



# APPROPRIATE LEGAL STRUCTURES FOR SOCIAL ENTERPRISES

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## **Abstract**

This research paper addresses the question what legal forms overcome the specific challenges of a Social Enterprise the most? The research design is organized in an empirical manner and analyses five specific legal frameworks worldwide according to nine criteria that were developed corresponding the latest research and literature. The findings show on the one hand the difficulty that arises for social entrepreneurs as well as for law-making entities in finding solutions how to deal with the dual mission dilemma. On the other hand the research observes how some innovative frameworks like the Community Interest Company (CIC), tandem structures and B Corporation certification provide good starting points for social entrepreneurs and are thus suited for such enterprises.

**TABLE OF CONTENTS**

1	Introduction .....	4
2	Literature Review .....	5
2.1	Theoretical insights on Social Enterprises .....	5
2.2	Theoretical insights on legal structures .....	6
2.3	Criteria for finding suitable legal forms.....	7
2.4	Application of the Criteria to conventional legal forms .....	10
3	Research Design .....	11
4	Case Studies .....	12
4.1	L3C –Low-Profit Limited Liability Company.....	12
4.1.1	Contextual analysis.....	12
4.1.2	Evaluation.....	12
4.2	FPC- Flexible Purpose Corporation.....	17
4.2.1	Contextual analysis.....	17
4.2.2	Evaluation.....	17
4.3	CIC-Community Interest Companies .....	21
4.3.1	Contextual analysis.....	21
4.3.2	Evaluation.....	22
4.4	Tandem Structure .....	26
4.4.1	Legal conditions.....	27
4.4.2	Foundation .....	27
4.4.3	Company limited by shares .....	28
4.4.4	Organizational structure .....	28
4.4.5	BOOKBRIDGE .....	28
4.4.6	SV Group .....	29
4.4.7	Evaluation.....	30
4.5	Alternative declarations: B Corporation.....	32
4.5.1	Contextual analysis.....	32
4.5.2	Evaluation.....	33
5	Synthesis .....	37
6	Conclusion .....	42
7	References .....	44

## 1 INTRODUCTION

Climate change, greenhouse gas emissions, unemployment or natural catastrophes – overwhelming challenges define our time. Whilst giving to charitable organizations in response seems like a laudable action, an attractive sustainable alternative exists: “If you can create a business to do the same job, the money circulates and recycles, and you address the social problem again and again with the same money. In a conventional business everything is for me, nothing for others. In a social business everything is for others, nothing for me.” (Yunus in Grove & Berg, 2014, p. 5)

Nobel Prize Laureate Professor Muhammad Yunus expresses substantial hope in the emergent field of Social Entrepreneurship and its capability to contribute to solving pending problems worldwide. This optimism is shared by many, calling it “enlightened capitalism” (Grove & Berg, 2014, p. 3) due to its social orientation, and emphasizing its potential to “fight for changes in the way we live, think, and behave.” (Skoll, 2006, p. 5)

Scientific research has begun to thoroughly investigate the field of Social Entrepreneurship and the purpose Social Enterprises are to fulfill. Yet, in mainstream research “the term social enterprise describes the purpose of a business, not its legal form.” (BIS Department for Business Innovation & Skills, 2011) This highlights an important situation: To date, only a minor fraction of research has been devoted to assessing legal structures and the way in which they address the special needs of Social Enterprises.

This paper will contribute to closing this gap by conducting inductive, explorative research trying to identify legal structures specifically designed to support Social Enterprises. Therefore, it poses the following research question: What legal forms overcome the specific challenges of a Social Enterprise the most?

In answering this research question, the following structure is taken: Chapter 2.1 introduces the main theoretical concepts by developing a definition for Social Enterprises and introducing the challenges this type of organization faces. Furthermore, the importance of legal frameworks in the realm is outlined (Chapter 2.2) and criteria for assessing the suitability of legal structures for the needs of Social Enterprises are explained (Chapter 2.3). After applying these criteria to conventional legal frameworks (Chapter 2.4) and an explanation of the research design (Chapter 3), the empirical part in chapter 4 introduces five case studies of legal frameworks specifically designed for Social Enterprises. The various insights gained will be gathered and reflected upon in the synthesis (Chapter 5). Moreover, recommendations for Social Entrepreneurs deciding which legal structure they wish their organizations to have will be formulated. Finally, a conclusion summarizes the main lessons inferred and highlights areas for future research (Chapter 6).

