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The governance of social enterprises: Mission drift and accountability challenges in hybrid organizations☆

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ABSTRACT

We examine the challenges of governance facing organizations that pursue a social mission through the use of market mechanisms. These hybrid organizations, often referred to as social enterprises, combine aspects of both charity and business at their core. In this paper we distinguish between two ideal types of such hybrids, differentiated and integrated, and we conceptualize two key challenges of governance they face: accountability for dual performance objectives and accountability to multiple principal stakeholders. We revisit the potential and limitations of recently introduced legal forms to address these challenges. We then theorize about the importance of organizational governance and the role of governing boards in particular, in prioritizing and aligning potentially conflicting objectives and interests in order to avoid mission drift and to maintain organizational hybridity in social enterprises. Finally, we discuss future research directions and the implications of this work for rethinking traditional categories of organizations, namely business and charity.

Contents

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Introduction

One of the most profound trends in the social sector over the past thirty-five years has been its steady rationalization and marketization (Eikenberry & Kluver, 2004; Mair & Hehenberger, 2014; Hwang & Powell, 2009; Powell, Gammal, & Simard, 2005; Smith & Lipsky, 1993). Nonprofit or charitable organizations, whose primary activities have traditionally been premised on achieving a social mission, are increasingly adopting practices that are typically associated with business (Frumkin, 2002; Tuckman & Chang, 2006; Young & Salamon, 2002). Since at least the 1980s, charities have generated a substantial portion of their revenues from the sales of goods and services, especially in the arts, education, and healthcare sectors (Child, 2010). And they have experienced a growing shift toward the hiring of professional managers, and the adoption of formalized practices such as strategic planning, independent financial auditing, and quantitative evaluation and performance measurement (Brest, 2012; Bromley & Meyer, 2014; Ebrahim, 2003b; Hwang & Powell, 2009).

This gradual sector-wide change is epitomized by the growth of so-called "social enterprises," organizations whose purpose is to achieve a social mission through the use of market mechanisms (Mair & Marti, 2006; Kerlin, 2009; Santos, 2012). Social enterprises are neither typical charities nor typical businesses; rather they combine aspects of both. Their primary objective is to deliver social value to the beneficiaries of their social mission, and their primary revenue source is commercial, relying on markets instead of donations or grants to sustain themselves and to scale their operations. For these organizations, commercial activities are a means toward social ends. As such, social enterprises are hybrid organizations that combine aspects of both charity and business at their core (Battilana & Lee, 2014; Besharov & Smith, 2014; Mair, Mayer, & Lutz, 2014; Galaskiewicz & Barringer, 2012). Microfinance organizations that aim to help poor entrepreneurs by giving them access to financial services are a well-known example of social enterprises.

Although social enterprises are viewed as promising vehicles for the creation of both social and commercial value (Sabeti, 2011), they are at risk of losing sight of their social missions in their efforts to generate revenue, a risk referred to as mission drift (Fowler, 2000; Jones, 2007; Weisbrod, 2004). This concern echoes a long tradition of scholarship in organization studies that has highlighted the risk for organizations and their workforces of losing sight of their purpose and values in the quest for organizational survival and efficiency (Selznick, 1949; Weber, 1952). It has also been a central concern of research on organizational governance in the social sector – which may be understood as "the systems and processes concerned with ensuring the overall direction, control and accountability of an organization" (Cornforth, 2014: 5) – particularly regarding the internal means through which governing boards and managers ensure that organizations remain focused on their social goals (Chait, Ryan, & Taylor, 2005; Cornforth & Brown, 2014; Drucker, 1989). Although the risk of mission drift is not specific to social enterprises, it is especially acute for them for two main reasons. First, because they are dependent on commercially generated revenue in order to financially sustain their operations, they are inherently at risk of giving priority to their commercial activities – which enable them to generate revenues and thereby survive – over their social activities which enable them to achieve their mission. Second, the consequence of mission drift for social enterprises is severe as it threatens their very *raison d'être*: if social enterprises lose sight of their social mission, they will fail to achieve their goals of delivering social value to their beneficiaries.

Social enterprises thus face a unique governance challenge: how to handle the trade-offs between their social activities and their commercial ones, so as to generate enough revenues but without losing sight of their social purpose. In terms of organizational governance, social enterprises offer a rich subject of study as they combine not only potentially conflicting goals (social and financial) but also potentially divergent stakeholder interests. In this paper we adopt an accountability lens to unearth these challenges of governance facing social enterprises. It is a function of governance to articulate both *for what* an organization is accountable, and *to whom* it is primarily accountable (Behn, 2003; Ebrahim, 2010; Kearns, 1996; Mulgan, 2000; Najam, 1996; O'Neill, 2002). Our main argument is that social enterprises face distinctive governance issues associated with these dimensions of accountability.

Social enterprises are accountable *for* both a social mission and for making profits (or surplus). By virtue of their hybrid nature, they are therefore required to achieve both social and financial performance. Traditional corporations and charities also increasingly track performance in these domains. However, social enterprises that combine social and commercial activities in their core face a distinct challenge because their definition of success includes both dimensions. These dual objectives are not necessarily aligned and are oftentimes contradictory, thereby often creating a risk to the mission. In addition, while methods for assessing financial performance are well established, the assessment of social performance generally lacks standardization and comparability (DiMaggio, 2002; Ebrahim & Rangan, 2010; Paton, 2003).

Social enterprises are also accountable *to* multiple "principal" stakeholders. They are confronted with often diverging interests of the beneficiaries targeted by their social mission and of their funders or investors. This is not a straightforward principal-agent setting in which the problem for principals or owners, as represented by governing boards, is to ensure that managers carry out their interests (Dalton, Hitt, Certo, & Dalton, 2007; Eisenhardt, 1989; Jensen & Meckling, 1976; Przeworski, Stokes, & Manin, 1999). Instead, it is a context in which there are multiple principal stakeholders (Freeman, 1984; Mitchell, Agle, & Wood, 1997) with different objectives, some of which can enforce their interests and others who cannot. In order to hold managers accountable in such settings and to avoid mission drift, a key task of governance is the proper alignment and prioritization of diverse and sometimes conflicting interests.

In this context we probe two aspects of governance. First, we examine a series of newly emerging legal forms that have been explicitly designed to enable organizations to pursue both social and commercial objectives. We revisit the specific structures of ownership, financing and enforcement mechanisms prescribed by these "legislative experiments," and we clarify their potential and limitations with respect to accountability for dual objectives and accountability to multiple stakeholders.

Next, we discuss organizational governance, paying particular attention to the role of governing boards, in addressing these same challenges. In doing so, we find it useful to distinguish between two ideal types of social enterprises. Whereas all social enterprises engage in social activities meant to achieve their social missions and in commercial activities meant to generate revenue, the level of integration between these two sets of activities varies across them (Battilana, Lee, Walker, & Dorsey, 2012; Battilana & Lee, 2014; Lee, 2013). For some organizations, the activities that are primarily targeted toward serving the beneficiaries and thereby achieving the social mission are separate from those that are targeted toward serving customers and thereby generating revenue; for others they are the same. In this paper, we refer to the former as differentiated hybrids (DH) and to the latter as integrated hybrids (IH) (Battilana et al., 2012).

Integrated hybrids achieve their mission by integrating beneficiaries as customers. Most microfinance organizations are examples of integrated hybrids: they pursue their social objectives by providing loans to their beneficiaries who are also their customers. The primary activities in which they engage when they make loans to the poor enable them both to pursue their social mission and to generate revenue to sustain their operations. Such an integrated model does not exist only in microfinance. For example, consider VisionSpring, an organization that delivers affordable, high-quality eyeglasses and sunglasses to the poor in emerging market countries. Its social purpose is to provide improved vision and, as a result, greater economic opportunities and productivity for visually impaired individuals who can't easily afford or access eyeglasses. The organization seeks to achieve its social objective through an extensive distribution network of local organizations and also by hiring and training poor local women, whom it calls vision entrepreneurs, to visit villages and sell glasses for a price of less than four dollars per pair (Karnani, Garrette, Kassalow, & Lee, 2011). VisionSpring's beneficiaries are its paying customers.

With differentiated hybrids, the social activities are separate from commercial ones. The profits generated by commercial activities, such as the selling of products and services, are used to fund social activities that help beneficiaries who are not the primary customers of the goods or services. In differentiated hybrids, customers and beneficiaries are thus two distinct groups. The Belgian organization, Mobile School, is an example of such a differentiated hybrid (Battilana et al., 2012). It provides educational materials to street children worldwide. Children who live on the streets have access to "a mobile school," basically a box on wheels, which contains blackboards and educational games and can be pulled through the streets of a city. As these children are not able to pay for the products offered and services provided, Mobile School sustains its operations through offering corporate training programs to multinational and smaller corporations.

We draw on the examples of Mobile School and VisionSpring throughout this paper, arguing that integrated and differentiated hybrids warrant distinct mechanisms of governance for avoiding mission drift and for ensuring that hybridity can be sustained. In doing so, we open up new avenues for research on how social enterprises, and hybrid organizations more broadly, can resolve the accountability problems arising from potentially competing objectives and expectations from multiple and diverse stakeholders (Cornforth & Brown, 2014; Ebrahim, 2010; Renz & Andersson, 2014). Each of these dimensions of accountability creates tensions that are likely to persist throughout the life of the organization. In addressing these challenges, we complement the literature on social enterprises (Galera & Borzaga, 2009; Mair, Battilana, & Cardenas, 2012) and contribute more broadly to the organization theory literature on organizations that combines different organizational forms (Haveman & Rao, 2006; Padgett & Powell, 2012; Battilana & Lee, 2014).

