

Inc.

The Magazine for Growing Companies

Go Ahead,

Be Evil

AMAZON'S
HIDDEN
MASTERMINDS
PAGE 34

INSIDE THE
VICIOUS, VICIOUS
CHEERLEADER
WARS
PAGE 66

Do you
need a
social
mission?
Hell, no.
Profit
is the
mission
By Kevin
O'Leary



Kevin
O'Leary
is wrong
By Adam
Lowry

PAGE 52



MR. WONDERFUL
"You have to be willing
to fire your mother."
— Shark Tank's Kevin O'Leary

March 2016 \$5.99 U.S./Canada

117
372
P34B
06732

EDINBORO PA 16412-0094

PO BOX 94

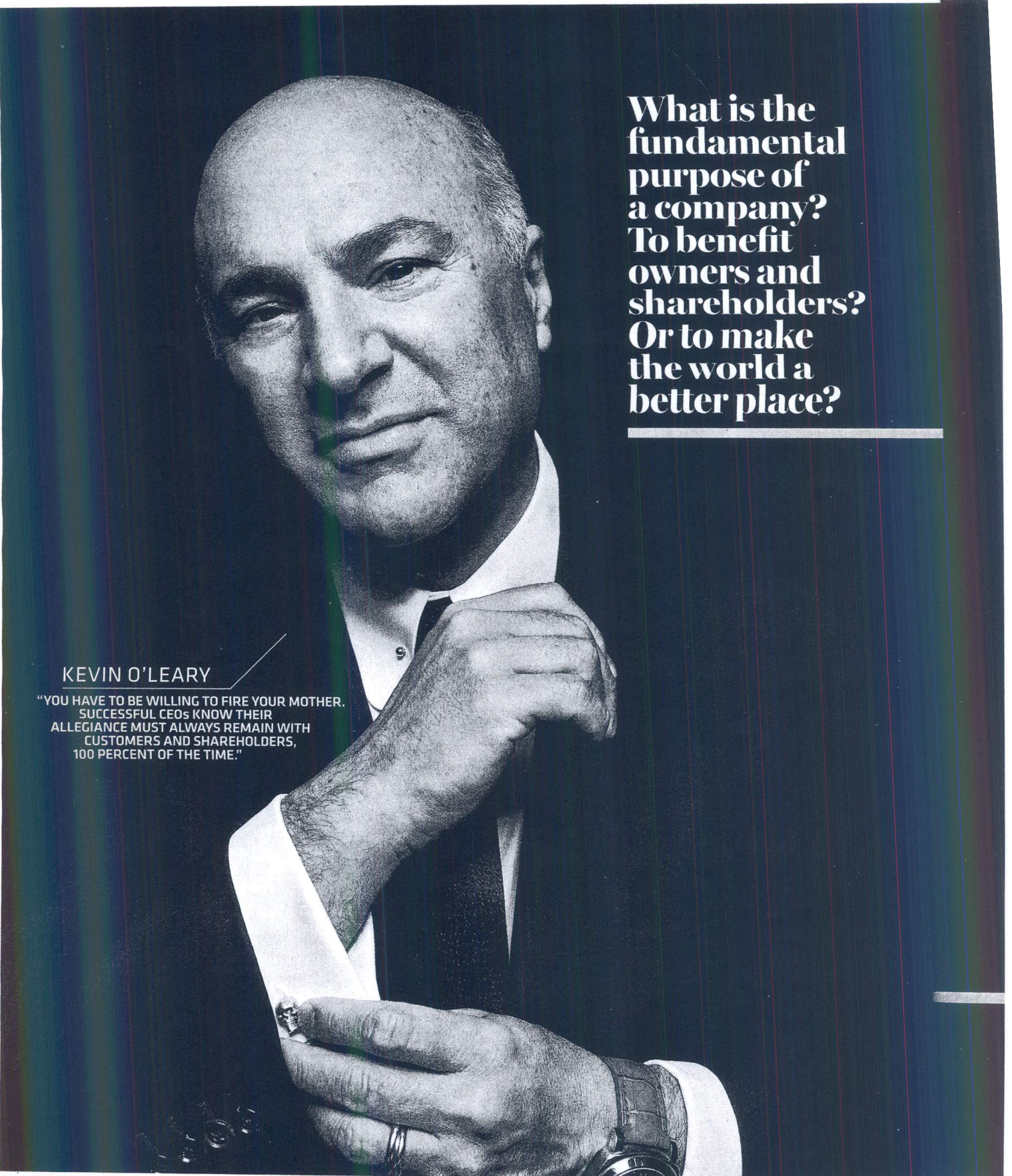
MR RONALD K SWIFT

#ICM0123582991/0# D/J18

6732

#BXBCGGT *****AUTO**S-DIGIT 16412



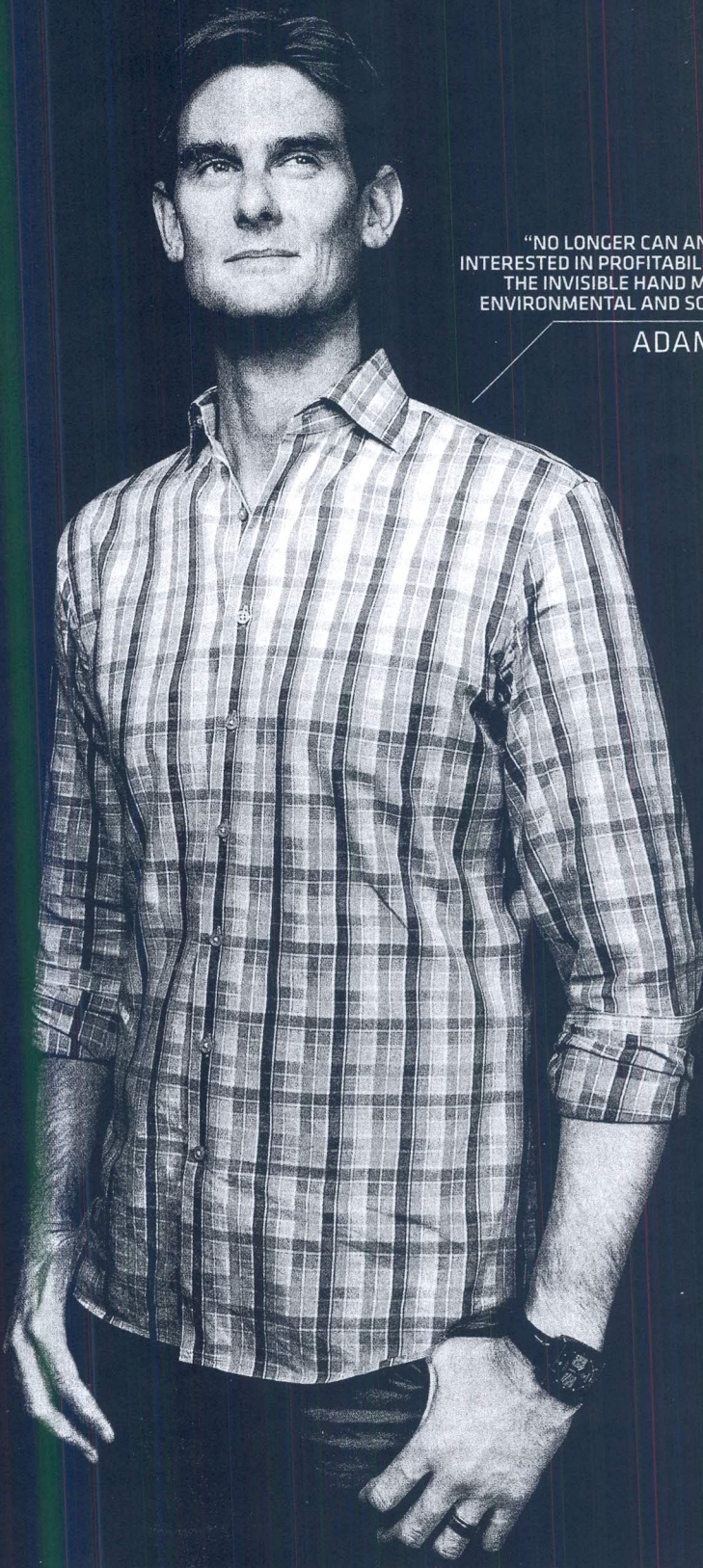


**What is the
fundamental
purpose of
a company?
To benefit
owners and
shareholders?
Or to make
the world a
better place?**

KEVIN O'LEARY

"YOU HAVE TO BE WILLING TO FIRE YOUR MOTHER. SUCCESSFUL CEOs KNOW THEIR ALLEGIANCE MUST ALWAYS REMAIN WITH CUSTOMERS AND SHAREHOLDERS, 100 PERCENT OF THE TIME."

PHOTOGRAPH BY MILLER MOBLEY



"NO LONGER CAN ANY BUSINESS INTERESTED IN PROFITABILITY AFFORD TO LET THE INVISIBLE HAND MANAGE ITS ENVIRONMENTAL AND SOCIAL IMPACTS."

ADAM LOWRY

***Inc.* asked two notable entrepreneurs who stand on opposite sides of the debate to make their cases**

PHOTOGRAPH BY CODY PICKENS

LEAD

Over the past decade, the ranks of entrepreneurs who see beyond the bottom line have been growing. Method, Toms, Warby Parker, and Whole Foods Market have planted the flag of social responsibility, or conscious capitalism, and defended it profitably. Some formally declare their commitment to all stakeholders—owners, employees, the community, and the environment—by becoming “benefit corporations,” a new legal designation. Others simply build a social benefit into their business plan.

