NPO vs CSR: Will CSR eliminate the need for NPOs? The case of companies limited by guarantee in the UK

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Abstract

In this paper the founder and Chairman of a successful social enterprise (company limited by guarantee), considers the differences between the strategic options available to such an NPO (not-for-profit organisation) and profit-orientated rivals with their increasingly common Corporate Social Responsibility (CSR) policies that could, on the face of it, produce similar outcomes in terms of the social good. The finding for this particular case is that while this form of organisation has some disadvantages compared to firms who have access to shareholder capital and thereby enjoy faster growth and the benefits this brings, it nonetheless has some advantages in terms of maximising the common good, even if we accept the Friedmanite view that extracting a surplus to give to shareholders isn't necessarily one of them. The aim of the paper is not, however, to label the differences in terms of pros and cons, but to identify which of them are intrinsic to the organisational form in order to test the hypothesis that CSR will eliminate the need for NPOs in future.

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Introduction

The author has established a number of social enterprises with his students, who until recently seemed happy to set up firms that put doing good ahead of profit. Lately, however, some have questioned this by asserting that they can use CSR policies to achieve the same amount of good while prioritising profit and enjoying the benefits of having shareholder capital to invest. The author is increasingly concerned that this argument is a threat to the future of social enterprises in the UK as the counter to it tends far too often to rely on examples of badly managed CSR, which is a critique far too easily rebutted by any student who feels that they can manage it better. Formulating a more convincing response prompted the writing of this paper, which began with the listing of observed differences (Lakdawalla and Philipson 2006, James and Rose-Ackerman 2013, Hinton and Maclurcan 2017), but soon moved on to the issue of which of these differences are intrinsic and which are not, which proved problematic as in the literature the distinction is seldom made between differences that accrue as a result of the choice regarding the legal form of the organisation and those which reflect subsequent strategic choices, tactical choices, or even habit. That the intrinsic, locked-in, constraints imposed on a company limited by guarantee need, nevertheless, to be identified if the idea that CSR is a substitute to it is to be countered, since they can amount to the same thing if the owners of a private firm are willing to sacrifice profit (Elhauge, 2005). In such a case we are comparing a company that in its governing documents must not prioritise profit with a firm that chooses not to. That this is a distinction with a difference rests both on what lies between 'can' and 'must' as well as the authors a priori feeling that not every difference can be boiled down to profit. To tease these differences out the author decided to adopted a longitudinal approach using two criteria for selection. The first of which is that the difference needs to be hard for the NFP to avoid, but not for CSR, and the second is that the issue is reoccurring. These criteria do not, however, eliminate longer term contextual factors (in this case of the UK in particular), which may change in future and in light of this it is important to appreciate the difference between intrinsic and inevitable in what follows. For example, the difference in terms of access to capital between social and private enterprise is intrinsic to the decision not to have shares, but in future the difference could evaporate if any of a long string of government reforms aimed at removing this constraint on NFPs were to prove successful.

Methods

In the UK social enterprises are already significant; in total they employ around 1.44 million people, account for nearly one in ten small businesses (BEIS, 2017) and were set to become more important based on start-up rates, (SSES, 2017) before the data was disrupted by Covid. It is the view of the author that while Covid has been more disruptive in the short term the biggest long term threat to the social enterprise movement is the idea, as discussed above, that CSR may undermine the need for it. To counter this it was decided to establish a social enterprises using participant observation (mostly by the author, although students have also become directors and thus participants), in order to show students at the University of South Wales (and occasionally other UK Universities), how things work in practice as a part of their general business education and to properly inform those with the strongest social consciences of the differences between social enterprise and CSR.

Results

The author co-founded Beacons Creative Wales (company number 06973271), in south Wales fifteen years ago and it has grown (albeit slowly) ever since. The specific idea behind BCW was to resurrect a County Council-run service that provided craft activities for a small number of people with learning disabilities, in the hope that by using their time to make candles, a company could be created that would simultaneously provide care cover for them and make revenues from the sale of the candles and thereby reduce the overall costs of care to the Council and provide funds for the expansion of the firm (which now encompasses candles, wholefoods, and cosmetics). Those involved felt that as long as the work was as interesting as the activities that it replaced and if the candles are bought because people want them, rather than simply as an act of charity, then this would be a sustainable and worthwhile thing to do. The company was duly established as a not-for-profit company limited by guarantee, and in most of what follows the comments are specific to that legal form, although there is a high degree of overlap with this and the newer Community Interest Company (CIC) form in the UK.