The paper proceeds as follows. First, we elaborate on the governance challenges facing social enterprises and expose the risk of mission drift that these organizations must confront in maintaining their hybridity. We build on the distinction between our two ideal types of hybrid organizations, integrated and differentiated hybrids, to further develop the sets of governance challenges they face: accountability for dual performance objectives and accountability to multiple principal stakeholders. We then discuss various means of addressing these governance challenges. More specifically, we probe the roles of new legal forms and organizational governance in monitoring the relationship between social and commercial activities, in monitoring manager performance through control strategies, and in enacting meaningful forms of accountability to beneficiaries. Finally, we close by highlighting how this paper contributes to research on governance, social enterprise, and more broadly on hybrid organizations, and we outline an agenda for further research.

Governance and the risk of mission drift

Social enterprises have existed for a number of decades in certain sectors such as education and healthcare, as well as in member cooperatives and mutual associations (e.g., Cornforth, 2004; Schneiberg, King, & Smith, 2008). For example, the hospital industry in the United States is populated by both for-profit and nonprofit entities that rely heavily on commercial revenues for their survival (such as the Hospital Corporation of America and Partners HealthCare, respectively). In the field of higher education, the University of Phoenix has attracted considerable scrutiny (and federal lawsuits) for its revenue generating activities (Galaskiewicz & Barringer, 2012). But it is only one of many universities, professional schools, and vocational institutions whose heavy dependence on commercial revenues potentially conflicts with its social purpose. More broadly, over the last decade, social enterprises have taken root and grown all over the world in areas as diverse as financial intermediation, retailing, consumer products, apparel, food processing and software development (Dorado, 2006; Hoffman, Gullo, & Haigh, 2012). These organizations profess a social mission, but they see markets as a vehicle for achieving financial sustainability and, in certain situations, as a mechanism for scaling their reach and social impact (Mair & Marti, 2006).

These social enterprises face challenges of governance that are largely unaddressed in the literature. At their core, they combine different sets of activities traditionally associated with the charity and business forms. They are thus bound to face trade-offs between addressing the demands of their paying customers who are viewed as key stakeholders for businesses, and addressing the needs of the beneficiaries of their social mission who are viewed as principal stakeholders in charities. Because organizations are likely to comply with the demands stemming from the external constituencies on which they depend for access to resources (Pfeffer & Salancik, 1978; Wry, Cobb, & Aldrich, 2013), over time social enterprises run the risk of conforming to demands from their paying customers, and to dismissing the needs of beneficiaries who may lack resources and the ability to pay (Battilana, Sengul, Pache, & Model, 2014). If so, social enterprises would be unlikely to retain their hybrid nature as they would, over time, drift toward the business form and away from their social missions. Echoing this scepticism, a number of social enterprises have been criticized for ultimately prioritizing financial gains at the expense of their social mission (Fowler, 2000; Strom, 2010; Weisbrod, 2004). Recent developments in the field of commercial microfinance further illustrate this risk of mission drift (Mersland & Strøm, 2010) as some commercial microfinance institutions have been criticized for focusing excessively on profits at the expense of outreach to poorer customers (Carrick-Cagna & Santos, 2009; Christen & Drake, 2002; Dichter & Harper, 2007).

Are social enterprises that combine social and commercial activities in their core doomed to drift away from their social missions? Or can they avoid this drift? More specifically, can they (1) sustain both social and financial performance, and (2) prioritize among and align the interests of multiple principal stakeholders over time? We contend that while newly introduced legal forms surface and try to speak to these challenges, social enterprises are unlikely to resolve them in the absence of explicit organizational governance processes and mechanisms that ensure the overall direction, control and accountability of the organization. Organizational governance assumes a critical role in navigating potentially contradictory objectives and in attending to the needs of beneficiaries even when the pattern of resource dependence might make social enterprises more likely to attend to the demands of their customers.

In this paper, we elaborate on the role of organizational governance in establishing and maintaining clarity about these two dimensions of accountability: (a) what value the organization seeks to create, that is "for what" it is accountable; and, (b) who is to benefit from that value creation, that is "to whom" it is accountable. We anticipate that governance approaches will differ based on whether the organization is an integrated hybrid (IH) or differentiated hybrid (DH). As outlined above, in DH, profits from commercial activities serve to finance their social activities. In IH, by contrast, the commercial and social activities are interwoven in achieving the social mission, such that profit and social value are created through the same set of activities. As a result of this difference, DH and IH experience the risk of mission drift in different ways.

Mission drift in differentiated hybrids arises when these social enterprises prioritize creating value for their customers (such as corporate clients who pay for a service) to the detriment of their beneficiaries (such as children who receive schooling), which will lead them to invest more resources into their commercial activities than in their social ones. Integrated hybrids do not experience this risk in the same way, as their beneficiaries are also their customers (such as the people who buy VisionSpring eyeglasses). This overlap enables the organization to focus on one set of activities that fulfill both its social and financial objectives. However, these integrated hybrids are still subject to the risk of mission drift as they may over time give priority to profit-seeking over social mission either by charging higher prices, offering additional products or services that are meant to generate profits rather than actually help beneficiaries, or by shifting to market segments that can afford to pay for their goods or services rather than those who most need them. This risk of systematically prioritizing profit is a reason why microfinance organizations have come under heavy scrutiny in recent years both by independent evaluators and by governments (Banerjee, Duflo, Glennerster, & Kinnan, 2013; Karlan & Zinman, 2011).

Below, we explore the implications of these differences in hybrid type for addressing the governance challenges of monitoring of dual performance objectives (accountability for what) and aligning the interests of multiple principal stakeholders (accountability to whom). In our analysis we pay particular attention to the role of governing boards. Governing boards play an important role in organizational governance as they serve as an interface between the organization and its external environment, acting both as carriers of pressures from the environment while simultaneously buffering the organization from them. Indeed, one of the primary duties of a board is to ensure that the organization adheres to and advances its mission (Carver, 1990; Drucker, 1990; Epstein & McFarlan, 2011; Ostrower & Stone, 2006). This implies not only an important oversight function but also a generative role that involves interpreting and reinterpreting the mission in light of current trends and changing circumstances (Ben-Ner & Hoomissen, 1994; Chait et al., 2005; Smith, 1992), and identifying and managing risks (Fisman, Khurana, & Martenson, 2009).

Accountability for what? Dual performance objectives

From a corporate governance perspective, the purpose of traditional business firms is to create value for their owners or shareholders. While they may consider non-financial interests, directors are generally expected under for-profit corporate law and convention to maximize shareholder wealth (Aguilera & Jackson, 2010; Brakman Reiser, 2010: 644). This emphasis on financial performance for private gain provides an important anchor for accountability within business firms. In contrast, the purpose of charitable organizations is to serve public, rather than private interests (Fremont-Smith, 2004; Hansmann, 1996). Accountability in these organizations centers on protecting the social mission—exercising care, loyalty, and obedience in serving the social purpose of the organization (Chisolm, 1995; Fremont-Smith, 2004). Success is defined in terms of progress toward the social mission. Ensuring accountability for the social mission, however, is complicated by a lack of common standards or benchmarks for social performance measurement, and the general difficulty of comparing social performance across organizations (Ebrahim & Rangan, 2014). Nonprofit charities are typically subject to legal prohibitions on distributing their profits and assets, and are thus prevented from any form of equity financing or ownership that would compromise their public purpose for private gain (Brakman Reiser, 2010; Fishman, 2003). These distinctions in the accountability of business and charitable organizations are enshrined in their respective legal frameworks and in organizational governance processes concerned with ensuring the overall direction and accountability of the organization (Cornforth, 2014).

Since social enterprises combine both the business and charity forms of organizing in their core, they are accountable for delivering both financial and social results, and for ensuring that their dual performance objectives are complementary rather than contradictory. Organizational governance is concerned with simultaneously balancing these dual objectives of profit (or surplus) generation and social mission, objectives that have traditionally been governed through the separate forms of business and charity, and codified in the laws of many countries as for-profit and nonprofit incorporation.

Over the last decade, a number of countries have developed new legal statuses to better fit the needs of social enterprises that are neither typical for-profits nor typical nonprofits. Below, we introduce a number of such new legal forms and we analyze how they address the problem of dual objectives in social enterprises. Although these new legal statuses help attenuate the governance problems that social enterprises face, we argue that they are unlikely to resolve them without supportive mechanisms of organizational governance, as social enterprises will continue to face internal tensions between the social and commercial aspects of their activities no matter what legal status they adopt.

