterprise that exist and the types of companies that might thrive under each variation. On one end of the spectrum, we have the *pure nonprofit enterprise*—a business that is incorporated as a nonprofit and thus lacks shareholders. This entity structure may best fit low-margin businesses without major upfront capital needs (or capital needs that can be tackled by philanthropic or debt financing). By requiring the business to specify a charitable purpose, the nonprofit structure can mitigate agency cost issues, so long as the purpose is viewed by employees as worthy and authentic. Moreover, because the company lacks shareholders, the business will be able to invest any profits that it generates back into the business, which helps it survive and thrive over the long term. Although management need not navigate the risk of shareholder intervention, it faces "donor principal costs," a term we use to describe the misalignment that can come from donor influence that is inconsistent with the organizational mission.[225]

Schools and hospitals, to take two examples, are a good fit for this category. They are low-margin businesses that can typically fund upfront expenditures using donations or debt funding. It is no surprise, therefore, that these businesses typically choose a pure nonprofit structure. Moreover, these pure nonprofit businesses typically outcompete their for-profit rivals, and our theory explains why: Without shareholders, any profits that accrue to the business can be plowed back into it. Moreover, the business has an obvious higher purpose—education or patient care—that is highly motivating for employees, so long as it is protected from donor principal costs. Shareholder involvement, therefore, is not needed to provide motivation or enforcement; indeed, shareholder

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223 Bill Chappell, Univ. Of Alabama Returns $21.5 Million Gift; Donor Urged Boycott Over Abortion Law, NPR (June 7, 2019), https://www.npr.org/2019/06/07/730671823/univ-of-alabama-rejects-21-5-million-gift-donor-urged-boycott-over-abortion-law.

224 Id.

225 *Cf.* Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767 (2017) (defining principal costs come from principal control); Robert A. Katz, *Can Principal-Agent Models Help Explain Charitable Gifts and Organizations?*, 2000 WIS. L. REV. 1 (2000). Of course, any type of stakeholder influence—including that of employees—can lead to principal costs. We focus on donor principal costs because of the unique issues they present in nonprofits, but our framework applies to other types of stakeholders as well.

intervention can actually undermine the stability and long-term focus of the business (the decrease in hospital quality as the private equity industry has taken hold of it provides an example of this effect[226]).

Likewise, generic drug manufacturers—low margin businesses that are typically funded by hospital systems that benefit from the availability of low-cost drugs[227]—are often pure nonprofits.[228] Because generic manufacturers can secure upfront financing from their hospital customers, they need not take shareholder equity that would drain the company's resources over time. And by advancing a higher purpose—securing the availability of lifesaving drugs for all patients—the organization bolsters its ongoing operations. In addition, many news organizations are converting to pure nonprofits as their margins plummet from falling subscription and advertising sales.[229] By becoming a nonprofit, the news organization can better protect its mission (and assets) over the long-term and unlock donor funding to help improve resilience. In turn, the mission encourages journalists to take risks and develop long-form articles that might not secure a place in the typical for-profit news outlets, potentially bolstering the business.[230]

Although we believe that many businesses would benefit from the promotion of purpose as an incentive alignment device for management and lower-level employees alike, the trouble is that many businesses need equity funding for growth. And as previous Parts noted, shareholders typically expect the pursuit of profit in exchange for their investment, and they have the tools to push for it. For companies that require shareholder investment, entrepreneurs have a spectrum of choices. On one extreme, they can choose the typical "good governance"[231] corporation, with a single class of equity and a unified board, which promotes maximal accountability to shareholders. In the middle is the "good governance" benefit corporation, which elevates a higher purpose but provides control rights to shareholders. And the furthest along the spectrum toward the nonprofit pole is the *blended entity*—either an enterprise foundation (that uses nonprofit ownership to deprive shareholders of control of the business) or an "insulated" benefit corporation (that deprives shareholders of key intervention rights over the purposeful business).

We explicitly discuss how our theory applies to benefit corporations in the next Part. For now, we note that our theory suggests that capital intensive, high-margin businesses that espouse an authentic higher purpose would be the best fit for a blended entity structure. Those businesses may be able to harness purpose as a substitute for dampened shareholder intervention rights. Moreover, we predict that a subset of these businesses would be especially likely to survive and thrive over the long term—those that experience robust product and labor market competition. Those market forces can supplement purpose by motivating and disciplining management for inefficient operations, making the need for shareholder control even less important.

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226 *See* Jake Miller, *What Happens When Private Equity Takes Over a Hospital,* HARVARD MEDICAL SCHOOL (2023), https://hms.harvard.edu/news/what-happens-when-private-equity-takes-over-hospital; *see also* Ofri, *supra* note 27.

227 Carter Dredge & Stefan Scholtes, *The Health Care Utility Model: A Novel Approach to Doing Business,* NEJM CATALYST (2021), https://catalyst.nejm.org/doi/full/10.1056/CAT.21.0189.

228 *Not-for-profit Generic Drug Company Officially Established, Attracts Interest of More Than 120 Health Organizations,* INTERMOUNTAIN HEALTH (Sept. 6, 2018), https://staging-sakunexo.kinsta.cloud/static/Civica_Rx_News_Release_9-4-18.f8fecc3d.pdf.

229 David Westphal, *Philanthropic Foundations: Growing Funders of the News,* CENTER ON COMMUNICATION LEADERSHIP & POLICY, USC ANNENBERG SCHOOL FOR COMMUNICATION (2009), https://communicationleadership.usc.edu/files/2015/07/PhilanthropicFoundations.pdf.

230 Richard Tofel, *What I learned from the Nonprofit News Revolution,* COLUM. JOURNALISM REV. (2021), https://www.cjr.org/first_person/propublica-tofel-nonprofit-news.php.