Discussion

i. Private vs Social Goods

   Working out what the difference between what is good for an individual and what is good for society is something that philosophers, sociologists and politicians have grappled with for centuries. Economists have managed to escape some of the trickier aspects of this by simplifying it to a question of value, since we can ask people what value they would place on something, or, for the subset of things people do where a market exists, we can look at prices, since in a perfectly competitive market with no 'market failures' price and value are synonymous, (Walras 1899, Mckenzie 1954, Arrow and Dedreu 1954). In such a market excess profits are competed away, profit is not a transfer of value from labour to capital, and the argument that sees the intrinsic difference between capitalist for-profit firms and not-for-profit firms in the extraction of the profit itself is invalidated as the profit is simply the thing that draws investors' capital toward the most beneficial use as determined by consumers. Although there are some heroic assumptions in this, the belief that this theoretical possibility is reflected in reality is why some, such as Friedman (1970), have argued that the social responsibility of business is to make profit and not get distracted by CSR concerns, except to the extent that consumers are willing to pay for it.

ii. Slow vs fast growth

   Although the founder of BCW is an Economist by training and can see that in a world of perfect competition NPOs probably need not exist, like most Economists he recognises that when BCW grabs a sale of a candle from a profit making rival it probably is a good thing as the candle market is far from perfect in practice. Every Economic textbook will list such market-failures and some of these in the UK candles and cosmetics industries reflect fundamental differences between the CSR policies that firms owned by capitalist can choose to implement and the policies that firms with no beneficial owners must apply to satisfy the designation of a 'social enterprise limited by guarantee,' or 'CIC' (although these can have shareholders). One such market-failure apparent in both candles and cosmetics markets is market power, since although there are many small firms operating in both sectors in the UK there are also some big powerful (multinational) ones who can drive a wedge between price and value and because of economies of scale can earn enough profit to do 'good' things like increasing the pay of their workers and improving the value for money of their products (Pull 2003, Bonnet & Schain, 2020). In other words, they can develop CSR policies that impose a constraint upon the 'exploitation' of their power and end up pricing below that at which small, non-exploitative, social enterprises can compete. One such powerful candle maker is Newell Brands, owner of the brand

'Yankee Candle,' which alone generates revenues of a billion dollars a year for the parent company and which produces candles at prices that BCW cannot hope to match without permanently running at a loss. For any and all social enterprises this is a strategic option that would, at best, further limit the growth of the firm and reinforce the disparity in scale that gave rise to the problem in the first place. The CSR response that could square this circle is for large firms to increase prices, which would be hard to justify to consumers and is therefore seldom seen in practice. The only other alternative is for social enterprises to also grow big, but they are at an inherent disadvantage in doing so since they cannot access investor capital and consequently, I think it is fair to describe this as an intrinsic difference between the option available to NPOs and the options available to capitalist firms.

iii. Profit vs Planet

Another market-failure is that there are some bad third-party effects (negative externalities) that accrue from the apparently harmless act of lighting a candle, effects that impact on some stakeholders who cannot voice their concern about this even if they wanted to, including such silent stakeholders as future generations hit by the effect on the planet of the gases released by burning a candle, including the greenhouse gas Carbon Dioxide. Indeed, while it's difficult to envisage any countervailing external benefits, the production of candles is also environmentally detrimental even if we look beyond the standard petroleum based candle to the alternatives, the best of which is Beeswax, although this is an expensive option, however, and consequently at BCW, where the governing documents specifically mention doing what is best for the planet, there has been much soul-searching over the years and many things experimented with. The search for less damaging alternatives to paraffin, continues but the fact is that even Bee's wax is not as clean as its promoters claim as although a Google search will produce top results that universally claim that it is 'completely environmentally friendly' and 'carbon neutral' this is not true when compared to the natural process in which the wax is recycled within the beehive many times until eventually being dumped and trapped in the soil. The other popular alternative using Soy (soya bean oil) was particularly disappointing in this regard since not only are rainforests being felled to make way for this fast-growing and profitable bean (Patricio, 2019), this is unlikely to end anytime soon since Soy production strips the soil of nutrients making restoring the soil uneconomical compared to chopping down more rainforest. The obvious solution of finding more ethical sources of Soy was investigated by BCW, but the fact remains that it is yet to be produced in a way that makes this a genuinely ethical choice. For one thing most Soya beans are genetically modified, treated regularly with herbicides and pesticides, and, since almost the only useful part of the plant is the seeds, much of the rest is simply burnt. In addition, the wax is then usually extracted from the beans using heat and chemical solvents that are often nickel based, which of course has to be mined. Other things that have been done at BCW to reduce environmental impacts include minimal packaging and recycling by actively collecting used candles and improvements to candlewicks to ensure that the wax burns more slowly, but ultimately also it has been decided to move away from candle production despite the profitability of this product line, which is an option that capitalist firms seldom freely choose and is another clear distinction, therefore, between what NPOs can do and what for-profit firms can include in their CSR policies.

