



SOCIAL LICENSE*

This brief makes the case that a firm's Social License to operate is an increasingly important intangible asset. For varied reasons, governments and array of stakeholders are questioning how the business operations of firms affect social welfare and whether firms are a net benefit for society.¹ While a firm's Social License embodies the discrete Yes or No answer to whether the firm can operate, it is important to recognize that a firm's Social License is multi-dimensional. Can the firm market its existing products? Can it develop new products? Can it operate in particular geographies? Can it employ its preferred business model? A firm's Social License can be strong, weak, or nonexistent on such dimensions; and its force can change over time and response to social and business developments.

Historically the Social Licenses for many firms were not questioned. The shoe cobblers in Adam Smith's times were guided by the *Invisible Hand* of the market,² and they only survived if they provided services valued by customers, paid employees wages that covered opportunity costs, and generated returns for their owners. In the second half of the last century, the US shoe industry led dramatic improvements in technologies.³ While these required changes in business operations and dislocations of some employees, in combination the improvements in product quality, lower prices, and increased variety generated substantial benefits for consumers. As a result, the Social Licenses of manufacturers remained strong.

By contrast, the Social Licenses of shoe manufacturers in the modern era have weakened. They face questions about (i) the hiring practices of global firms like Nike that manufacture their shoes outside of the EU and US, (ii) the environmental impacts of their global operations, and (iii) their marketing practices.⁴ Other examples of weakening Social Licenses include auto manufacturers (because of climate change), energy companies (because of environmental impacts), and bike-sharing companies (because of impacts on public spaces). One can also, however, identify examples where social acceptance of products has strengthened Social Licenses. Manufacturing and selling alcohol was illegal in the US during Prohibition (1920-1933), but it is not controversial the US now or in the EU and China.

Social Licenses, if relevant, mean that the set of questions for which individual firms must have convincing answers has increased from four traditional questions to a set of five:⁵

1. What should customers buy our products and services?
2. Why should employees be willing to work for our firm?

* © Edward A. Snyder. Mr. Jakub Madej provided valuable assistance with this brief. Several students enrolled in MGT 960 provided helpful comments on an earlier draft.

¹ Raufflet, E., Baba, S., Perras, C., Delannon, N. (2013). Social License. In: Idowu, S.O., Capaldi, N., Zu, L., Gupta, A.D. (eds) *Encyclopedia of Corporate Social Responsibility*. Springer, Berlin, Heidelberg. https://doi.org/10.1007/978-3-642-28036-8_77.

² Adam Smith, *The Wealth of Nations*, 1776.

³ Rf., Masten, Scott E. and Edward A. Snyder, "U.S. versus United Shoe Machinery Corporation,: On the Merits," *J. of Law & Economics*, vol. 36 (April 1993), pp. 33-70.

⁴ Need cites to cover these points. Should also cite Yale SOM's Nike case.

⁵ Sam Palmisano, former CEO of IBM, summarized these questions at a Yale Program in Fall 2023.



3. Why should suppliers, distributors, and partners contract with us?
4. Why should investors invest in our firm?
5. Why should governments allow us to operate in their jurisdictions?

Regarding the last question, can a weak Social License affect valuations? YES. By definition, if a firm cannot pursue new activities, cannot expand geographically, or faces termination of existing activities, then the firm's valuation is reduced.

Even if one accepts that a Social License may be relevant, two specific questions arise about the idea that "governments may not allow firms to operate."

First, how does the loss of support for a firm from the general public, politicians, media, families, communities, and educators result in constraints on the firm's operations?

Second, is there any meaningful difference between the role of Social Licenses and regulation?

The answer to first question is that the loss of support for a firm *leads* to government action to constrain or prevent the firm from continuing to operate. Governments have a lot of tools (formal licensing, permitting, reporting requirements, employment rules, etc.). The concept of Social License becomes meaningful when governments choose to use those tools to make it harder or impossible for firms with weak Social Licenses to operate.

The answer to the second question is that while regulations may exist, government agencies often exercise considerable discretion about whether they should be enforced. In addition, regulations do not cover all activities, e.g., the use of algorithms to feed content to users. In the absence of regulations, governments may simply ban certain firms or activities.

In sum, whether the firm's Social License is strong or weak influences the likelihood of government action.

Let's turn to factors that influence a firm need for a strong Social License. A strong Social License is probably more important for firms seeking to operate outside their domestic market. Chinese EV manufacturers will face challenges if they enter the US market. In a similar vein, Google's search engine and related services are blocked in China. Another influence on the importance of a Social License is whether the firm is B2B or B2C. In the former case, it is typically the case that business customers care primarily about price, quality, and service. If those are good, the issue of Social License may be moot.

What about high-tech industries – once the darling of most stakeholders? Many high-tech firms seem to lack convincing answers to the fifth question in the list above. The general public and many stakeholders now express concerns about (a) the economic and political power of individual firms, (b) their collection and use of vast amounts of personal information, (c) how content and ads are targeted to individuals, and (d) their broader impacts on families, communities, schools, and society. In recent years, governments around the world have limited the distribution of products



and services by companies such as Meta, Byte Dance, Apple.⁶ A mix of local and national governments has also limited how businesses operate and their scope in terms of product offerings. Examples include (i) Uber and whether its drivers must be employees, and (ii) Alibaba and whether it could move aggressively into financial services. It is important to note, however, that as high-tech companies are under attack, governments and societies are asking high-tech firms to solve pressing issues, including how to improve educational systems and reverse climate change. Arguably, this presents opportunities to high-tech firms to burnish their reputations and thereby strengthen their Social Licenses.

Will Social Licenses become more important in the future? YES. While market-oriented economies dominate, societies face huge challenges and the role of governments within economies continues to grow.⁷ With increasing power, governments can restrict what firms can do. Artificial Intelligence by itself will make Social Licenses a yet more important asset. Indeed, AI's impact on industries, communities, and societies will lead firms to pay greater attention to whether they have permission to operate and how to operate.

Is working in China a liability for one's social license to do business with the United States government? Or in the United States at all? In February 2024, several prominent Republican senators called banning McKinsey from US government contracts after FT reported that the Chinese government's central planning agency had commissioned a think-tank affiliated with McKinsey to produce research for Beijing's 2016-2020 five-year plan.⁸

What's the threshold of conduct to raise social license issues? This changes over time but what today is entirely non-controversial may not be so tomorrow. In March 2024, the US House of Representatives passed the "Protecting Americans from Foreign Adversary Controlled Applications Act", a piece of legislation intended to force ByteDance to sell TikTok's US operations or face a ban⁹, despite any clear rationale how TikTok presents a national security threat. Is being "a Chinese-owned app" enough to not be allowed to operate in the US, as some critics argue¹⁰?

References:

1. John Morrison, The Social License. How to Keep Your Organization Legitimate, Springer 2014, <https://doi.org/10.1057/9781137370723>
2. BCG, Why AI needs a social license, <https://www.bcg.com/publications/2022/why-a-social-license-is-needed-for-artificial-intelligence>

⁶ Cites to each.

⁷ Cite to Edward A. Snyder. Five Easy Questions. Explain that this is not a normative statement.

⁸ <https://www.ft.com/content/641fde96-6bb5-4d98-88f0-6e8b382a4b7b>, <https://www.ft.com/content/15a3e8d9-6c57-422a-8eb8-35a3c24a50e3>.

⁹ <https://www.law360.com/articles/1811058/house-panel-advances-bills-to-ban-tiktok-block-data-sales>,

¹⁰ <https://www.ft.com/content/3603b4d2-ce38-4d2c-a21b-baae6ea1921e>.