New legal forms: Dual objective provisions

There are no universally accepted rules and legal provisions regulating social enterprises at present. In fact, most social enterprises end up incorporating either as for-profits or not-for-profit (Austin, Stevenson & Wei-Skillern, 2006; Renko, 2013) although these well-established legal forms do not ideally fit their needs (Brakman Reiser, 2013). Social entrepreneurs sometimes even create two distinct legal entities, a for-profit and a not-for-profit one, in order to run their social and commercial operations (Mair et al., 2014; Battilana et al., 2012; Bromberger, 2011). However, a series of "legislative experiments" have been untaken – increasingly over the last decade – to facilitate the pursuit of dual performance objectives by organizations. We consider three of the most prominent examples of such endeavors: the low-profit limited liability company (L3C) in the United States; the community interest company (CIC) available in United Kingdom; and, the benefit corporation also in the U.S.[1]. Given the present dearth of empirical evidence on the adoption and effectiveness of these relatively new forms, we draw primarily on the analysis of legal scholars who have examined their potential implications for balancing social and commercial performance objectives (Gottesman, 2007; Katz & Page, 2013; Keatinge, 2009; Tyler, 2010), and especially on a comparative analysis provided by Brakman Reiser (2010, 2011, 2013). In particular, we focus on two means of enabling accountability for dual performance: the structure of ownership and financing, and mechanisms of enforcement.

In terms of ownership and financing structure, there is substantial variation across the three forms. The L3C form retains much of the flexibility inherent in the standard limited liability company (LLC) form, adding hybrid elements to it. L3C status offers an organization the ability to create an ownership structure where different members can have different decision rights. An L3C may, for example, create multiple tranches of membership with the option of granting equity and decision rights only to investors such as private foundations who would be most likely to safeguard

[1] There are many other efforts to provide legal frameworks for social enterprises such as social cooperatives including the following: flexible purpose corporation in California; social purpose corporation in Washington; société coopérative d'intérêt collectif (collective interest co-operative society) in France; cooperative sociali di tipo A and cooperative sociali di tip B (A- and B-type social cooperatives) in Italy; cooperativa de solidariedade social (social solidarity co-operative) in Portugal; cooperativa de iniciativa social (social initiative co-operative) in Spain; société à finalité sociale (social purpose company) in Belgium; Koinonikos Syneterismos Periorismenis Eufthinis, KoiSPE (limited liability social cooperative) in Greece (Defourny & Nyssens, 2008; Esposito, 2013; Brakman Reiser, 2013).

the social mission as a result of a program related investment[2]. The L3C form does not mandate such a structure for balancing social and financial concerns, but provides the flexibility to create it[3]. Thus, while L3C legislation (which varies by state) generally requires an L3C to prioritize social mission over profitability (Tyler, 2010: 123), how it does so is entirely up to its governing board. Its social purpose is thus "essentially unprotected" such that "as a default, an L3C's commitment to a blended enterprise seems enforceable only by internal consensus" of its governing body (Brakman Reiser, 2010: 650). And because the L3C is an option grafted onto existing LLC statutes, the only consequence of a failure to pursue its social mission is conversion of the company to a standard for-profit LLC. The circumstances for such conversions have yet to be empirically observed.

The CIC is stricter in terms of regulatory requirements intended to preserve the social purpose of the organization but, as a result, it also offers less flexibility with respect to assets and earnings distribution. The ownership structure is similar to any other company, with members typically being shareholders who have the right to elect and remove directors. Unlike private companies that *may consider* non-financial interests, the *primary* responsibility of a CIC's directors is to the stated social purpose of the company. And unlike an L3C, a CIC is subject to an "asset lock" requirement that prohibits it from transferring its assets into private hands. Instead, it can transfer its assets only to another organization with a social purpose, such as another CIC or a nonprofit charity. In addition, while CICs can pay dividends to members, these are capped at approximately thirty-five percent of distributable profits (Pearce and Hopkins, 2013; Brakman Reiser, 2010). These limitations on the assets and earnings distribution of a CIC are intended to preserve its social purpose, and are enforceable by a CIC Regulator. CICs have been criticized, however, on the grounds of constraining the company's ability to attract investors, particularly due to the caps on returns (Brakman Reiser, 2010; Grant, 2013; Katz & Page, 2013).

The benefit corporation offers yet a third model. While in many respects similar to enacting states' existing corporate codes (Clark & Vranka, 2013), benefit corporation status requires directors to consider outside interests beyond shareholders, such as those of other stakeholders, communities, society and the environment (Eldar, 2014: 58; Katz & Page, 2013: 863). Organizations seeking benefit corporation status are further required to pursue a public benefit purpose beyond profit making and to issue an annual benefit report disclosed to shareholders and the public (André, 2012: 145; Brakman Reiser, 2011: 604; Cummings, 2012: 592; Munch, 2012). This report discloses the social and environmental performance of the benefit corporation as assessed against a third-party standard (Murray, 2012: 42; Olson, 2011). These independent third parties, such as B Lab and the Global Reporting Initiative, set the standards used by benefit corporations to define, report and assess their social and environmental performance (Brakman Reiser, 2011: 600; Olson, 2011)[4]. Although periodic audits by these independent third parties are possible, a benefit corporation need not be certified by a third party to meet the third party standard requirement; it must only apply the third-party standard to itself. Moreover, there is no enforcement provision that mandates directors to balance dual performance objectives (only that they consider them), nor are there any caps on dividends or limitations on the transfer of assets (Brakman Reiser, 2013). Given this lack of enforcement mechanisms, the strength of the benefit corporation legal status in enabling dual performance stands on its requirement that a company amend its charter to specify social and environmental interests.

In short, all three forms create opportunities for combining social and commercial objectives, but they vary significantly in their approaches for doing so. The CIC form offers the highest degree of regulatory enforcement in requiring explicit community benefits that are reported annually, and imposing an asset lock and capped dividends. But this assurance to the social mission comes at the potential cost of attracting market investors for financing growth. This form is closest to the traditional nonprofit charity, except that it allows equity capital and restricted revenue sharing. Both the L3C and benefit corporation, on the other hand, rely primarily on the commitment of executives and governing boards for balancing dual performance objectives. The L3C offers the option (but not enforceable requirement) of strengthening oversight of its social mission by creating a tiered ownership structure. But the L3C can convert to standard for-profit status should the directors of the company choose to shed their social mission. The benefit corporation can do so as well, but only if a supermajority of shareholders agree. In other words, the L3C and benefit corporation forms can transfer their assets into entirely private hands, whereas CICs cannot do this because of the asset lock requirement.

These new legal entities help to clarify the governance challenges that social enterprises face when it comes to the joint pursuit of social and commercial objectives. Indeed the creation of new legal statuses marks the will to recognize social enterprises as distinct organizations that are neither typical for-profits nor typical nonprofits. This legal recognition provides greater legitimacy to the blended social and commercial objectives of social enterprises in the eyes of both staff and external stakeholders such as providers of capital. However, new legal forms are unlikely to resolve all the governance issues

[2] The L3C form was originally created in the United States, in part, with the intent of enabling the flow of "program related investments" (PRIs) from private foundations. PRIs are investments with the primary purpose of advancing the foundation's charitable goals; any investments that violate this purpose are subject to a penalty. PRIs are appealing to nonprofit private foundations as they qualify under their legally required annual asset distribution (see Brakman Reiser, 2013; Keatinge, 2009).

[3] A multi-level funding structure, for example, would allocate key voting rights to private foundations, as they would bear the most financial risk while receiving the lowest returns. Mezzanine investors would bear comparatively moderate risks and moderate returns. And mainstream investors would seek market-rate returns with minimum risks. For further elaboration in the context of L3Cs, see Pearce and Hopkins (2013).

[4] For a listing of such standards, see http://benefitcorp.net/third-party-standards/list-of-standards (accessed 8/8/2014).

that social enterprises face since, no matter what legal status they adopt, they will continue to experience internal tensions between the social and commercial aspects of their activities. This problem is especially apparent in L3Cs and benefit corporations where the risk of mission drift is not solved by legal status, but remains primarily a concern of internal decision making by executives and board members. Even when legal arrangements impose greater costs to mission drift, as in the case of CICs, social enterprises still face daily trade-offs in the pursuit of their social and commercial objectives, which require attention to organizational governance.

Organizational governance: Balancing dual performance objectives

We turn now to examining specific organizational governance mechanisms; that is, the internal means through which boards and managers seek to balance social and commercial objectives. The primary risk, as we have noted above, is one of mission drift. We focus our discussion on the roles of governance in monitoring performance in order to mitigate this risk. We first elaborate on the challenges of assessing social performance in comparison to financial performance. Then we highlight two main roles of governance – monitoring the relationship between social and commercial activities, and monitoring the performance of agents – and we argue that effective organizational governance differs between integrated and differentiated hybrid organizations. We draw on two stylized examples (Mobile School and VisionSpring) in illustrating our arguments.

Assessing social performance is a fundamentally different task from assessing financial performance. Firms typically use multiple measures of financial performance such as accounting measures (e.g., sales, profit, return on investment) and market measures (e.g., market value, share price, return on equity) that together provide an overall view of performance (Meyer & Gupta, 1994). These measures are generally well established, with standardized definitions and methods of assessment, allowing for comparability over time and with other enterprises. Whether a board is overseeing an organization like Mobile School or VisionSpring, its financial health can be assessed using similar methods and metrics.