231 Dorothy S. Lund, *In Search of Good Corporate Governance*, 131 YALE L.J. 854 (2022).

In this way, our theory contradicts that of Hansmann by suggesting that producers of "standardized industrial goods and farm produce" may actually benefit from nonprofit or blended forms of business.[232] Those businesses will not only experience the discipline and motivation that comes from purpose, but also from product market competition. Moreover, consumers can also receive a "warm glow" from purchasing goods from a purposeful business, providing a way for the business to differentiate itself and even raise prices.[233]

Therefore, it is no surprise that blended consumer products companies exist and in some cases outperform their for-profit rivals: consider, as just a few examples, the Carlsburg Group (a Danish enterprise foundation brewery that uses a share of profits to fund scientific research[234]); Patagonia (an American enterprise foundation clothing retailer that donates a percentage of the company's profits to support the environment[235]); Warby Parker (a dual-class benefit corporation that manufactures glasses and distributes a pair to a person in need for every pair that is purchased[236]); and Allbirds (a dual class benefit corporation that manufactures sustainable shoes[237]). In the category of farm products is Vital Farms, a successful dual-class benefit corporation that sells pasture raised eggs.[238] For these firms, purpose is not necessary to convince consumers to trust their products—consumers can easily evaluate them and switch if needed. Instead, purpose may offer a competitive advantage for a different reason: the genuine embrace of purpose provides warm glow for the consumer who wishes to use their purchasing power as a force for good. That same embrace of purpose can lead to improved employee motivation and stakeholder enforcement, mitigating inefficiencies that arise from the company's decision to eliminate shareholder control rights.

In addition, we further posit that a blended form may best fit high-margin businesses with substantial research and development costs. Such businesses can afford shareholders (and benefit from their investment) and may improve stability by depriving those investors of key intervention rights. As such, it is not surprising that some successful pharmaceutical companies, which must wait years before reaping profits from drug development, are enterprise foundations. Likewise, blended governance has become more popular in the U.S. among early-stage technology companies, with the two leading AI companies—Anthropic and OpenAI—adopting an enterprise foundation model (although OpenAI has since announced its intention to abandon the model due to its enormous capital needs).[239] And although these companies have taken steps to identify and promote a higher organizational purpose, not all technology companies have made this choice. Instead, the vast majority of technology companies choose a dual-class c-corporation structure with a conventional purpose.[240] For these companies, the decision to dampen shareholder involvement is the goal, and not the

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232 Hansmann, *The Role of Nonprofit Enterprise, supra* note 14 at 843.
233 https://academic.oup.com/qopen/article/2/2/qoac020/6643343
234 *The Carlsberg Foundation*, CARLSBERG GROUP, https://www.carlsberggroup.com/who-we-are/the-carlsberg-family/the-carlsberg-foundation/.
235 *Environmental Activism*, PATAGONIA, https://www.patagonia.com/activism/.
236 Timothy Beck Werth, *Warby Parker Has the Best Under $100 Sunglasses for Any Season,* THE DAILY BEAST (July 28, 2024), https://www.thedailybeast.com/warby-parker-mens-sunglasses-review.
237 *Sustainability*, ALLBIRDS, https://www.allbirds.com/pages/sustainable-practices#reality.
238 *About Us*, VITAL FARMS, https://vitalfarms.com/about-us/.
239 Sebastian Duesterhoeft & Nathan Wu, *The Remarkably Rapid Rollout of Foundational AI Models at The Enterprise Level: A Survey*, LIGHTSPEED (May 15, 2023), https://lsvp.com/stories/remarkably-rapid-rollout-of-foundational-ai-models-at-the-enterprise-level-a-survey/. OpenAI is now contemplating transitioning to a for-profit benefit corporation structure in order to appeal to a greater number of investors. https://www.reuters.com/technology/artificial-intelligence/openai-remove-non-profit-control-give-sam-altman-equity-sources-say-2024-09-25.
240 Gregory H. Shill, *The Social Costs (and Benefits) of Dual-Class Stock*, 75 ALA. L. REV. 221 (2023).

elevation of purpose. And yet, as the next Part discusses, we believe that purpose could also help these entities unlock operational efficiencies.

In sum, our purposeful enterprise theory helps explain why nonprofit and blended enterprise exists and even thrives in various industries across the globe. The next Part describes some of the implications that can be gleaned from our analysis.

III. IMPLICATIONS FOR CORPORATE LAW AND CORPORATE GOVERNANCE

Our purposeful enterprise theory posits that purpose can substitute for shareholder monitoring and control in combating agency costs in certain organizations. It also suggests that nonprofits may provide unique value-creating advantages. These characteristics help make nonprofit enterprise possible, and potentially successful, even relative to for-profit business.

This Part turns to implications. The first set of implications are theoretical. We consider how our theory affects longstanding debates in corporate law, including those about corporate purpose and the role of benefit corporations in society. The second set of implications are practical. Specifically, we consider how our theory can be implemented by founders, managers, and shareholders who seek to harness the benefits of purposeful enterprise.