iv. Absolute NPO vs relative CSR

Indeed, CSR is such a mutable concept that it can be applied to the relative harms of a product, without seemingly ever raising the question of whether such things should be produced in the first place. Consequently in the capitalist candles sector we see a proliferation of relative benefits being extolled, with Soy for example being universally described as the 'best choice for the environment' or 'less polluting' (both of which are probably true if the only other choice is paraffin), and this relativism is applied even where (as is increasingly common) only a small percentage of Soy is used. In this way firms can minimise costs by treating Soy wax as a wholesale commodity buy, while claiming (in their report and accounts and online) to be fulfilling their ESG responsibilities. This is not to say that such firms are cynical, merely to note that the flexibility of CSR allows for relativities to be put to the fore in a way that the governing documents of social enterprises often don't, (particularly as such relativities would need to be as relevant and inclusive today as they were when the company was first formed).

v. Few vs multiple aims

Another difference is that private enterprises tend to have more strategic focus, as although it is not the case that private firms are totally single-minded about profit, it is often found that they have fewer multiple goals than social enterprises (Doherty et al, 2014) and it can be argued that there is an advantage in this, as tensions and managerial conflicts tend to rise and overall performance decrease when firms pursue multiple goals (Emsley, 2003). Social enterprises have to make income to survive but by their very nature are aiming primarily for something else and must inescapably therefore be satisficers rather than maximisers (Simon, 1947). A simple comparison between BCW and Newell Brands suggests that while the latter may by virtue of scale have more managerial resources than any SME (Battisti and Perry, 2011), it also has very few competing objectives (Newell Brands, 2023, p1.).

The personal experiences of those running BCW also reflects this, as directors find themselves constantly pulled in different directions by different stakeholders and, while even the most single-minded profit maximiser cannot be completely free of this, in the opinion of the author -who has also run capitalist firms- there are advantages in developing other policies, including CSR ones, when there is an underlying yardstick by which everything gets measured. This is not to presuppose that all objectives reflect trade-offs rather than complementarities and synergies, (with growth for example creating income that can be shared amongst other objectives), but rather to recognise that at the governance level things are easier to manage when guided by one unchanging objective (Jensen 2002, Sundaram and Inkpen, 2004). If we consider the previously mentioned 'planet' objective, for example, that BCW imposed upon itself when it was formed, we can see that as the science has evolved what this means for the business has fundamentally changed in a way that the descriptive term 'profit' simply couldn't.

vi. Open ownership vs asset locks

One of the objectives enshrined in the governing documents of BCW is the creation of secure long-term employment for people with disabilities sufficient to make their employment elsewhere unlikely. This automatically puts a brake on productivity and profitability, and it is interesting to note that another social enterprise in south Wales (Monwel Ltd) with the same objective failed. The response of the Monwel board was to simply drop the objective and open a new for-profit firm using the old firm's assets since the assets were not legally locked to the original firm and its objectives.