In assessing social performance, however, governing boards and managers have no common currency of measurement to rely on, as the results involve diverse activities – for example, in education, healthcare, poverty alleviation, and environment – for which there are few common benchmarks or standards. A vast body of scholarship in the field of evaluation studies has explored this challenge over the past four decades (Guttentag, 1973; Weiss, 1972). A suite of evaluation methods broadly known as "theory-driven evaluation" have become especially prevalent (e.g., Chen, 1990; Chen & Rossi, 1983; Rogers, 2007), premised on articulating "an explicit theory or model of how the program causes the intended or observed outcomes" as a basis for evaluating performance (as quoted in Coryn, Noakes, Westine, & Schröter, 2011: 201; Rogers, Petrosino, Huebner, & Hacsi, 2000). At the heart of much of this work is a "logic model" or results chain in which organizational *inputs* (e.g., knowledge, equipment, and financial resources) are used to support *activities* or *processes* for the production of goods and services (e.g., food, shelter, health services, schooling, job training, etc.) that in turn result in the delivery of *outputs* to a target beneficiary population (typically measured in terms of the number of people reached within that target population and immediate benefits to them). These short-term outputs are expected, over time, to lead to improved *outcomes* in the lives of beneficiaries typically measured in terms of long-term benefits (e.g., increased incomes, health, social integration, or quality of life) (Bickman, 1987; Chen & Rossi, 1983; Donaldson, 2007; Ebrahim & Rangan, 2014; Liket, Rey-Garcia, & Maas, 2014; Weiss, 1972). The distinction between outputs and outcomes has also been described in terms of proximal and distal goals, particularly in the field of health, with the former referring to delivery of services or goods and short-term changes in patient behavior, and the latter to longer-term improvements in health that arise from achieving a combination of distal goals (Brenner, Curbow, & Legro, 1995; Seijts & Latham, 2001; Singh-Manoux, Clarke, & Marmot, 2002). Notably, organizational activities and outputs are typically much easier to measure than outcomes, but it is ultimately the latter that indicates progress toward the social mission.

VisionSpring, for example, measures its outputs in terms of the delivery of eyeglasses to low-income individuals and communities, claiming that the resulting vision correction leads to longer-term outcomes in increased economic productivity and monthly incomes of beneficiaries[5]. Similarly, Mobile School's short-term outputs include its delivery of educational content and games to street children and training workshops to educators, which it measures in terms of the numbers of street children and educators reached in urban slums and streets[6]. The organization's outcome measures include behavioral changes in children terms of self-esteem, trust, and social reintegration, as well as improvements in education such as in skills of numeracy and literacy.

For managers and board members, the core implication of "theory-driven" evaluation is that their monitoring role requires scrutiny of the causal assumptions underlying the organization's interventions, thereby clarifying the organization's working hypotheses and ensuring that it is testing them as part of its performance evaluations. Where cause–effect pathways are well established, the measurement of activities and their immediate outputs can serve as reliable proxies for longer-term outcomes. However, assessments of social change are complicated by the fact that knowledge about cause–effect is often

[5] VisionSpring claims to have delivered 2.2 million pairs of eyeglasses by early 2014. Based on assumptions that glasses increase economic productivity by 35% and potentially increase monthly income by 20%, VisionSpring estimates that it has created an economic impact of $269 million (see visionspring.org, accessed 7/6/2014).

[6] Mobile School claimed to have reached over 51,000 street children in 2012, delivering 2250 school sessions on the street through 33 mobile schools (see http://www.mobileschool.org/en/results/facts-figures, accessed 7/11/2014).

highly incomplete or context-specific, making it difficult to specify the causal links between activities and outcomes, particularly when those outcomes occur outside of organizational boundaries or are affected by multiple actors and environmental factors. Recent scholarship has begun to distinguish among levels of complexity in causal logics (Glouberman & Zimmerman, 2002; Rogers, 2008), developing contingency frameworks for assessing social performance (Ebrahim & Rangan, 2010), and creating forms of developmental evaluation better suited to conditions of poor or emergent causal knowledge (Patton, 2011).

Even where causal knowledge is relatively well established, there remains the problem of comparability: that the performance of one social enterprise such as Mobile School is not readily comparable to the performance of another such as VisionSpring because their social objectives are different. In order to increase comparability across interventions, there have been growing efforts to quantify social performance using methods of benefit-cost analysis, social return on investment, and economic rate of return calculations (Brest & Harvey, 2008; Tuan, 2008; Weinstein & Bradburd, 2014). These methods have primarily been used in the context of evaluating basic social services and job training programs where there is some established knowledge around the relationship between cause and effect. Despite these developments, there remains a wide range of approaches to social performance assessment, with as yet limited convergence on how to assess, compare or aggregate the performance of diverse interventions.

In short, these problems of causality and comparability render the assessment of social performance not only more difficult than the assessment of financial performance for governing boards and managers, but they also demand greater governance attention since the results cannot easily be interpreted. We expect that these dual performance objectives of social enterprises put their social missions at risk because of the temptation to assess performance in terms that are clear with well-established definitions and benchmarks (financial results) rather than in terms that are ambiguous with few established benchmarks and greater potential to be contested (social results) (Brakman Reiser, 2013: 710–711). Moreover, although both integrated and differentiated hybrids face this risk to their social missions, it plays out differently in each type. We elaborate these differences below and their implications for governance in terms of two types of monitoring roles: monitoring the relationship between social and commercial activities, and monitoring the performance of agents.

Monitoring the relationship between social and commercial activities

In differentiated hybrids, the separation of commercial and social activities enables their performance to be monitored separately. In Mobile School, for example, the organization is able to assess the performance of its consulting activities in terms of financial metrics such as profit, while separately assessing the performance of its school carts in terms of their effects on the lives of street children. This division enables boards and managers to set distinct performance objectives for their commercial and social activities. While the organization may still face challenges in assessing social performance (due to the difficulties noted in the previous section), this firewall between social and commercial activities enables greater clarity in both its commercial and social performance assessment.

However, commercial activities can still pose risks to the organization where they contradict or are incompatible with mission. For example, if the commercial arm of Mobile School were to provide business consulting to a multinational organization suspected of employing child labor, it could potentially harm the organization's reputation in providing schooling to children. Also, managers on the commercial side of the organization could seek to capture revenues for themselves (for example, by justifying excessive salaries or perquisites). In other words, by separating the commercial and social activities, and by monitoring them separately, boards run the risk of failing to recognize contradictions or potential inconsistencies that could harm the overall social purpose of their organization. This risk can be conceptualized in terms of policy-practice decoupling (Bromley & Powell, 2012) where top managers legitimate their commercial activities on the grounds of financially supporting a social mission, but in practice routinely engage in actions that are detached from those social goals or that might prevent the organization from pursuing social goals. Framed another way, managers and governing boards invoke a moral justification for their commercial activities (Kreps & Monin, 2011), but in practice do not scrutinize those commercial activities for risks to the social mission. As commercial activities are organized separately from social activities, monitoring revenue-generating activities for an appropriate relationship to social mission is particularly relevant for mitigating this risk.

In integrated hybrids, because commercial and social activities are the same, the risk of mission drift takes a different form. Integrated hybrids run the risk that commercial objectives (profit) will overtake social objectives, undermining the social outcomes of the integrated activity. For example, if VisionSpring were to price its eyeglasses to attract middle-income customers but as a result make them unaffordable to the poor, it would be undermining its social outcomes. Similarly, microfinance organizations that succeed in establishing high loan repayment rates (financial performance) do not necessarily succeed in getting their customers out of poverty (social performance). The challenge for integrated hybrids is to ensure that the commercial transaction actually leads to social change – whether it is finding an affordable price point for its target market, or producing the right set of products or services in order to achieve desired social outcomes – and that they remain aligned over time. This risk may be conceptualized in terms of means-ends decoupling (Bromley & Powell, 2012) in which the alignment between organizational activities and intended social outcomes breaks down, or where the causal relationship between them is poorly established to begin with. A function of effective governance is to monitor whether revenue-generating activities result in the intended social outcomes.

In short, the governance challenge in differentiated hybrids lies in monitoring for contradiction or conflict between commercial and social activities, while the challenge in integrated hybrids is in ensuring a clear causal link between the integrated activity and social outcomes[7]. Although all social enterprises face the problem of clarifying cause–effect relationships between their activities and social outcomes, this risk is especially pronounced in integrated hybrids where good financial performance can mask poor social performance.

Monitoring the performance of agents

The second broad performance monitoring challenge facing social enterprises concerns how to oversee the performance of agents. Agency theory specifies two primary mechanisms for overseeing agents: monitoring the behavior of management and staff (how social and economic activities are carried out); and/or, monitoring outcomes directly (social and financial results) (Eisenhardt, 1989; Jensen & Meckling, 1976). This distinction is often referred to as procedural versus substantive accountability (Coleman & Porter, 2000; Woods, 2001) or process versus outcome accountability (Tetlock, 1985). The choice is not necessarily dichotomous, and most organizations are likely to employ both but with heavier emphasis on one or the other for monitoring performance (Patil, Vieider, & Tetlock, 2014)[8]. In addition to these mechanisms of oversight emphasized by agency theory, organizational theorists have offered a third governance mechanism that emphasizes the selection, training, and socialization of agents in order to imbue members with organizational values and working practices (Battilana & Dorado, 2010; Campbell, 2012; Hwang & Powell, 2009; Ouchi, 1979; Selznick, 1949; Selznick, 1957). We discuss the implications for social enterprises of the agency theory perspectives here, and probe the role of socialization in our discussion section.