A. Theoretical Implications

1. Corporate Purpose Debate

One of the most fundamental (and contentious) debates in corporate law is over the purpose of corporations in society.[241] For nearly half a century, shareholder primacy theory has provided the answer and in so doing, shaped corporate law, policy, and practice.[242] This theory argues that the role of a corporation and its managers is to maximize value for the corporation's shareholders, which will render the firm most profitable and capable of helping others.[243] Indeed, shareholder primacy advocates argue that the pursuit of a broader purpose, such as stakeholder value, would undermine the functioning of the firm over time. This is because stakeholder governance leaves management with too much discretion and therefore provides ample room for bad behavior, increasing agency costs in the process.[244]

And yet, stakeholder governance is experiencing a "renaissance" of interest.[245] As just one example, consider a 2019 announcement by the Business Roundtable, a group of CEOs of major American companies.[246] In their "Statement on the Purpose of a Corporation," the Business Roundtable announced that the statement's signatories were committed to running their businesses "for the benefit of all stakeholders—customers, employees, communities and shareholders."[247] They noted that "[e]ach of our stakeholders is essential. We commit to deliver value to all of them, for the

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241 Gabriel Rauterberg, *The Corporation's Place in Society*, 114 MICH. L. REV. 913 (2016).
242 Dorothy S. Lund, *Toward a Dynamic View of Corporate Purpose*, (European Corporate Governance Institute - Law Working Paper No. 746, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4665040; Lund & Pollman*, supra* note 24.
243 FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1996), at 38.
244 Id.
245 Elizabeth Pollman, *The History and Revival of the Corporate Purpose Clause*, 99 TEX. L. REV 1423 (2021) (tracing the history of the corporate purpose clause in charters); Lund, *Toward a Dynamic View*, supra note 257.
246 *Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy That Serves All Americans"*, BUS. ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.
247 *Id.*

future success of our companies, our communities and our country."[248] In response to this renewed interest in stakeholder governance, many corporate law scholars have responded with dismay, arguing that stakeholderism would only harm companies and their stakeholders by increasing management insulation, reducing their accountability, and hurting economic performance.[249]

Purposeful enterprise theory provides a reason to be more hopeful, at least for a subset of businesses that take steps to elevate and guard an authentic organizational purpose. For those businesses, purpose can serve as an incentive alignment device, encouraging employees across the organization to work hard to pursue the entity's mission. It may allow the business to recruit talented employees and save on employee compensation. If management veers from its purpose, employees and other stakeholders can intervene. In sum, our analysis suggests that shareholder ownership and control is not the only way to achieve management accountability and focus or economic performance, providing a powerful counterargument to advocates of shareholder primacy.

Our theory further sheds light on the persistence and success of entities that not only eschew shareholder ownership and control, but also engage in "pluralistic stakeholderism," which Lucian Bebchuk and Roberto Tallarita define as governance that views stakeholder interests as ends to themselves.[250] According to Bebchuk and Tallarita, pluralistic stakeholderism is doomed to fail because it fails to anticipate and respond to the ubiquity of tradeoffs between the interests of stakeholders and leaves management with far too much discretion.[251] And yet, as our analysis reveals, blended entities need not leave everything to management—instead, purpose can help limit discretion and promote enforcement. More drastically, businesses can take steps to incorporate stakeholders into the company's governance structure via nonprofit governance.

Enterprise foundation Norske Veritas—a Norwegian industrial shipping conglomerate with over 15,000 employees and an annual operating revenue of over $3 billion[252]—has taken steps to ensure stakeholder representation in its governing foundation. The non-profit Norske Veritas foundation (which is the sole owner of the business) is governed by a board with members chosen and compensated by a council. The council has 45 members, with seven spots reserved for employee directors, nineteen members elected by the council, and nineteen appointed by seven different Norwegian stakeholder organizations (including the Norwegian Shipowners' Association, the Confederation of Norwegian Enterprise, and the Nordic Association of Marine Insurers).[253] As such, the managers of the business are not accountable to shareholders, nor are they bereft of monitoring—instead, they are supervised by a board that is composed of important business stakeholders.

Norske Veritas' structure is one way that careful nonprofit governance can help companies achieve something that corporate law scholars have viewed as impossible—pluralistic stakeholderism without runaway management agency costs. Specifically, Norske Veritas appears to have responded to agency costs not just by elevating its organizational mission of "safeguarding life, property, and the environment," but also by directly empowering its key stakeholders in governance.[254] Rather than collapsing under the weight of agency costs, the company has survived for nearly 200 years under this

[248] *Statement on the Purpose of a Corporation,* BUS. ROUNDTABLE, https://www.businessroundtable.org/opportunity-commitment.
[249] Bebchuk & Tallarita, *The Illusory Promise of Stakeholder Governance, supra* note 38.
[250] Id.
[251] Id.
[252] *Id.*
[253] *Annual Report 2023 for Stiftelsen,* DET NORSKE VERITAS, *https*://www.detnorskeveritas.com/wp-content/uploads/2024/05/DNV-Stiftelsen-Annual-Report-2023.pdf)
[254] *About DNV,* DET NORSKE VERITAS, https://www.dnv.us/about/.

model, and currently operates 350 offices operating across 100 countries—representing a 21% share of the global shipping market.[255]

2. *The Spectrum of Purposeful Enterprise*

Although our purposeful enterprise theory emerged out of our analysis of nonprofits, it can also apply to other organizations. Indeed, our theory applies (to lesser and greater degrees) to purposeful business across a spectrum and provides insights about the benefits and challenges these organizations face.

Benefit corporations are a good example of how entities can have feet planted in both camps: they are for-profit businesses designed to allow founders to pursue "social enterprise," or business aimed at advancing a social purpose beyond profit maximization.[256] Forty-one states and Washington, D.C. have benefit corporation statutes.[257] Although states differ in their requirements, all benefit corporations require the founder to specify a public-oriented purpose in their charter and report periodically on how the company is fulfilling these goals. The benefit corporation also provides shareholders the right to bring a "benefit enforcement proceeding" in which a court will review whether the company is doing enough to advance the public benefit.[258]

Benefit corporations lack the non-distribution constraint that characterizes nonprofits. But like many nonprofits, benefit corporations must specify a public benefit other than profit.[259] And for benefit corporations that take steps to insulate the firm from shareholder influence (such as by using a dual-class structure or by otherwise limiting shareholder voting and intervention rights), the entity is functionally equivalent to an enterprise foundation—the governance structure helps protect the mission from shareholder influence. For this reason, we have used the term "blended entity" to refer to both insulated benefit corporations and enterprise foundations.