But should you join them?

Should your business try to do anything other than generate sales and profits? Survival, after all, is a noble goal in itself. Do you really have to save the planet, too? To dog-eat-dog entrepreneurs like Kevin O’Leary, any startup trying to do more than serve customers and generate profits is being run by labradoodles playing among the pit bulls of commerce. “Running a business is hard,” says *Shark Tank*’s resident cynic and co-founder and chairman of O’Leary Funds, who has myriad investments. “You have to be willing to fire your mother. When you are the leader of a business, your responsibility is to the success of the whole organization, not any one individual, including yourself. Successful CEOs know their allegiance must always remain with customers and shareholders, 100 percent of the time.”

If you’re starting a business, or reevaluating how to focus your existing business, the profit vs. purpose debate has never been sharper. The argument started some 50 years ago, when capitalist icon Milton Friedman tried to smother the nascent corporate social responsibility movement. Friedman argued that earning profit for the owners has been the mandate—and for public companies the legally binding fiduciary responsibility—since capitalism appeared. While Friedman didn’t oppose social responsibility, he reasoned that society is better served

when companies maximize profits for the owners, who can then invest in social causes with the proceeds. He said founders who do otherwise are “unwitting puppets” of socialism who effectively “tax” customers—because prices would have to increase to cover the cost of all that social responsibility.

But the number of entrepreneurs who want to use commerce in ways great or small as a force not just for profit but also for good is growing. These founders have witnessed the consequences of unfettered capitalism, and it isn’t a pretty picture: global warming, pollution, income inequality, environmental degradation,

and resource depletion. Many Millennials saw their Boomer parents spat out in one restructuring or another as corporations pay fealty to Wall Street over people. And they are saying, “No, thanks.”

“The meltdown of our global financial system was a direct result of inadequate checks and balances,” says Adam Lowry, co-founder and chief global sustainability officer of Method, which makes chemical-free household products. (It was purchased by Belgium-based “green” cleaning products company Ecover in 2012.) “It’s a prime example of the invisible hand reigning supreme, while placing the trillions of dollars of recovery

PREVIOUS SPREAD: O’LEARY: CRODNING; DAVID SHANNON FOR FORD; STYLING: ANNE GOLDMAN
FOR FORD; LOWRY: CRODNING; TAHMI SMITH; STYLING: CHUN-KAI

costs onto the backs of American workers, whose real wages have been declining since the Great Recession.”