From an agency theory perspective, a fundamental task of governance is to determine what kind of control strategy – behavior-based or outcome-based – is most appropriate and feasible for its organizational context. While most organizations can be expected to employ some combination of both types of control strategies, their primary strategies may differ. Behavior-based control requires having information on what staff and management actually do, which can be achieved through observation and supplemented with information systems where that behavior is difficult to observe directly (such as activity logs, and sales and expense reports) (Eisenhardt, 1985). Behavioral controls rely on measures of process, such as the activities carried out by an organization and an assessment of effort rather than effect (Scott, 1992: 355). Because such control requires having relatively clear criteria for judging the quality and quantity of behavior, it is best suited to highly predictable and programmable tasks that can be readily observed and judged (Ouchi, 1979; Thompson, 1967) or, as discussed above, where there is a well-understood theory of performance linking activities to short-term outputs and ultimately to long-term outcomes. Employees who are paid a salary or hourly wage, for example, are compensated through a behavior-based reward system because they are essentially paid to perform a set of tasks, on the basis that the completion of those tasks will predictably lead to the desired outcomes.

Under the second governance mechanism, outcome-based control, agents are rewarded for the results of their actions rather than for the actions or tasks themselves. Such a control strategy may be desirable in contexts not only where behavior is difficult or costly to observe, but also where results are more readily measured (Eisenhardt, 1985; Ouchi, 1979). Notably, outcome-based controls transfer some of the risk of achieving results to the agent, even where the agent may have little control over the context within which she operates. For example, employees who are paid on commission are compensated through an outcome-based reward system because they are paid to achieve a set of results (such as sales), regardless of factors beyond their control such as whether the economy is in recession or growth. As noted above, this task is generally more complex and less standardized in social enterprises than in traditional businesses, especially where knowledge linking activities to outputs and outcomes is poorly developed, and it therefore requires greater governance attention.

Because the primary purpose of social enterprises is to achieve a social mission, we expect that boards of both differentiated and integrated hybrids will seek to establish control strategies that help them to prioritize social results over financial results (to minimize mission drift). However, because their primary revenue sources are commercial, we also expect that they will seek to monitor the results of their commercial activities. As we elaborate below, we expect differentiated and integrated hybrids to differ in terms of the potential conflicts between social and financial performance and, as a result, how they monitor and reward managers for achieving these social and financial goals.

A differentiated hybrid engages in commercial activities meant to serve customers and separate social activities meant to serve beneficiaries. The primary risk to the social mission is that the organization will prioritize creating value for customers to the detriment of beneficiaries. This may occur when the commercial activities generate increasing revenue but managers fail to invest the additional resources in improving or scaling its social activities, choosing instead to further grow its business or

[7] There is a second kind of drift – what might be termed "revenue drift" – in which an organization leans so heavily towards pursuing its social goals that it cannot sustain itself financially through commercial means. The potential consequences are many: the organization may go out of business, it may pare back its social activities, or it may convert into a traditional charity in order to attract donations and grants. Unlike mission drift, such revenue drift is likely to be visible in the financial statements and cash flow of the organization, and thus to receive governance attention. Our focus in this paper is on the governance mechanisms for addressing the risk of mission drift rather than revenue drift.

[8] Notably, the term "outcome" is often used synonymously with "output" in the for-profit business literature. However, as discussed above, these terms are distinct for organizations with a social mission. Agents are more likely to have control over the outputs generated by the organization (as these are created within organizational boundaries) than its outcomes (as these occur outside of the organization).

capturing those excess revenues for themselves. As a result, the monitoring of both sets of activities requires attention to their outcomes. How much revenue is being brought in by the commercial activity, and what is the resulting increase in its provision of social benefits? This monitoring is focused both on the senior managers who head the separate commercial and social activities of the organization, as well as those who bring together both portfolios and thus determine the appropriate relationships and revenue transfer between them.

In contrast, the core activities of an integrated hybrid, such as selling eyeglasses or microfinance to the poor, have the potential to be simultaneously commercial and social. The primary risk to the social mission is that the activities will be carried out in a way that provides little social benefit. Therefore, the main monitoring challenge is behavioral, in that it requires oversight of the process through which social benefits are created: Are eyeglass vendors providing adequate quality of vision testing and eyeglass fitting to their customers, in order to help them see better? Or are they simply trying to make as many sales as possible? Are they targeting their sales efforts toward poor communities who need them the most, or are they shifting toward market segments that can better afford the products? A similar set of questions can be asked of microfinance: Are loan officers providing products suited to helping the poor climb out of poverty? Or are they simply getting the poor further into debt? Are they targeting the poor who could most benefit from a microloan, or simply those who want a loan? Where this task is programmable, such that a routinized sales method leads to predictable social benefits and sales, behavioral rewards may be sufficient. Where the behavior of vendors is difficult to observe or the task is not easily programmable, behavior-based rewards can be supplemented with outcome-based rewards (e.g., higher commissions on sales to the poor or on certain products), provided they do not incentivize vendors to make sales against the interests of the poor.

The costs and practical difficulties associated with behavioral controls (due to the fact that boards are distant from senior managers who, in turn, may be distant from front line staff) make it likely that boards will combine behavioral information with outcome-based information and incentives—using, for example, beneficiary feedback surveys and data on the numbers of poor beneficiaries reached (Bonbright, Campbell, & Nguyen, 2009; Twersky, Buchanan, & Threlfall, 2013). However, in the absence of a behavioral control strategy, we expect that it will be difficult to incentivize vendors to stay focused on their target customers and products that create social benefits for those customers, especially if it means less overall revenue generation. In sum, the primary governance challenge – that the commercial activities provide little social benefit to the poor or that they do not reach the poor – require some capacity to monitor and reward desirable behavior. Notably, the critical agents to monitor in this case are not necessarily the senior-most managers but those responsible for overseeing the behavior of the vendors of the integrated product or service. This discussion is summarized in the top half of Table 1.

As with any control strategy, governing boards are constrained by feasibility in terms of the costs of monitoring and accuracy of measurement. The costs associated with behavioral controls can be high particularly when behavior is difficult to observe directly, such as in settings where managers are in the field with customers or beneficiaries rather than in a controlled office environment. But the costs of measuring outcomes are also likely to be high, particularly where social outcomes are difficult to assess, either due to a lack of standardized metrics or insufficient evidence of a causal link between activities and outcomes. The dual performance objectives of social enterprises render the governance challenge of monitoring performance especially complex, involving not only oversight of the organization's financial performance, but also attention to the risks posed by those very same revenue sources to its social mission.

Accountability to whom? Aligning principal stakeholders

In addition to overseeing dual performance objectives, organizational governance also involves accountability to

Table 1
Governance roles in ideal types of social enterprises.

Ideal type		Differentiated	Integrated
Activity relationship		Commercial $\neq$ social	Commercial = social
Accountability for what	*Governance role:*		
	Monitor activities	Contradiction/conflict between commercial and social activities	Contribution of integrated activities to social outcomes
	Monitor agents	Outcome-based controls	Behavior-based controls
Accountability to whom	*Governance role:*		
	Align upward and downward interests with social mission	Ensure upward fit with mission	Prioritize beneficiary markets that are critical to mission (exit)
		Strengthen downward representation (loyalty), feedback and data (voice)	Ensure upward fit with mission
			Strengthen downward representation (loyalty), feedback and data (voice)

Table 2
Distinctions between business, charity, and social enterprise.

Organizational Form	Business	Charity	Social Enterprise
Performance objective	Financial	Social	Financial + social
Value accrues to	Owners	Beneficiaries	Beneficiaries + possibly owners
Value paid for by	Customers	Funders	Customers (DH), beneficiaries (IH)
Interests aligned by	Market	Governance	Market + governance

multiple principal stakeholders. The problem of multiple accountabilities is not unique to social enterprises, but it is arguably more thorny than in traditional businesses and charities. The problem lies in how to align the interests of various stakeholders, or demanders of accountability, and whose interests to prioritize when those interests conflict.

Business firms have many stakeholders including suppliers, distributors, retailers, customers, and investors, and they often face demands from other external actors such as regulators, local communities, and NGOs (Austin & Ebrahim, 2010; Teegen & Doh, 2003). Stakeholder theories of the firm suggest that organizations may prioritize among stakeholders on the basis of their power, social legitimacy, and the urgency of their claims (Dunfee, 2008; Mitchell et al., 1997; Neville, Bell, & Whitwell, 2011) and that greater value results from the alignment of interests (Freeman, 1984). Although for-profit firms may well face multiple accountabilities, models of shareholder primacy based in principal-agency theory (Dalton et al., 2007; Eisenhardt, 1989) typically assume that the interests of shareholders or owners take priority over those of others, or that owners consider the interests of other stakeholders where it is material to the performance of the firm (e.g., Jensen & Meckling, 1976; Jones, 1995; Zingales, 1998).

Scholars of nonprofit organizations, in contrast, point to a persistent tension between the accountability demands of powerful stakeholders who control access to key resources – donors, foundations and governments – and beneficiaries who typically have little voice although their claims constitute the purpose of the organization (Ben-Ner & Gui, 2003; Jordan & Van Tuijl, 2006; O'Dwyer & Unerman, 2008). This literature highlights the potential conflicts of interest between these groups (or at least divergence of interests) and an implied tension at the organizational level between "upward accountability" demands of powerful donors and "downward accountability" toward beneficiaries (Edwards & Hulme, 1996; Najam, 1996).