Therefore, our theory suggests that purposeful enterprise exists on a spectrum. At one end are nonprofits that are bound by the non-distribution constraint and lack shareholders. On the other are traditional for-profit corporations. Along the continuum are the blended organizations—enterprise foundations and insulated benefit corporations—both of which use governance to insulate management from their shareholders and enshrine a higher purpose in the organization's DNA. Although nonprofits are often more intentional about the identification of purpose and often have a head-start at establishing authenticity, that is not always true. For-profit entities can and do harness the benefits of purposeful enterprise, just as certain blended entities have.

3. *Donor Principal Costs*

Purposeful enterprise theory also sheds light on another form of agency cost: donor principal costs. Previous economic analysis of nonprofits argue that nonprofit management may fail to pursue

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[255] *DNV GL to unveil rules this year,* TANKEROPERATOR (Jan. 30, 2015), https://www.tankeroperator.com/news/dnv-gl-to-unveil-rules-this-year/6356.aspx

[256] J. Haskell Murray, *Social Enterprise Innovation: Delaware's Public Benefit Corporation Law*, 4 HARV. L. REV. 345 (2014).

[257] Blaine Townsend, Beyond Profits: The Rise of B Corps and Benefit Corporations (Jan. 12, 2024) https://bailard.com/beyond-profits-the-rise-of-b-corps-and-benefit-corporations/#:~:text=The%20Certified%20B%20Corp%20is,a%20C%20Corp%20or%20LLC (last visited Aug. 26, 2024).

[258] Jaime Lee, *Benefit Corporations: A Proposal for Assessing Liability in Benefit Enforcement Proceedings*, 103 CORNELL L. REV. 1075 (2018).

[259] See, e.g., DGCL 362 (requiring the public benefit corporation to "identify within its statement of business or purpose….one or more specific public benefits promoted by the corporation"); *Nonprofit Purpose and Tax-Exempt Status*, SCORE, https://www.score.org/resource/blog-post/nonprofit-purpose-and-tax-exempt-status (last visited Aug 31, 2024).

the interests of their principals—their donors—due to the donors' inadequate incentives to monitor management.[260] However, donors often depart from their passive stance and exercise substantial influence over the organization, which can lead to the mitigation of managerial agency costs.[261] At the same time, donor influence can create principal costs, which Zohar Goshen and Richard Squire define as "*competence costs*, which arise from honest mistakes attributable to a lack of expertise, information, or talent, and *conflict costs*, which arise from the skewed incentives produced by the separation of ownership and control."[262]

As an illustrative example of donor principal costs, consider how Elon Musk, one of OpenAI's founders and largest early investors, exerted influence over the company. From the start, Musk (who donated approximately $45 million) emphasized that OpenAI would need to raise billions of dollars to be taken seriously.[263] In 2015, he promised to cover whatever the company was not able to raise. By 2018, he clarified his meaning: he stated that the best path forward for OpenAI was to sell itself to Tesla.[264] After the company refused his offer, Musk left the OpenAI board. Musk eventually sued the company, accusing it of "betrayal" and a failure to safeguard its mission.[265]

The Musk example illustrates how donor influence can be a double-edged sword. Musk's participation in the early venture and even his later lawsuit could have represented beneficial donor engagement aimed at encouraging managerial focus on the company's mission. Another view, however, is that his views about the path forward for the company represented obvious conflict costs—he sought to use the technology to benefit other companies that he controlled.

Donor influence remains an area ripe for further research.[266] Practically speaking, founders that seek to unlock the benefits of purposeful enterprise via a nonprofit that is financed by donors will need to think carefully about donor principal costs and how to mitigate them.

4. Tax

Although we have largely sidestepped tax law in order to focus on organizational form, our theory raises questions in another core debate in business law—that of the wisdom of the nonprofit tax exemption.[267] The tax rules governing nonprofits are sufficiently complex that a leading scholar has argued that they should be conceived of as "entanglement" rather than "exemption."[268]

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[260] Manne, *Agency Costs and the Oversight of Charitable Organizations, supra* note 26; see also Katz, *Can Principal-Agent Models Help Explain Charitable Gifts and Organizations?*, *supra* note 225.

[261] See also DAVID SCHIZER, HOW TO SAVE THE WORLD IN SIX (NOT SO EASY) STEPS: BRINGING OUT THE BEST IN NONPROFITS at 48 (2023) (discussing how nonprofits are subject to the control of donors, which control what risk a nonprofit can take).

[262] Goshen & Squire, *Principal Costs: A New Theory for Corporate Law and Governance, supra* note 225 (emphasis in original).

[263] *OpenAI and Elon Musk,* OPENAI, *https*://openai.com/index/openai-elon-musk/

[264] David Goldman, *OpenAI publishes Elon Musk's emails. 'We're sad that it's come to this',* CNN (Mar. 6, 2024), https://www.cnn.com/2024/03/06/tech/openai-elon-musk-emails/index.html.

[265] Oluwapelumi Adejumo, *Elon Musk files new lawsuit accusing OpenAI co-founders of profit-driven betrayal,* CryptoSlate (Aug. 5, 2024), https://cryptoslate.com/elon-musk-files-new-lawsuit-accusing-openai-cofounders-of-profit-driven-betrayal/.