It's Millennials, the largest demographic in America, who are powering the popularity of socially conscious capitalism. For one, they are not shy about their desire to buy from, do business with, and work for companies that have more than profit as a goal. According to the Deloitte Millennial Survey, 87 percent of Millennials believe that a company should have a larger purpose than racking up profits.

Consumers in general are also expanding their purchasing criteria. According to a report by the Natural Marketing Institute, those living lifestyles of health and sustainability now represent 22 percent of the consumer base. That's up from 15 percent in 2005. More important, NMI reports a continued “greening” of consumers across the board: The segment of consumers who call themselves “conventional” or “unconcerned” about social responsibility continues to decline. More consumers care, and more care more.

Increasingly, consumers buy on the basis of values and value. In turn, retailers, always sensitive to consumer sentiment, are putting profit into the equation.

Target, for instance, introduced a program in 2014 called Made to Matter—Handpicked by Target that features sustainably manufactured and sourced products. The popularity of the line compelled Target to nearly double its size, to more than

200 products. Sales of Made to Matter products were expected to hit \$1 billion for 2015, the company said, up 30 percent from the prior year. Target's research showed that shoppers wanted more transparency and authenticity from the brands they buy.

Target may want to look up a reusable plastic lunch bag called (Re)zip, made by Blue Avocado, based in Austin. Company co-founder Amy George is on a mission to cut waste, source locally, and address gender inequality. She also invests a portion of sales in microentrepreneurs. “There is a more conscious consumer at the table,” says George. “The Millennials are driving growth and they care. They study your supply chain, and they know a ton about it. That's good for businesses like mine. The buyers at these retailers are also Millennials.” (Re)zip's customers, which include Bed Bath and Beyond and the Company Store, are pushing Blue Avocado toward \$8 million in sales.

But Friedman acolytes argue that if (Re)zip is paying above-market wages and sourcing locally, surely it's not going to generate the returns of its profit-driven competitors—and therefore won't be as efficient in raising or using capital. There are signs that his argument is starting to break down. Philip Berber, an entrepreneur who founded Austin-based Enable Impact, which connects so-called “impact investors” with companies such as Blue Avocado, says any gap that once existed in returns has diminished. “We're seeing [socially responsible] investment funds outperforming the S&P and traditional investment managers,” he says.

According to a study by Cambridge Associates, impact investment funds launched between 1998 and 2004—meaning those that have had a chance to sell their portfolios—have outperformed comparable private-equity funds. Those of later vintage still lag, returning 6.9 percent to the PE competition's 8.1 percent, but there's still value to be realized when they cash out of investments, according to the study. Berber says both types of companies exhibit similar early-stage mortality rates.

There is even some evidence that socially responsible companies are more resilient than profit-driven firms. A type of certified “socially responsible” company called a B Corp has higher two- and five-year survival rates than traditional companies, according to B Lab, the sanctioning organization for B Corps. Method, Warby Parker, and the evergreen Ben & Jerry's are B Corps, a designation that involves getting a formal certification and biannual “audit” of criteria such as environmental and community impact, wages, and governance.

There are 1,577 B Corps worldwide, a figure that is growing rapidly, and 26 of them landed on the 2015 Inc. 5000.

This model might also make it a lot easier to hire top talent. The Deloitte survey found that 44 percent of Millennials have turned down a job offer because the company's values did not match their own.

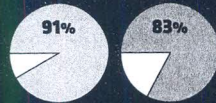
So if the consumer wants it, the market wants it, profits and performance aren't necessarily sacrificed, it could make your company more resilient, and make it easier to hire top

THE UPSIDE OF BEING A B CORP

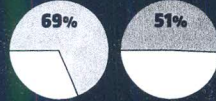
B CORPS ARE CERTIFIED AS SOCIALLY CONSCIOUS ENTERPRISES. THEY ARE ALSO MORE RESILIENT.