The common challenge of governance lies in how to prioritize and align interests. From this perspective the role of principals, and of governing boards in particular, is not only one of a principal overseeing agents, but also one of a strategic political actor seeking to align interests around a purpose, and to prioritize among stakeholders' demands when such alignment cannot be achieved. That purpose and the mechanisms available for alignment, however, differ based on whether the organization is a business, a charity, or a social enterprise.

In businesses, the alignment of upward and downward interests is facilitated by market exchange: value is created for owners when customers buy the goods and services produced by the firm (see Table 2). Only when customers buy their products do investors and shareholders receive any benefit. Downward accountability to customers hinges on the option of exit (Hirschman, 1970), where customers who are dissatisfied with the product or service can leave for a competitor. Upward accountability to investors or owners is also facilitated by exit, particularly in publicly traded companies where shares can readily be sold. This alignment of interests is further operationalized through the company's contracts along the value chain with suppliers, distributors, and retailers, all designed to get products to customers while also maximizing return for owners. Although businesses face further expectations for accountability from actors whose interests are not expressed through markets, such as advocacy NGOs, local communities, and regulators, the market serves as a powerful mechanism for aligning the interests of two principal stakeholders: owners and customers.

Charities, in contrast, do not have a mechanism of alignment akin to the market. In many instances, beneficiaries do not pay (or are heavily subsidized) for the goods or services offered by the charity. Instead, it is funders such as governments, foundations, and donors who pay for or subsidize those services. This separation of those who pay for services and those who receive them creates a potential misalignment of interests, a problem that is exacerbated in settings of multiple funders with divergent interests. Even charities that do have commercial revenue sources, such as those with fee-for-service operations, rely on third-party donors that subsidize their costs. It is therefore not uncommon for a charity to have several funders, with each attaching conditions on the use of its funds, with customized requirements for reporting and evaluating results (Ebrahim, 2003b; Edwards & Hulme, 1996; Hudock, 1999). These "multiple and competing audience pulls" (Lindenberg & Bryant, 2011: 218) have even been characterized as creating a "multiple accountabilities disorder" in organizations (Koppell, 2005, 2011).

Upward accountability to funders is made possible by the option of exit, where funders can revoke their funding if they are dissatisfied with the charity, much in the way that investors or shareholders can exit from a business. But this option is much weaker in downward relationships with beneficiaries, despite the fact that beneficiaries are the primary targets of the organization's social mission and that the organization exists ultimately to create social value for them. Where beneficiaries find the services of a charity to be unsatisfactory, their options to refuse the service (exit) are weak. They are most often in a "take it or leave it" position (Cooke & Kothari, 2001; Najam, 1996) with few if any alternatives, even when they pay something for those services, as a result of both market and government failure (Weisbrod, 1988). More recently, efforts to increase the "voice" of beneficiaries have gained some traction (Bonbright et al., 2009; Twersky et al., 2013), where bottom-up feedback from beneficiaries is systematically shared with both the charity and its funders. For the most part, however, it is a function of governance to consider the interests of beneficiaries and to align their interests and those of funders (i.e., the principal stakeholders) with the mission of the organization.

The business and charity models help to surface the challenges implied in aligning interests of multiple stakeholders in social enterprises. In integrated and differentiated hybrids alike, upward accountability is made possible by the threat of exit where investors or funders can revoke financial support if they feel the organization is not delivering either financial or social value. The more difficult task lies in aligning funders' with beneficiaries' interests. New legal forms developed to better fit the needs of social enterprises help them address this challenge. However, as we explain below, they are not a panacea, and additional organizational governance mechanisms are required to insure that the interests of the non-shareholding stakeholders are taken into account.

New legal forms: Stakeholder provisions

Recent innovations in the legal forms discussed above – such as L3C, CIC and benefit corporation – include provisions for attending to the interests of different stakeholder groups. Each form varies in its consideration of upward and downward interests, and in the degree of formal power allocated to various stakeholders. In general, all three forms allow flexibility in prioritizing among investors (upward accountability), but they do little to empower beneficiaries and other non-shareholding stakeholders (downward accountability).

The possibility of creating a tranched membership structure in the L3C form allows it to differentiate among the upward accountability requirements of its investors. In theory, private foundations are ideally suited to comprising the equity tranche of investors in an L3C. They have the greatest incentives to monitor an L3C for adherence to its social mission due to the legal constraints built into program related investments, which can only be made for advancing social purposes (Katz & Page, 2013; Tyler, 2010). Under a tranched membership structure, private foundations may be allocated greater decision rights on the L3C's governing board than mezzanine investors who receive dividends at below-market rates, or other senior investors who receive market-rate returns in exchange for little or no decision rights (Brakman Reiser, 2010). This is, however, only one option of membership structure available to L3Cs, and there is presently little empirical research on whether or how it has been used. More generally, the flexibility inherent in the L3C allows it to innovate with how it structures its governing body, such that it is able to prioritize some set of stakeholder interests over others, presumably to prevent the financial interests of owners from overtaking the social purpose of the company. An L3C company is not required, however, to include non-investor stakeholders such as beneficiaries in its governing body.

The CIC form, in contrast, is required by law to put in place mechanisms for stakeholder input, although it need not allocate decision rights to non-shareholders. Each company is required to submit an annual community interest report to a government regulator describing how it has sought to include stakeholder perspectives in its governance and decision making. This may include, for example, the use of stakeholder meetings, consultations, and online feedback, as well as the creation of advisory groups and committees that inform the work of the board. Such stakeholder inclusion is part of a broader "community interest test" that each CIC must satisfy upon its founding and every year thereafter, which requires that "a reasonable person might consider [the CIC's] activities are being carried on for the benefit of the community" (as quoted in Brakman Reiser, 2010: 633). Its members, who elect the directors, are responsible for monitoring the performance of the company and its directors, particularly in meeting the community interest test. In the event that regulators determine the CIC is not serving community interests, the government may alter the board composition or shut down the CIC. In short, the CIC includes provisions for gathering stakeholder input toward the community interest test, but there is no requirement for empowering stakeholders other than investors.

The benefit corporation offers a more conventional corporate arrangement, empowering directors to consider "outside interests" (Katz & Page, 2013). However, beyond shareholders, those who feel that directors are not adequately considering the interests of non-shareholding stakeholders are not empowered to take the governing board to task (Brakman Reiser & Dean, 2013; Clark & Vranka, 2013). And although benefit corporations are required to apply a third party standard to themselves, the standards vary considerably in their attention to stakeholders, and there is no requirement for certification or audit. The underlying philosophy is thus that the governing board is empowered to act in the interest of society through its amended charter, and that all decisions beyond this requirement be left to internal governance.

In sum, all three of the legal forms discussed above allocate explicit responsibilities to governing boards for considering stakeholder interests beyond the narrow financial interests of shareholders. Formal decision rights, however, remain largely in the hands of shareholders, thereby maintaining a focus on upward accountability to providers of capital. Mechanisms for enhancing downward accountability to beneficiaries or other non-shareholding stakeholders are essentially left to the discretion of governing boards. We thus explore below options for accountability to beneficiaries through the organizational governance of social enterprises.

Organizational governance: Enhancing downward accountability

In developing an organizational governance perspective on accountability toward beneficiaries in social enterprises, we draw on Hirschman's (1970) work on exit, voice, and loyalty. This work provides a conceptual basis for differentiating among mechanisms of accountability, and thereby for articulating the conditions under which different mechanisms might apply (Anheier & Krlev, 2014; Ebrahim, 2003a). In both of our ideal types – differentiated and integrated hybrids – upward accountability is made possible by the threat of exit by investors or funders who can revoke financial support if they feel the organization is not delivering either financial or social value. The more difficult task lies in identifying downward accountability mechanisms. We contend that the challenges that integrated and differentiated hybrids respectively face are conceptually distinct, and thus how governing boards enable downward accountability is likely to vary between them.

In integrated hybrids, the beneficiaries are also customers of goods and services. At face value, beneficiaries have a strong exit option because their withdrawal would have a direct impact on revenues of the hybrid enterprise. In principle, market exchange strengthens downward accountability to them, much as it does in a traditional business, thereby aligning their interests with those of funders or investors. But there is an important difference with traditional business: markets are still most often agnostic about social purpose and can create a risk to the mission when beneficiaries become viewed primarily as paying customers rather than as people for whom the organization generates social value. This risk manifests itself when the pricing and quality of a product or service is driven by a concern for profits (upward accountability to shareholders) rather than a concern for social benefits (downward accountability to beneficiaries). For example, if a microfinance organization were to make loans to poor farmers under conditions that made them chronically indebted, it would generate revenue but little social benefit. Similarly, if VisionSpring were to pursue a middle-income market in order to increase its margins, and thereby price its eyeglasses beyond the reach of its poorest customers, the exit of those low-income customers would not significantly affect its bottom line. Or if the organization produced affordable but low quality eyeglasses or vision testing, it might be able to sell them to poor customers but without substantially improving their vision.

An important role of governance in integrated hybrids is thus to assess whether its activities are reaching the right set of beneficiaries and whether they have a meaningful exit option. We propose that a meaningful exit option is available to the beneficiaries of an integrated hybrid when: (a) the beneficiaries constitute a sufficiently important part of the organization's market such that their exit would significantly impact revenues; and, (b) the social performance of the organization is explicitly tied to serving those beneficiaries. Even when the first condition is met, beneficiaries may be captive to the organization in underserved markets due to a lack of alternatives or competitors. The second condition thus becomes necessary to minimize incentives for the organization to take financial advantage of its beneficiaries. This task can be aided by segmenting the organization's market in order to prioritize those beneficiaries most critical to its social mission and, as discussed in the previous section, by monitoring for any means-ends decoupling of the organization's activities from its social mission (Bromley & Powell, 2012).