[266] For an early analysis of the problems that come from donor influence, see Brody, Agents Without Principals, supra note 100.

[267] See, e.g., Victor Fleischer, *"For-Profit Charity": Not Quite Ready for Prime Time*, 93 VA. L. REV. IN BRIEF 231 (2008); Susan Rose-Ackerman, Unfair Competition and Corporate Income Taxation, 34 STAN. L. REV. 1017 (1982); Henry Hansmann, *Unfair Competition and the Unrelated Business Income Tax*, 75 VA. L. REV. 605 (1989); Boris Bittker & George Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L. J. (1976).

[268] Daniel Hemel, *Tangled up in Tax: The Nonprofit Sector and the Federal Tax System, in Nonprofit Sector: A Research Handbook* (3rd edition, Patricia Bromley & Walter Powell eds., Stanford University Press, 2019).

Nonetheless, a few basic principles emerge. Both federal and state governments can support nonprofit organizations by exempting them from entity-level tax and giving deductions to their donors under certain circumstances. Two conditions are particularly relevant here. First, the organization must be operated for a specific purpose—for (c)(3) entities, "religious, charitable, scientific, testing for public safety, literary, educational, fostering national or international amateur sports competition, prevention of cruelty to children, and prevention of cruelty to animals" and for (c)(4) entities, "organizations not organized for profit but operated exclusively for the promotion of social welfare."[269] Further, the nonprofit organization is taxed on business income that is unrelated to its specified purpose. Second, the organization must adhere to the non-distribution constraint by not distributing profits to shareholders.[270]

In other words, the U.S. tax code subsidizes the two features of purposeful enterprise that mitigate agency costs and lead to thrift and stability. Specifically, the tax code sensibly (and perhaps unintentionally) rewards nonprofit businesses that articulate a higher purpose and fashion its business activities to further it. The code also forces the entity to put profits back into the business.[271] Although the scope of the debate over the nonprofit exemption extends beyond this project, we simply note that by encouraging the use of purposeful enterprise, the tax subsidy can create value.

B. Implementation

1. *Authentic and Specific Higher Purpose*

As discussed in Part II, an authentic higher organizational purpose can lead to economic benefits for for-profit and non-profit firms alike.[272] A higher purpose differs from a corporate vision and strategy—it provides the *raison d'etre* for the business. Moreover, purposeful enterprise theory is agnostic about what the organizational purpose entails. Rather than wading into the debate on whether purpose should promote ESG or other prosocial values, we simply argued that corporate purpose can play a variety of functional roles.[273] However, in order for purpose to be useful, it must be compelling enough to enhance the intrinsic motivation of the business' employees.

Our analysis further reveals why nonprofits have a distinct advantage relative to for-profit firms in defining and adhering to an organizational purpose: For-profit firms will have trouble moving away from the belief that the company exists to drive shareholder profits. As Jill Fisch and Steven Davidoff Solomon observed, vague and aspirational statements of purpose that are typically used by for-profit incorporators "provide neither direction nor legal cover to corporate decision makers, particularly if purpose is understood as constraining the pursuit of shareholder value."[274]

For-profit businesses can demonstrate that they are authentically committed to a higher purpose in several ways, such as by choosing a profit-sacrificing course of action or otherwise spend money on actions that align with the company's purpose. Iconic Michigan gourmet food company Zingermann's, for instance, chooses to shut down operations several times per year to train employees

[269] Donors to 501(c)(4) organizations do not get a tax deduction. Id.
[270] Id.
[271] The entity can also make further donations that further its purpose.
[272] See also Hansmann & Thomsen, *supra* note 16 ("identity economics assumes that participants in an organization can, through appropriate experiences and framing, be induced to identify their personal goals more closely with those of the organization, and hence to serve the organization more effectively").
[273] *See also* Gerard George et al., *Purpose in the For-Profit Firm: A Review and Framework for Management Research,* 49 J. MGMT. 1807 (2023).
[274] Fisch & Solomon, *Should Corporations Have a Purpose?*, *supra* note 148.

on managing the company, pursuant to its purpose of developing its employees as entrepreneurs.[275] Benefit corporation Warby Parker gives a pair of sunglasses away to someone in need with every purchase, pursuant to its mission of "inspir[ing] and impact[ing] the world with vision, purpose, and style.[276] These actions clearly communicate to employees that the business exists to promote a higher goal other than profits.

In sum, a business that wishes to use purpose as a substitute for shareholder control must convince employees that it is both central to the business and authentic—not just a mere attempt at marketing.[277] Moreover, the purpose must also be sufficiently specific to provide direction and stakeholder enforcement.[278]As Fisch and Davidoff Solomon noted, the vast majority of corporate purpose clauses in for-profit corporations are non-specific.[279] Vagueness, we expect, does little to provide direction, motivation, and monitoring.

Moreover, organizations that announce a specific purpose that is merely tangential to the business's operations (for example, Exxon Mobil's mission statement indicating a commitment to sustainability[280]) will harness fewer the benefits of purposeful enterprise. In addition, the purpose must be one that employees care about, which is often the case for nonprofit employees who select the organization because of its purpose.

Accordingly, founders of purposeful enterprise will have a head start when it comes to communicating an authentic purpose. Those businesses have chosen their organizational form in order to elevate a purpose other than shareholder wealth maximization. For-profit entities can do the same, but the success of the purpose will depend not only on the centrality of purpose, but also its authenticity.