There are two things that can be done when establishing a social enterprise to stop later boards converting it in this way. One obvious way to eliminate this possibility is to legally lock the assets to the social enterprise, (as all CICs in the UK have to). The problem for a firm limited by guarantee is that the founders can try to do this but since it is not a part of the legal requirement of this organisational form, quite how to do this to ensure that it can never happen is not entirely clear as different ways of picking such locks evolve over time. The fact that many social enterprises limited by guarantee chose not to do this may reflect this but may also be because there are advantages in not doing so (Perry, 2013), and because there are some principles at stake (Jeyaloganathan, 2020). The result, however, is that many social enterprises remain at risk of conversion into something fundamentally different to that intended by their founders in a way that capitalist firms are not, as although for-profit firms are subject to acquisitions and merger threats these seldom involve such radical changes in ethos and direction. BCW has faced this threat, although in this case it came through people lobbying to join the board since in BCW 'ownership' is via membership which is limited to members of the board who are appointed only on the understanding that they share the firm's ethos. This approach to the conversion threat has worked so far, and although widening membership to include all staff might seem a more equitable option, since alignment to the firm's ethos is not a condition of employment this is more risky as we have seen with the conversion of Building Societies and mutual Insurance companies cashing-in on membership can be very tempting for those not ideologically opposed to it. This does, of course, mean that a few people have a lot of power in the organisation and at BCW it is probably fair to say that we may display what small-scale community based organisations are often characterized as having in terms of a rather fuzzy division between governance and management, (Ostrower & Stone, 2006).

vii. Employment vs productivity

Despite the stated aim regarding employment, BCW like other social enterprises cannot ignore productivity completely, particularly as such firms often face capital constraints too and cannot easily increase productivity by adding more technology. This is the case with BCW, as although some staff are rather more subsidised than is the norm in British industry since some are earning but also paying the firm (usually through the county council) for one-to-one care, there is still the need to encourage productivity gains in order to grow the business and increase pay. At BCW this has been achieved by innovations in machinery, better utilisation of the firm's own intellectual property, and in particular redesigning the work to better suit what each employee can actually do, although growth remains slow and it is probably true to say -as DeVaro and Brookshire, (2007) found in other social enterprises- that the firm relies too much on the loyalty of staff while at the same time offering relatively few opportunities for promotion. Similarly, since the benefit of private provision in terms of efficiency over public provision (which there would probably need to be more of without social enterprises like BCW), is often overstated (Knyazeva, et al. 2013), we cannot simply rely on any intrinsic advantage in letting those who label themselves as social entrepreneurs take over the provision of some thing or other. It is, however, the case that in common with other social enterprises (Yaari et al, 2020), the board of BCW do a lot of the management that in both the public and private sectors would need to be paid for.

viii. Entrepreneurs vs Social entrepreneurs

Austerity measures in the UK after 2010 led to more councils looking to divest services wherever they could and the early success of BCW garnered considerable interest from a number of county councils that would have allowed the firm to expand (and maybe get some of the economies of scale mentioned previously). All offers were rejected, however, on the grounds that they came too early in the firm's development, particularly as the firm's initial success was largely due to the adoption of a 'minimum viable product,' approach (Robinson, 2001) built on one unusual cubist candle design that had been developed by a member of staff with severe disabilities on the basis of what she could physically manage to make. This meant that the board were unsure of their ability to cope with rapid expansion into a multi-product firm as this kind of learning is complex, (Nicolini and Mesnar, 1995), and it may be the case that without the tangible lure of profit that a certain lack of enthusiasm for large scale risks prevailed. Whether this is as a result of the approach adopted or more to do with the relative caution of those who think of themselves as doing something good rather than something profitable, is hard to say.

The lean start-up approach had certain benefits for BCW, particularly the emphasis put upon experimenting on real customers to identify what will sell (Blank, 2013) as opposed to extensive (and potentially expensive) market research. I think it's also fair to say that we also followed academic advice in how we developed thereafter, since a lot of work was put into the development of the candles before any attempt was made at the generally more risky diversification (Ansoff, 1957), as this approach seemed to be recommended in some relevant cases (Watts et al. 1998, Hussain et al. 2013), and it may be that this represents one example of the benefits of being small. This is not to say, however, that everything was planned, as much of the strategizing was 'emergent' (Mintzberg, 1994) as BCW's first wholefoods shop and coffeehouse were opportunities that arose in the local area and were simply responded to in order to avoid strategic drift (Johnson, 1988) as both seemed to reflect emerging trends at the time, although it was a tight decision on both counts as the board were aware that lack of focus is correlated with start-up failure (Zacharakis et al. 1999, Klotins, 2018). Again, there was an element of distinction with private firms insofar as these opportunities although not specifically for enterprises limited by guarantee were offered to BCW specifically because of the firm's good work in the local community.