In contrast, in differentiated hybrids customers who pay for the organization's products are distinct from those who receive its social benefits. The exit option for customers, such as clients who pay for a consulting service, is more powerful than it is for beneficiaries, thus creating a risk that the organization will skew its focus toward serving customers who pay for its services (Jay, 2013; Smith & Lewis, 2011), especially as those who pay for the services in social enterprises may be agnostic about the social mission of the organization. A role of governance in a differentiated hybrid may thus be to strengthen downward accountability to its target beneficiaries despite the absence of a meaningful exit option for them.

We see at least two means of enhancing downward accountability – direct representation and indirect voice – both of which involve strengthening beneficiary voice and loyalty rather than exit (Hirschman, 1970). While both of these mechanisms are also relevant to integrated hybrids, they are especially critical in differentiated hybrids because of the absence of an exit option for beneficiaries. The first mechanism involves providing beneficiaries with direct representation on the governing board, giving them a say in the organization's activities. Hybrids may be able to learn from the experience of some traditional charities, such as international development NGOs that have experimented with governance arrangements designed to enable such downward accountability (Brown, Ebrahim, & Batliwala, 2012) as well as from mutual associations and cooperatives (Cornforth, 2004). But doing so is not a straightforward task, requiring processes for legitimate selection, and training to build the capacities of beneficiaries to contribute to board deliberations. The second mechanism is indirect representation of beneficiary interests in the organization, for example via systematic data collection on their preferences, needs, and perceptions about goods or services being offered (voice), using tools such as beneficiary feedback noted above (Bonbright et al., 2009; Twersky et al., 2013), crowd-sourced social media platforms (Scott & Orlikowski, 2012) or other complaint and response mechanisms (Woods, 2001), coupled with closer monitoring of how they use the organization's products or services. These mechanisms for aligning downward and upward interests with the social mission of the organization are summarized in the bottom half of Table 1.

Discussion

Social enterprises force us to rethink traditional categories of organizations as they offer a fourth way of organizing that is distinct from business, nonprofit, and governmental organizations. The combination of commercial and social activities in their core is certainly not without precedent, as they have existed for some time in sectors such as healthcare and education, and have also played an important role in American welfare capitalism of the 1800s and the trajectories of welfare regimes across Europe (Evers, 2005; Hall, 2013). But the increasing visibility and growth of social enterprises suggests that a more fundamental categorical shift may be in the making, as manifest in the emergence of new legal forms meant to better address the needs of hybrid organizations (Esposito, 2013; Tyler, 2010). Although these new legal forms help attenuate the governance challenges that social enterprises face, they do not fully resolve the basic organizational challenges – of dual objectives and multiple principal stakeholder interests – inherent in hybrid organizations that we have presented and discussed in this paper.

A growing stream of research examines the conditions under which social enterprises can sustain their hybrid nature over time (e.g., Battilana & Dorado, 2010; Canales, 2013; Murray, 2010; Pache & Santos, 2013). These studies have identified organizational processes and systems that help maintain versus disrupt hybridity. However, these studies have not systematically examined the role of organizational governance in maintaining hybridity (Mair et al., 2014). This is particularly surprising as newly created legal forms and governing boards assume a critical role in surfacing and reconciling potentially competing objectives and expectations (Cornforth & Brown, 2014; Ebrahim, 2010; Renz & Andersson, 2014).

Our aim has been to fill this gap by theorizing about the organizational governance of social enterprises, exploring the challenges they face in attending to the multiple demands, possible conflicts, and unique opportunities arising from the combination of the charity and business forms at their core. We have proposed that the role of organizational governance in avoiding mission drift and maintaining hybridity involves: (a) monitoring the relationship between social and commercial activities; (b) developing appropriate control strategies for monitoring manager performance; and, (c) enacting meaningful forms of downward accountability to beneficiaries. We have further argued that, in considering these three dimensions, it is necessary to distinguish between the two ideal types of integrated and differentiated hybrids. The governance challenges facing these two types of hybrid organizations are summarized in Table 1.

Contributions

Our paper contributes to the literatures on governance, hybrid organizations, and social enterprises. First, the literature on corporate governance, premised largely on agency theory (Dalton et al., 2007), has provided little direction on how organizational governance might contend with dual performance objectives and multiple demands for accountability, although it has urged greater attention to the role of boards in attending to long-term risks rather than short-term compliance (Lorsch & Clark, 2008; Lorsch, Berlowitz & Zelleke, 2004). Similarly, research on nonprofit governance has only just begun to explore the roles of boards in addressing potentially competing objectives and interests (Cornforth & Brown, 2014; Ebrahim, 2010), and engaging in “generative” behavior (Chait et al., 2005) in which fundamental questions about values, mission, and incommensurate objectives are revisited and negotiated (Fisman et al., 2009). More recently, scholars of both corporate and nonprofit governance have emphasized the need to go beyond compartmentalizing governance research according to established organizational forms, and instead to address governance issues in and around new forms of organizing (Aguilera & Jackson, 2010; Cornforth, 2012; Westphal & Zajac, 2013). This paper provides a first step in this direction by exploring the organizational governance of social enterprises.

Second, our paper also contributes to better understanding hybrid organizations that combine aspects of distinct organizational forms (Haveman & Rao, 2006). Because social enterprises combine aspects of charity and business, they operate in conditions of institutional complexity (Greenwood, Raynard, Kodeih, Micelotta, & Lounsbury, 2011). They have to deal with potentially competing demands stemming from the market and social welfare sectors that they straddle. Research has highlighted both the internal and external tensions that hybrids face as a result of this straddling (for a review, see Battilana & Lee, 2014). Scholarship has begun to examine the roles of managers in handling tensions between social and commercial activities in social enterprises (Battilana & Dorado, 2010; Besharov & Smith, 2014; Canales, 2013; Pache & Santos, 2013), but it has surprisingly not devoted much attention yet to the role of governance (see Mair et al., 2014 for an exception). We contribute to this literature by proposing that organizational governance is vital for hybrid organizing, defined as the activities, structures, processes and meanings by which organizations make sense of and combine aspects of multiple organizational forms (Battilana & Lee, 2014).

Finally, we complement existing literature on the social enterprise. Recent literature has emphasized that social enterprises are not unitary actors and that they vary across geography and communities (Kerlin, 2009; Mair, 2010; Seelos, Mair, Battilana, & Dacin, 2011; Zahra, Rawhouser, Bhawe, Neubaum, & Hayton, 2008). This paper further emphasizes how social enterprises vary in their form of organization (Mair et al., 2012). More specifically, social enterprises vary in how they combine aspects of business and charity in terms of the level of integration, or differentiation, between their social and commercial activities. The degree of integration is, in turn, likely to affect how social enterprises address the accountability problems of dual performance objectives and multiple principal stakeholders. We have elaborated on the role of governance in addressing these challenges, but there is a need for more empirical and conceptual work on the wider organizational conditions necessary for social enterprises to maintain their hybridity and to succeed in achieving their missions.

Limitations and future research directions

We have conceptualized social enterprises as hybrid organizations and have adopted the two categories of integrated and differentiated hybrids in order to theorize about the governance challenges that they face, while recognizing that not all social enterprises fall squarely into our two ideal types (Mair et al., 2014; Mair et al., 2012). For example, a more complex arrangement is illustrated by work integration social enterprises (WISEs) that provide job training to beneficiaries through the process of producing goods or services for customers in a competitive marketplace. These organizations are partially integrated hybrids in that the social activity of job training is partly achieved through the commercial activity of producing a good or service, and yet they are not fully integrated as they also need to engage in separate social activities (such as social training and counseling) in order to help their beneficiaries acquire the social skills that they will need to find a job (Battilana et al., 2014). In the case of WISEs, customers and beneficiaries are thus separate groups, with the exit option likely being strong for the former but weak for the latter. How such organizations are best governed is an empirical question, but we expect that the challenges we have identified for our ideal types – managing the risk of mission drift in the face of dual performance objectives and multiple principal stakeholder demands – will be equally salient to their governance.

Because of their hybrid nature, social enterprises offer a rich context for the study of complex questions of governance. We suggest three promising research directions here—employee selection and socialization, performance measurement, and governance beyond organizational boundaries.

Organizational governance and human resources

In examining the role of governance in social enterprises, an important and enduring question concerns workforce selection and socialization (Battilana & Lee, 2014; Campbell, 2012) as a complement to oversight through behavioral or outcome-based controls (Eisenhardt, 1985; Ouchi, 1979). Research suggests that organizational membership decisions and socialization policies contribute to imbuing members with organizational values and associated working practices (Selznick, 1949; Selznick, 1957), so that they may act based on moral reasoning and commitment to organizational goals rather than making decisions based primarily on following rules or responding to incentives (Schwartz, 2011; Sen, 1976). Supporting this finding, two sets of policies have been identified as crucial levers that hybrid organizations can use to influence how organizational members balance the pursuit of social and economic objectives: hiring policies, which establish the profile of individuals who can become organizational members; and socialization policies, which influence what behaviors they adopt (Battilana & Dorado, 2010). The profiles of managers and board members, as well as the ways in which they are socialized when they join the organization, are critical components of the organizational governance of social enterprises and hybrid organizations in general.