As a result, we are skeptical of proposals to legally require C corporations to articulate a purpose.[281] The benefits of purposeful enterprise appear to accrue mostly to businesses that pursue something other than shareholder gain, and which take steps to elevate and promote that purpose in the face of strong market pressures to do otherwise. Requiring conventional for-profit businesses to identify a higher purpose will not help them secure the benefits of purposeful enterprise; they are likely to adopt the vague purposes that Fisch and Davidoff Solomon observe. Moreover, the requirement could eliminate the signaling benefit that accrues to the purposeful businesses that voluntarily select it.

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275 Thakor & Quinn, *Higher Purpose, Incentives and Economic Performance, supra* note 126; *see also* Henderson & Van den Steen, *Why Do Firms Have "Purpose"? The Firm's Role as a Carrier of Identity and Reputation*, *supra* note 132.

276 *Impact Report,* WARBY PARKER, https://www.warbyparker.com/assets/img/impact-report/Impact-Report-2022-Executive-Summary.pdf

277 In this way, we differ from Fisch and Davidoff Solomon, who argue that purpose should be used to signal to stakeholders how corporate surplus will be divided. Although this is one function of purpose, we believe that the more important role is to inform employees—and management in particular—why the business exists, as a means of motivating them and helping them resolve tradeoffs.

278 Colin Mayer, *The Future of the Corporation and the Economics of Purpose* (forthcoming in the Journal of Management Studies, 2021), https://www.ecgi.global/sites/default/files/The%20Future%20of%20the%20Corporation%20and%20the%20Economics%20of%20Purpose-%20Paper.pdf ("A purpose is precise about what problems it is seeking to solve, whose problems, how it will solve them, when and why the company in question is particularly well suited to solving those problems").

279 Fisch & Solomon, *Should Corporations Have a Purpose?*, *supra* note 148.

280 *About us,* EXXONMOBIL, https://www.exxonmobilchemical.com/en/exxonmobil-chemical#:~:text=Our%20mission%20is%20to%20provide,the%20principles%20of%20sustainable%20development.

281 See COLIN MAYER, PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD 22, 24 (2018) (proposing that corporations be legally required to articulate a purpose).

2. *Dual-Class Companies*

Some of the benefits created by purposeful enterprise could be harnessed by a broader set of entities, such as by the recent spate of technology companies that opt for a dual-class equity structure to preserve founder control.[282] Much ink has been spilled about the potential agency costs inherent in dual-class companies,[283] as well as the benefits that may offset these costs.[284] Our theory suggests that these businesses could use purpose to ameliorate the risks inherent in a dual-class structure. More specifically, a dual-class company that elevates purpose—in an authentic and specific way—may better direct and motivate employees and secure internal enforcement, reducing the risk of agency cost issues.

Meta is an example of a dual-class company that may have benefited from a more specific and authentic purpose. Meta's mission statement is to "giv[e] people the power to build community and bring the world closer together."[285] But for many, its mission statement rings inauthentic: the company has been the frequent target of litigation and regulatory scrutiny on the grounds that it developed addictive products[286] and that it promotes misinformation.[287] It is no surprise, therefore, that employee morale has suffered in recent years:[288] Employees report that they feel that they are working for a company that does more harm than good[289] and that is moving in the wrong direction.[290]

A specific and authentic purpose might have mitigated some of these issues. A specific purpose could have provided guidance for business decisions—including the derided decision to expand into virtual reality (which appears only tangentially related to the broadest interpretation of the company's mission). The company could have demonstrated authenticity of purpose by elevating purpose above profits. Indeed, the dual-class nature of the company would have made this course of action achievable, as Zuckerberg controlled the outcome of all voting contests.

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[282] Many technology companies choose this structure. *See* Shill, *supra* note 239; Goshen & Hamdani, *Corporate Control and Idiosyncratic Vision, supra* note 207.
[283] *See, e.g.*, Paul Gompers et al., *Incentives vs. Control: An Analysis of U.S. Dual-Class Companies* (NBER Working Paper 10240, 2004), https://www.nber.org/system/files/working_papers/w10240/w10240.pdf; Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585 (2017).
[284] Goshen & Hamdani, *Corporate Control and Idiosyncratic Vision, supra* note 207.
[285] *Our mission,* META, https://about.meta.com/company-info/
[286] Commonwealth of Massachusetts v. Meta Platforms, Inc. and Instagram, LLC., https://www.mass.gov/doc/2023-10-24-meta-complaint-redacted/download; Emma Woollacott, *European Commission Probes Meta Over Youth Social Media Addiction,* FORBES (May 16, 2024), https://www.forbes.com/sites/emmawoollacott/2024/05/16/european-commission-investigates-facebook-and-instagram-rabbit-hole/.
[287] Vera Bergengruen & Billy Perrigo, *Facebook Acted Too Late to Tackle Misinformation on 2020 Election, Report Finds,* TIME (Mar. 23, 2021), https://time.com/5949210/facebook-misinformation-2020-election-report/; Press Release, Fed. Trade Comm'n, FTC Imposes $5 Billion Penalty and Sweeping New Privacy Restrictions on Facebook (July 24, 2019), https://www.ftc .gov/news-events/press-releases/2019/07/ftc-imposes-5-billion-penalty-sweeping -new-privacy-restrictions. See also Cathy Hwang & Matthew Jennejohn, *Contractual Depth*, 106 MINN. L. REV. 1268 (2022) (discussing Meta's fine).
[288] Naomi Nix, *Meta employee morale is low. Mark Zuckerberg is touting AI to fix that.,* THE WASHINGTON POST (June 9, 2023) https://www.washingtonpost.com/technology/2023/06/09/meta-morale-artificial-intelligence/; Sheera Frenkel & Mike Isaac, *Mass Layoffs and Absentee Bosses Create a Morale Crisis at Meta*, N.Y. TIMES (Apr. 3, 2023),
[289] Shirin Ghaffary, *What Meta employees really think about their company's brutal year,* VOX (Jan. 11, 2023), https://www.vox.com/recode/2023/1/11/23547490/meta-facebook-mark-zuckerberg-stock-employees-morale-survey-2022-year.
[290] Frenkel & Isaac, supra note 288.