■ 2-YEAR SURVIVAL RATE
■ 5-YEAR SURVIVAL RATE

B CORPORATIONS



TRADITIONAL SMALL BUSINESSES



SOURCES: B LAB, DUN & BRADSTREET

TOP 5 B CORPS IN THE INC. 5000

RUNA
NO. 203
INC. 5000 RANK
2,068%
3-YEAR GROWTH
\$4.6M
2014 REVENUE

BRIDGESTONE NATURAL FOODS
NO. 495
INC. 5000 RANK
927%
3-YEAR GROWTH
\$83.8M
2014 REVENUE

ECOZOOM
NO. 768
INC. 5000 RANK
589%
3-YEAR GROWTH
\$6.8M
2014 REVENUE

SUNDIAL BRANDS
NO. 876
INC. 5000 RANK
511%
3-YEAR GROWTH
\$123M
2014 REVENUE

FULL CIRCLE HOME
NO. 895
INC. 5000 RANK
502%
3-YEAR GROWTH
\$4.3M
2014 REVENUE

other issues raises the risk of failure.

Don't be misled by the success of companies like Warby Parker, says O'Leary. They're the exception, a green shoot, and there's no evidence this model can scale consistently and over decades. Even Ben & Jerry's, one of the most successful socially conscious companies, is now owned by a conglomerate, Unilever, of the sort that Millennials claim to abhor.

Steven Kaplan, a professor of entrepreneurship and finance at the University of Chicago's Booth School of Business, warns against trying to serve too many masters. Without profit as a focus, "it's very hard to tell if you're doing a good job," he says. "You have to worry about accountability. It's easy to say: 'I'm great. I'm delivering value to consumers, to the environment. That's why profitability is suffering.' But it's a slippery slope."

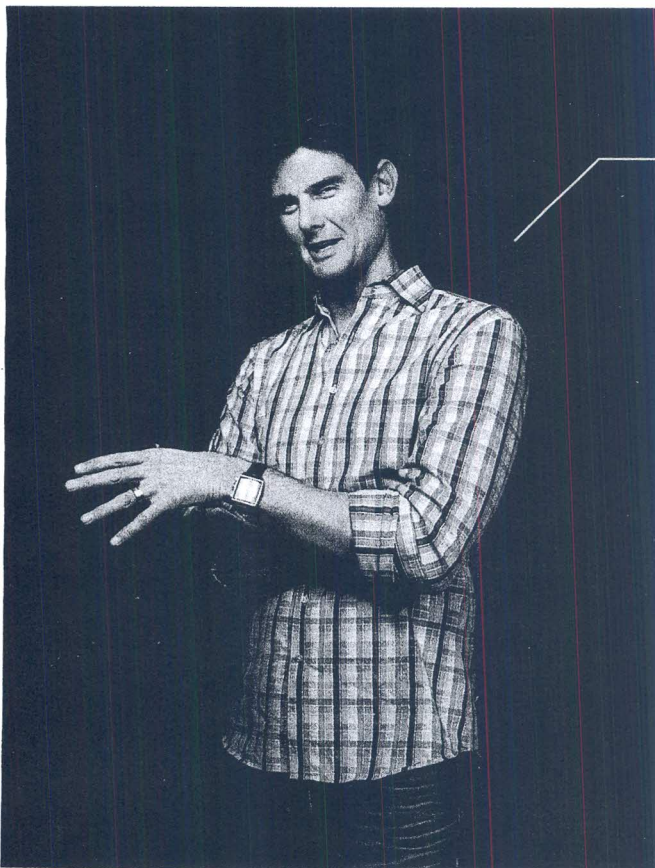
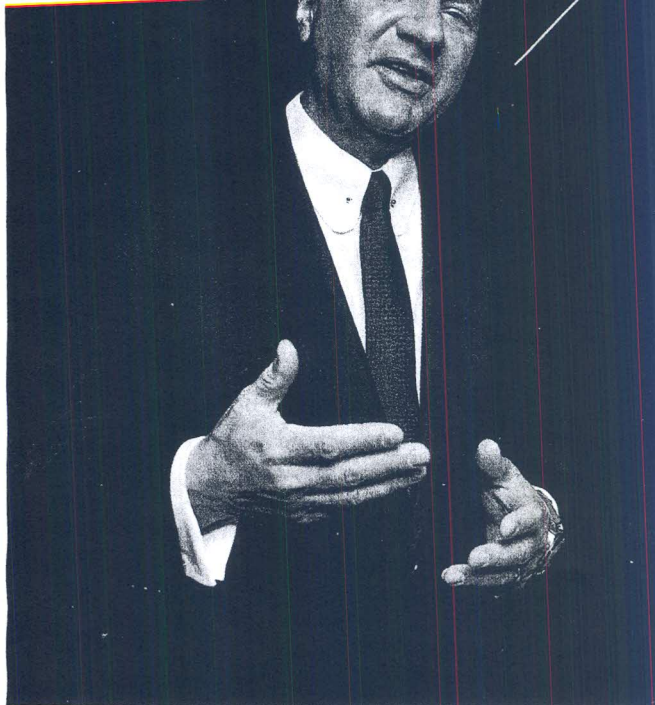
Being an entrepreneur also demands that you be able to pivot constantly, says O'Leary. That's hard to do when you're serving constituencies outside the core business.