ix. Local vs global

Although after one hundred or more years of research into the benefits of locational agglomeration (Marshall, 1920), the fact that geography acts as a constraint on the growth of firms is often overlooked (Audretsch et al, 2007). In the case of BCW it simply couldn't be overlooked despite the fact that the distances were not great and it wasn't as if the firm began in a good location to begin with as industrial rents in the Brecon area are relatively high, while the number of potential customers relatively low compared to the Welsh capital Cardiff which is only an hour's drive away. Nonetheless, it took the firm a decade to establish any retail presence in the capital and it's probably fair to say that there is a certain bias in the board in favour of diversification in activities and products rather than place, even where the synergies and transferable skills between activities and products are low (between catering and candle making for example). Some of this bias may relate simply to size, but some may be more specific and possibly intrinsic to social enterprises. On the size front geographical diversification is recognised as having higher sunk costs particularly for manufacturing that may be proportionately harder for small firms to bear. Another, more specific concern for social enterprises was the different rules that apply in civil society over small distances, in the case of BCW in particular between adjoining Councils and how they work with suppliers (Johnson and Cochrane, 2017). This meant that in each new location a new, and often very different, service level agreement would have to be signed with different expectations and understandings, which would have put a relatively heavy burden on management in comparison to larger profit-orientated firms. Such contracts might also be less advantageous than for capitalist firms who can adopt a more hard-nosed approach to contract negotiation as this is seldom an area that attracts much public attention on the CSR front, in contrast to social enterprises where the ethics are legally enshrined in the organisation and waiting for the public gaze before acting is less of an option. Dealing with supermarkets, for example, has been a bitter experience at BCW despite their apparent 'love' of BCW's ethos and their CSR policies which, to be fair, increasingly focuses not just on consumer issues but on supplier issues too, albeit mostly where it can best be employed in PR pitches to consumers (Fearne et al, 2005), and while often genuine in intent and not simply 'greenwashing,' is nonetheless reflective of an element of selective attention. The question then is whether this is indicative of an intrinsic difference? At one level it certainly isn't true to say that every social enterprise acts in a saintly way to suppliers or indeed customers (Aldrin, 2018), although much of the criticism around this topic is actually directed at private firms that describe themselves as social enterprises. On the other hand, a social enterprise limited by guarantee can specifically block this tendency to be drawn to specific and partial concerns by inserting broad ethical clauses into their governing documents if the founders feel that they need to enshrine this in the future of the firm (as BCW did), which means that for some social enterprises it most definitely is a distinction with a difference.

Conclusion

The BCW case suggests that social enterprises are at an intrinsic disadvantage in terms of access to capital, but that size is only one of a number of market-failures applying to the markets in which BCW operates that have different effects which may be positive of negative for social enterprises, but since the purpose of the paper is not to quantify these but merely to identify them, have not been empirically evaluated here. Other differences were also found regarding the ability of capitalist firms to apply an element of relativity in their CSR policies, the problem for social enterprises of having a multiplicity of aims, and the need to deal with conversion threats that can change their whole raison d'etre, as well as some issue around productivity, and routes to expansion.

Limitations and Discussion

This paper only covers one Welsh firm and, although it is based on fifteen years of reflection from the firm's Chairman and co-founder, generalisations made from it are therefore inevitably tentative. The emphasis on the legal distinction between private firms and -in particular- social enterprises limited by guarantee is also a limiting factor, although it is clear-cut and sidesteps a lot of debate around what constitutes a social enterprise, with firms like Google being excluded even though others would include them on the basis that their aim is to provide information, which is a social good (Elkington and Hartigan, 2008). This is not to say, however, that adopting this legal definition implies any greater consistency in this group than amongst those included in broader definitions regarding their contribution to the social good, which has been found to vary greatly at any one point in time, (Tan et al, 2005) and over time (Dees and Elias, 1998). Nor is it deny that many private firms serve clear social needs, or that they never trade off profits for a good reputation, or above average wages, or that profit precludes the creation of social value, since firms of all shapes and sizes do this on a daily basis (Austin, 2006) and are likely to do more of it rather than less with the advent of CSR. Indeed, for some such as Porter and Kramer (2011), CSR is now so much a part of any and all businesses that the distinction being made in anything other than simple legal terms between social and other types of enterprises is increasingly redundant.

List of Abbreviations

- BCW, Beacons Creative Wales.
- CSR, Corporate Social Responsibility.
- CIC, Community Interest Company.
- ESG, Environmental, Social, and corporate Governance.
- NPO, Non-Profit Organisation.
- UK, United Kingdom.

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