3. Blended Entities

As discussed, our theory has application for organizations beyond nonprofits, such as blended entities. But blended entities such as benefit corporations face: they may fail to secure both managerial accountability and the benefits that come from elevating purpose.

Danone, the global food manufacturer of yogurt fame, provides one cautionary tale. The company incorporated in France as a "Société à Mission", which is the French equivalent of a benefit corporation.[291] As part of this, Danone was required by law to "articulate social and environmental goals, materialize them in their bylaws, create a Mission Committee to monitor progress, and appoint a third party to verify the mission is achieved."[292] Danone had also taken steps to protect management from shareholder influence, such as granting double voting rights to shareholders who had held stock for more than two years,[293]and adopting a bylaw provision that "at Shareholders' Meetings, no shareholder may cast more than 6% of the total number of voting rights attached to the Company's shares in his or her own right or through proxy"[294] in order to "avoid having a shareholder exercise undue influence or even realize a 'stealth' takeover of the Company."[295]

Nonetheless, an activist hedge fund acquired a small stake in Danone and pushed the company to remove its pro-ESG CEO, Emmanuel Faber, in 2021.[296] The activist contended that Faber "did not manage to strike the right balance between shareholder value creation and sustainability."[297] Faber eventually stepped down and was replaced by an executive who emphasized profits and shareholder gain.[298]

American ice cream giant Ben & Jerry's provides another salient example. Founders Ben Cohen and Jerry Greenfield viewed their ice cream business as "an experiment to see if it was possible to use the tools of business to repair society."[299] They were committed to their home state of Vermont and relied heavily on local suppliers to make their products. They also cultivated their investor base carefully, refusing venture capitalist financing and instead selling stock to Vermont residents.[300] In

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[291] *Raison D'être*, DANONE, https://www.danone.com/about-danone/sustainable-value-creation/danone-societe-a-mission.html (last visited July 14, 2024). Further, Danone's U.S subsidiary is a public benefit corporation. Michael B. Dorff, James Hicks & Steven Davidoff Solomon, *The Future or Fancy? An Empirical Study of Public Benefit Corporations,* ECGI Working Paper No. 495, 153, https://www.ecgi.global/sites/default/files/working_papers/documents/dorfhickssolomonfinal.pdf.

[292] Emilie Aguirre, *The Social Benefits of Control*, 74 DUKE L.J. 1, 27 (2024).

[293] DANONE, UNIVERSAL REGISTRATION DOCUMENT: ANNUAL FINANCIAL REPORT 299 (2020), https://www.danone.com/content/dam/corp/global/danonecom/investors/en-all-publications/2020/registrationdocuments/Danone_URD2020_EN.pdf.

[294] *Id.*

[295] *Id.*

[296] Dean Best, *Danone Activist Investor Bluebell "Says Emmanuel Faber Should Quit as Chairman"*, JUSTFOOD (Mar. 3, 2021), https://www.just-food.com/news/danone-activist-investor-bluebell-says-emmanuel-faber-should-quit-as-chairman/; Laurence Fletcher & Leila Abboud, *The Little-Known Activist Fund that Helped Topple Danone's CEO*, FIN. TIMES (Mar. 24, 2021), https://www.ft.com/content/dd369552-8491-40a2-b83b-9a1b2e32407a; Aguirre, *The Social Benefits of Control*, *supra* note 210, at 27. (The multinational company Danone, which owns brands such as Activia, Oikos, and evian, invested in "best-in-class soil health programs" and expensive product reformulations to improve the health profile of its product portfolio in furtherance of its goals to promote environmental and human sustainability.)

[297] *Id.*

[298] Fletcher & Abboud, *supra* note 214.

[299] Antony Page & Robert A. Katz, *The Truth About Ben and Jerry's*, STAN. SOC. INN. REV. (2012), https://ssir.org/articles/entry/the_truth_about_ben_and_jerrys#.

[300] *Id.*

1985, they created the Ben & Jerry's foundation and agreed to contribute 7.5% of its pretax profits each year.[301]

In the 1990s, Ben & Jerry's agreed to an acquisition by Unilever.[302] Unilever allowed Ben & Jerry's to become an "autonomous subsidiary," with Unilever controlling the financial and operational aspects of the ice cream maker with Ben and Jerry's retaining an independent and self-perpetuating board "to help provide leadership for the social mission and the brand's integrity." Unilever also agreed to continue making annual charitable donations to the foundation and maintain a presence in Vermont.[303]

Over time, however, the combination was viewed as a poor fit for both entities. Ben & Jerry's founders expressed concern that the company had drifted from its original mission, a sentiment that was shared across the organization.[304] For Unilever, the business dragged down its margins.[305] In 2022, after Unilever refused the independent board's urging to stop selling ice cream in Israel, the board sued its parent company.[306] The dispute over ethics and geopolitics further dampened employee morale.[307] Eventually, Unilever spun off Ben and Jerry's.[308]

Two lessons can be gleaned from these examples. First, shareholders and mission-driven businesses can be a poor fit, as both groups may joust over the surplus. Second, the pursuit of profit can undermine the benefits that come from a higher organizational purpose.