Charles Koch, the chairman of Koch Industries, the \$115 billion leviathan of 100,000 employees, and author of *Good Profit: How Creating Value for Others Built One of the World's Most Successful Companies*, says the most compelling reason to focus on profit is because you'll do more good in the long run. "We're not a charity," says Koch. "The more earnings we have, the more good we can do and make our employees' and communities' lives better." While the Koch brothers are known more for their conservative causes, in 2014, the latest year for which data is available, the Charles Koch Foundation donated \$36 million, from assets of \$528 million, to dozens of colleges and universities. It's just one of the many Koch-run foundations that are funded by the company's profits.

Koch Industries companies are among the nation's biggest polluters, but Koch says they are addressing this problem by running plants better. Retailers like Target and Walmart demand this as they respond to their customers' calls for greener, cleaner products. Walmart is nobody's idea of liberal, but the retailer has forced vendors like Koch's Georgia-Pacific unit, which makes paper products, to reduce packaging and optimize their truck deliveries to cut waste, CO2, and other pollution. That, says Koch, is the market working.

Maybe there's a third way to think about this fundamental business question—one that reflects the fact that social responsibility is altering business practices at all companies, whatever the founders' profit philosophy. As consumer demands shift, fair treatment of employees (which boosts productivity), green off-the-grid energy sources (which lower price volatility), and sustainable sourcing (which reduces supply-chain and political risk) isn't profit-killing idealism. It's prudent management. "That's a value-maximizing strategy," says Kaplan. "That's perfectly consistent with Milton Friedman."

BILL SAPORITO is an Inc. editor-at-large.



FROM TOP: MILLER MOBLEY, CODY PICKENS

“Here is the truth: The DNA of a business is to maximize returns to its shareholders.”

KEVIN O'LEARY, CO-FOUNDER AND CHAIRMAN OF O'LEARY FUNDS

I was sitting in my *Shark Tank* chair recently, taping a pitch from two Millennials who were looking to raise \$250,000 for their fledgling underwear business. The undergarment market is brutally competitive, the margins are razor thin, and getting shelf space from retailers is next to impossible.

If someone asked me to find a business that most emulated hell on earth, it would be this.

Chances that I would invest in this? Zero. But wait! This proposal was different. For every pair of skivvies they sold, they were going to give a dollar to charity. They believed that adding a dose of altruism to their business model would somehow make them impervious to the brutal realities of the undergarment market. I've heard the same pitch for socks, knapsacks,

ties, and dog accessories.