When it comes to hiring, hybrids face a unique challenge as most people are still socialized either in the social or the commercial sector. As a result, they often cannot rely on an existing pool of job candidates with either extensive experience working in, or education about, hybrids. In contrast, both corporations and charities can rely on large pools of candidates with training and experience working in either type of organization. The challenge for hybrid organizations in comparison with both business and charity is that often they still often cannot count on hiring people whose professional background perfectly fits the demands of their hybrid work context.

Because those hired by an organization bring along their professional histories (Aldrich & Ruef, 2006; Bourdieu, 1977), a key decision for hybrid organizations when they cannot hire people with hybrid backgrounds is whether to hire those with relevant social and/or commercial experience or to hire junior people who have not yet been professionally imprinted (Higgins, 2005; Marquis & Tilcsik, 2013; Stinchcombe, 1965). The former hiring approach, which is more focused on candidates' capabilities, prioritizes hiring individuals with required skills to work either in the commercial or social sector. These individuals are likely to have some skills that the hybrid organization will be able to leverage. Although they are not familiar with hybrid work environments, their past work experience will be relevant to the accomplishment of some of the tasks in which they will engage within hybrids. However, these individuals will also bring to the organization their preconceived notions as to what to expect and how to behave in organizations (Bourdieu, 1998; Scott, 1992; Zilber, 2002). In contrast, the second hiring approach prioritizes candidates' "socializability" over their capabilities. Instead of hiring people with experience in the social or commercial sectors, hybrids that adopt a socialization-focused hiring approach select junior people who are malleable to the hybrid model of social enterprise.

Future research could explore whether and how capability vs. socialization-focused hiring approaches shape governance systems and processes in organizations. How do organizations balance their dual performance objectives when they select managers and board members separately for their experience with the charity and business forms? Are managers and board members who embody expertise in both (even though they are still few of them) better able to oversee and support dual performance objectives? Does this differ depending on whether the organization is an integrated or differentiated hybrid?

Once hired, organizational members need to be socialized into the organization. Though the capability-focused and socializability-focused hiring approaches present different challenges for hybrids, both require them to invest considerable resources in socialization processes and systems including training, performance incentive systems, and promotion (Feldman, 1976, 1989; Gómez, 2009; Saks & Ashforth, 1997). Research suggests that agency controls such as incentives and monitoring may be less necessary for improving the effort and performance of "conscientious" employees than they are for less conscientious ones (Fong & Tosi, 2007). The process of socialization whereby individuals come to understand the values and work practices essential to assuming an organizational role provides an opportunity for organizations to instill their desired values and associated work practices in their hires (Bauer, Morrison, & Callister, 1998; Louis, 1980; Van Maanen & Schein, 1979). Transforming new recruits into effective employees is challenging for any organization (Goffman, 1961; Wanberg, 2012), but it is especially difficult for hybrids as new recruits' previous experience may be an obstacle to their socialization in a hybrid work environment (Adkins, 1995).

Further research may help us understand the role of socialization in handling complex tradeoffs involving social and financial performance in social enterprises. Can, for example, socialization help reconcile the tensions inherent in the dual nature of these organizations, thereby maintaining hybridity? Under what conditions does socialization enable the development of "moral skills" in employees to make decisions in gray zones (Anteby, 2008; Schwartz, 2011), and when does it suppress the development of such capabilities? Future empirical research will need to further explore this issue.

Organizational governance and performance measurement

Research is also needed on performance measurement in social enterprises—for example on how financial and social performances are assessed and compared, potential contradictions and complementarities between them, and how this analysis shapes organizational decision making. Social enterprises, like all social sector organizations, are increasingly adopting formalized practices such as quantitative evaluation and third-party auditing and rating (Brest & Harvey, 2008; Hwang & Powell, 2009). But, as we discussed above, while metrics for assessing financial performance are relatively well established, there is not a commonly accepted method or currency for assessing social performance (DiMaggio, 2002; Ebrahim & Rangan, 2014; Paton, 2003). In addition, the time horizons in which financial and social performance are assessed tend to vary, with financial results typically being reported quarterly or annually while social outcomes often require multi-year program evaluations (Edwards & Hulme, 1996; Lindenberg & Bryant, 2001; Rogers, 2007).

How do these factors affect the adoption of performance measurement in social enterprises, especially when financial data are likely to be more standardized and auditable than social performance data? Previous research has shown that charitable organizations use performance measurement not only for internal purposes of assessing and improving their own performance, but also for social legitimation, often adopting short-term and easily quantifiable metrics over more ambiguous or complex measures of social change (Ebrahim, 2003b; Hwang & Powell, 2009). Measurement and reporting systems thus serve not simply as rational instruments of assessment, but as political and contested means of legitimation. What forms of performance measurement do social enterprises employ in order to gain legitimacy in an institutional environment that is still dominated by traditional forms of business and charity? How does the composition of the board and management affect what kinds of data receive attention in decision making? For example, are social enterprises dominated by business leaders more likely to focus on activities that are auditable and quantifiable than on those for which there is greater social need but less auditability? And how do social enterprises signal their performance to diverse audiences of investors, beneficiaries, and customers, given their different expectations for accountability? Research can shed light on the measurement practices social enterprises adopt, their tensions and conflicts, as well as the implications of such measures for advancing or hindering the core social mission.

Governance beyond the organization

Finally, there is a need for research that situates the governance of social enterprises within a much wider context. In this paper we have assessed organizational governance as the "systems and processes concerned with ensuring the overall direction, control and accountability of an organization" (Cornforth, 2014: 5). In contrast, Davis (2005: 143) offers a more expansive concept of governance that takes into consideration not only "the structures, processes, and institutions within" but also "around organizations that allocate power and resource control among participants." This later perspective emphasizes the need for future research to account for dynamics at a broader field level. Research on governance at an institutional field level could examine whether and how hybrid actors, like social enterprises, participate in reshaping the institutional order, redefining traditional categories and establishing new ones over time in order to become a stable way of organizing. If, as institutional theory suggests, organizations adopt the values, norms, and expectations of their external environment in order to be regarded as legitimate (DiMaggio & Powell, 1983; Meyer & Rowan, 1977), then a key governance challenge at the field level is how to legitimate the unorthodox combination of money and mission (Binder, 2007). Because they diverge from the established categories of for-profit corporations and non-profit charities, social enterprises are likely to face an uphill climb in establishing their legitimacy in society and thereby in attracting the resources to sustain themselves. Previous research suggests that mass audiences have difficulty understanding categorical misfits, resulting in their devaluation and limiting their ability to garner resources (Hsu, 2006; Whetten, 2006). It is not that such organizations are disregarded by important resource providers or gatekeepers, but rather that they tend to be scrutinized and negatively evaluated because they violate well-established boundaries (Ruef & Patterson, 2009).

The creation of new legal forms suggests an emerging legitimation of social enterprises. However, these legal forms are in an experimental phase and still lack broad acceptance. As a result, the founders and governing boards of social enterprises often opt for more traditional and taken-for-granted legal forms associated with the categories of nonprofit or for-profit organizations, even though these legal forms rarely fit their needs (Santos, 2012). Recent empirical work on the governance practices of seventy social enterprises found that half of these organizations self-identify with established categories of nonprofit or for-profit organizations, and strictly adopt governance practices associated with these categories (Mair et al., 2014). The other half resists identifying with any established category, selectively coupling existing practices and developing novel approaches to governance. Future research will need to examine these diverse governance practices more systematically and over time. Equally important, further research is necessary on the conditions under which social entrepreneurs opt for new legal forms, and how the choice of legal form influences their functioning and governance. Are social enterprises that adopt one of the new legal statuses any less at risk of mission drift? Are they more or less able to attract resources to enable them to become financially self-sustained? Are they evaluated any differently than social enterprises that register as traditional for-profit businesses or nonprofit charities? And, how do these assessments change over time?

Conclusion

At a time when questions about reforming our economic system remain acute, social enterprises invite optimism as well as caution. They seem to offer a promising way of creating both economic and social value. However, we need to have a better understanding of the conditions under which they can successfully sustain their hybrid nature over time and achieve high levels of both social and financial performance, as well as the conditions under which they are unlikely to succeed. According to estimates produced by Morgan (2010) and Monitor Institute (Freireich & Fulton, 2009), the nascent market in social impact investing will exceed $500 billion in the current decade. This anticipated growth is promising for social enterprises that will be on the receiving end of these investments, but in order to realize their potential, social enterprises will need to establish organizational processes and systems that enable them to sustain themselves without compromising their missions. Doing so is particularly challenging because the ecosystem is still organized to support more traditional organizational forms, with business on the one hand, and charity on the other. In this context organizational governance will assume a vital role in navigating the tensions between social welfare and markets. Further developing research on hybrid organizing will not only provide a better understanding of the conditions under which social enterprises can maintain their hybridity, but in doing so it will also contribute more broadly to research in organization studies. In discussing the risks for organizations losing sight of their purpose and values in the quest for efficiency, Selznick (1957: 135) cautioned more than fifty years ago that the ''cult of efficiency in administrative theory and practice'' was ''a modern way of overstressing means and neglecting ends.'' Scholarship on social enterprises can help us better understand whether and how organizations can heed Selznick's warning in using commercial activities as a means toward social ends.

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