Companies have tried different approaches to help mitigate this kind of tug-of-war between shareholders and purpose. Anthropic, for example, layers several mission-oriented governance structures on top of each other. Anthropic's for-profit subsidiary (of the parent nonprofit) is an insulated benefit corporation, controlled by a long-term benefit trust (also known as a "purpose trust"). The organization lauded this structure as capable of aligning the company's business with its mission of "developing and maintaining advanced AI for the long-term benefit of humanity."[309]

Two issues make us skeptical that this governance structure will safeguard the company's purpose, to the extent that it is incompatible with shareholder interests. Anthropic's benefit corporation, for example, has large, sophisticated equity investors—including Amazon and Google[310]—who wield important governance rights. Under Delaware's public benefit corporation statute, shareholders are the only stakeholders that can bring a "benefit enforcement proceeding" if the company veers from its purpose; they are also the only stakeholders that can sue for breaches of fiduciary duty or elect trustees to the purpose trust. Moreover, currently only a single trustee seat (out of five) is held by a non-shareholder stakeholder representative.[311] Shareholders also have a key

301 *Id.*
302 *Id.*
303 *Id.*
304 *Id.*
305 Aimee Picchi, *Unilever bought Ben & Jerry's 24 years ago. Now it's exiting the ice bream business,* CBS NEWS (Mar. 19, 2024), https://www.cbsnews.com/news/unilever-ben-jerrys-spinning-off-ice-cream/.
306 *Ben & Jerry's vs Unilever: how a star acquisition became a legal nightmare,* https://www.ft.com/content/30efd993-8c23-4f1b-9385-132bbba3d863.
307 *Id.*; BRAD EDMONDSON, ICE CREAM SOCIAL: THE STRUGGLE FOR THE SOUL OF BEN & JERRY'S (2014).
308 Courtney Bonnell, *Unilever to cut 7,500 jobs and spin off its ice cream business, which includes Ben & Jerry's*, AP NEWS (Mar. 19, 2024), https://apnews.com/article/unilever-job-cuts-ice-cream-business-e43ecfd917e7102d86f5f0978013426c
309 *The Long-Term Benefit* Trust, ANTHROPIC, https://www.anthropic.com/news/the-long-term-benefit-trust.
310 Billy Perrigo, *How Anthropic Designed Itself to Avoid OpenAI's Mistake,* TIME (May 30, 2024), *https*://time.com/6983420/anthropic-structure-openai-incentives/.
311 *Id.* This number will eventually creep to three out of five, leaving shareholders still with strong representation in management.

bargaining chip: a supermajority of shareholders can vote to rewrite the rules of the purpose trust at any time, without the trustees' consent.[312]

Forged in the wake of the boardroom coup at OpenAI, this structure was likely developed in response to concerns that the OpenAI board failed to appropriately consider shareholder interests. And the result is that shareholders have a whole lot of say over the direction of the business. Ironically, a company founded out of concerns that profit would trump safety adopted a governance structure less capable of mitigating that risk than the company it sought to distance itself from.

This example therefore showcases the difficulties facing entrepreneurs who seek to harness our purposeful enterprise theory. As the previous Section explored, benefit corporation status and enterprise foundation ownership might not be enough to safeguard the business from mission drift over time. Pure nonprofits, which eliminate shareholders entirely, may better promote stability of purpose, although the financing challenges that they face make them a poor fit for capital-intensive business. What other options remain for blended entities?

In a thoughtful paper, Emilie Aguirre considers this problem—the fact that "business law … lacks a durable commitment mechanism for [purposeful] companies to bind themselves to long-term pursuit of their multiple objectives."[313] Aguirre proposes (among other things) that benefit corporations that IPO or exceed a certain size should be required to include stakeholder representatives on the board.[314]

Although stakeholder representatives could help mitigate mission drift, we believe that any efforts in this direction should be voluntary, which would enable differentiation between entities and their purpose. Moreover, a minority or even a majority of stakeholder board representatives may not be able to withstand coordinated pressure from shareholders.

All in all, the inability to devise a long-term commitment mechanism for entities with shareholders is both a feature and a bug. Proponents will argue that shareholder pressure can help respond to agency costs and redirect the business when entrenched management would prefer to dig in their heels.[315] But a consequence is that profit-seeking shareholders may push the business away from its founding purpose.

For now, the best bet for blended entities is to weigh these two considerations and attempt to balance them as best they can, using the tools of governance to anticipate conflict over purpose and profit and allocate control rights accordingly. For companies that need a substantial capital infusion to grow, those founders may be limited by their investors in how much insulation they can secure. And yet, our Article provides another reason for all stakeholders—including investors—to embrace insulation in service of purpose under certain circumstances: a genuine attempt to do so may mitigate agency cost problems and promote long-term stability.

CONCLUSION

Drawing on research in behavioral economics and organizational science, we advance a novel purposeful enterprise theory that shows how nonprofit enterprise can offer efficiency advantages relative to for-profit business, due to the elevation of purpose and the elimination of shareholders.

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312 *Id.*
313 Emilie Aguirre, *Beyond Profit*, *supra* note 205.
314 *Id.*
315 *See* Schizer, *Enhancing Efficiency at Nonprofits with Analysis and Disclosure, supra* note 115 at 90 ("At for-profit firms, when managers and board members have outdated confidence in the status quo, declining profits and stock prices can force them to face reality. Yet at nonprofits, there are no comparably clear 'wakeup calls'").

Our theory modernizes Hansmann's classic contract failure theory, which argued that nonprofit enterprise ameliorates information asymmetries between consumers and producers. Specifically, our theory explains why businesses ranging from apparel vendors to artificial intelligence developers have successfully operated as nonprofits or enterprise foundations. Moreover, our theory of purposeful enterprise explains why nonprofit enterprises survive and even thrive without shareholder intervention and control, shedding light on debates at the core of corporate law and governance.

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