I never hear from these companies again; I assume they go out of business. It seems to me that when people go out to buy underwear, they want the best product at the lowest price. Always have, always will.

There seems to be an assumption, mostly by people who have never run a business, that corporate America can and should do more than achieve its primary mandate of maximizing its return. Here is the truth: The DNA of a business is to maximize returns to its shareholders, so they are incentivized to reinvest their capital and start new businesses, create new jobs, and provide innovative products and services that improve lives.

When you contort a business to change this mission, you destroy the very essence of what

makes America great. Modifying the corporate model to solve all of society's problems is simply un-American. And when a CEO takes on a social mission that doesn't serve all constituencies, that's a recipe for disaster.

If you're going to adopt a social mission, it has to pay for itself. A business that disadvantages its model with expenses that don't add value for owners gets beaten by more efficient competitors. This is the Darwinian nature of competition.

I have no problem with the concept of “do no evil” in business. The fair debate is this: Who should pay for it and where should the expense live—on the income statement, or as a gift from shareholders after they have been paid their dividend?

We don't need more companies trying to solve social prob-

lems. We need businesses to return more capital to their owners so they can do what they have always done—pass it forward. It's the reward for running a good business, not a function of one. Think of the multibillion-dollar commitments made by Microsoft's Bill Gates, Berkshire Hathaway's Warren Buffett, and, more recently, Alphabet's Larry Page and Sergey Brin and Facebook's Mark Zuckerberg. There are hundreds of thousands of business leaders doing exactly the same thing. No one has to tell them; it's already in their hearts.

Corporations can be bad actors, and we have laws and regulations to deal with them. But we are at a critical point in capitalism's history. It's time for those who believe in it to stand up and defend it. I'm raising my hand.

“Sustainable businesses are better, more profitable businesses.”

ADAM LOWRY, CO-FOUNDER OF METHOD

There are those who still cling to the antiquated idea that the invisible hand of the free market is all we need to prosper and ensure equitable outcomes for shareholders and stakeholders. They argue the best way for a business to “do good” is to make as much money as possible and then donate some of it to causes it thinks are important. It's a convenient, but flawed, logic. It doesn't protect the interests of society and the environment, and it actually produces poorer economic outcomes.

In December 2015, after 20 years of trying, the world's governments reached a historic agreement to limit greenhouse gases. It happened in no small part because a massive cadre of businesses called for action. Some of the world's largest and

most successful companies signed pledges to greatly reduce their carbon footprints heading into the meeting. That's because today, even the most profit-minded companies know climate change is a huge limitation on economic growth.

Enlightened corporate governance is expanding past initial leaders like my business, Method, and into the mainstream. The success of businesses like ours is the best and final argument against a “profit-first-and-only” focus.

Method provides several examples of how integrating society and environment actually produces better financial outcomes. Method bottles are unique not just in their design, but in that they are made from 100 percent post-consumer recycled plastic. While the free-

market economist would argue that we pay a premium for this material, which is true, the premium is far outweighed by the financial benefit. When oil prices spiked in 2011, nearly all of Method's competitors were forced to raise prices to cover inflated commodity costs. Because post-consumer plastic is far less carbon intense, as are most ingredients in Method products, we were able to hold our pricing. This resulted in market share gains and revenue growth 20 times the cost of the better materials. These gains have sustained, and—even now, with lower commodity prices—our recycled plastic costs essentially the same as virgin plastic. This is a direct strategic and financial benefit to Method, but there are also cost savings to society in the reduction in the

billions of tons of plastic flowing into our landfills and oceans each year.

Method provides full benefits to our hourly factory workers. This investment reduces absenteeism and turnover, and increases productivity. These gains more than cover the cost of providing these benefits. Our factory is also powered by 700 megawatts of wind and solar power generated onsite. Over a 10-year horizon, our energy costs will be lower than they would be if we bought energy from the grid.

No longer can any business interested in profitability afford to let the invisible hand manage its environmental and social impacts. Companies like ours are demonstrating definitively that sustainable businesses are better, more profitable businesses. **i**