## 2 LITERATURE REVIEW

Before focusing on specific legal forms, one first has to gain a solid understanding of the basic theoretical concept of Social Enterprises. Hence, this literature review elaborates a definition of Social Enterprises and introduces their key characteristics (Chapter 2.1). It continues with the importance of legal frameworks (Chapter 2.2), and concludes by elaborating important evaluation criteria for finding suitable legal forms of Social Enterprises (Chapter 2.3) and applying them to conventional legal structures (Chapter 2.4).

### 2.1 THEORETICAL INSIGHTS ON SOCIAL ENTERPRISES

“Social Enterprise is the way forward”.

(Pozniak, 2013)

“Social Enterprise means different things to different people.”

(Dees, 2001, p. 1)

Whilst positive opinions highlighting the future potential of Social Enterprises are widespread, the current academic debate does not possess an agreed upon definition of what Social Enterprise means and entails. Nevertheless, a general endorsement of attributes such as moral considerations and a responsible approach exists. Whilst “there is no universal, commonly accepted definition of Social Enterprises” (OECD, 1999, p. 9), literature review identified three different approaches:

Action-based definitions center on activities of the organization in order to identify a Social Enterprise (Masseti, 2011). The given action will then allow conclusions as to whether the organization is a Social Enterprise, a non-profit or merely a normal business engaging in corporate social responsibility activities. It is important to note that the action itself does not preclude any legal forms for the Social Enterprise.

A second approach focuses on the entrepreneur: For instance, Dees (2001, p. 5) elaborates qualities such as altruistic motives, responsibility, social mission etc. an entrepreneur needs to fulfill. This approach sees the Social Enterprise solely as the organization the social entrepreneur uses for his mission (Achleitner, Pöllath, & Stahl, 2007, p. 7). Again, there is no limitation on what legal form the entrepreneur might employ.

A third approach emphasizes the organization itself: Green and Rogerson state social enterprises are “organizations primarily intended to pursue social impact, which are also financially viable.” Whilst this does not per se exclude any legal forms from the sphere of possible social enterprises, this definition is a useful starting point as it highlights an important duality: Both the social mission as well as

the financial return represent a primary focus in a Social Enterprise. Yet, these two aspects do not necessarily work seamlessly with one another and might, due to their simultaneous presence, represent a trade-off in certain cases. This conflict is inherent to Social Enterprises and is called “dual mission dilemma” in literature (Compare Brakman Reise (2010, p. 619ff) or Brakman Reise (2011, p. 610)).

As to be financially viable, Green and Rogerson (2013) reason that the Social Enterprises “must offer the clear prospect, over the medium and long term [...] of at least breaking even, servicing reasonable debt, and providing acceptable returns to investors”. This financial criterion can be fulfilled by various means, including operating income or a wide range of investors. Social impact, on the other hand, is to be achieved in a field of a pending social problem by the means of an active contribution. Green and Rogerson (2013) leave a broad field of possibilities for pursuing that impact, ranging from resource depletion to economic development, education to job training or greenhouse gas emissions.

A final definition for this paper needs to be chosen considering the research question of finding suitable legal frameworks for Social Enterprises. Accordingly, the definition should satisfy the function of an umbrella term, which includes all possible legal forms of Social Enterprises, a broad array of possibilities for financing as well as different specific social impact orientations. The following definition allows this flexibility:

*“A Social Enterprise is an organization primarily intended to pursue social impact within a field of a not further specified social problem, while at the same time being financially viable, which can be accomplished by different economic means.” (Arbter, 2013, p. 12)*

Thereby, a zone emerges which might include many different legal forms. This is useful as it enables us to keep an open mind when trying to find legal structures which are particularly suitable for the specific needs of social enterprises.

## **2.2 THEORETICAL INSIGHTS ON LEGAL STRUCTURES**

Having found a suitable definition for a Social Enterprise, the importance of the legal framework needs to be discussed. A neutral assessment states that the legal path represents the possibility for the state to enshrine certain rules organizations need to adhere to. Accordingly, they are an important tool for exercising impact on the field of Social Entrepreneurship. The Thomson Reuters Foundation and Morrison & Foerster LLP (2013) provide an example thereof in regard to the aforementioned duality of social mission and financial revenue, saying the “legal structure can have mate-

rial impact on the entity's pursuit of this dual mission." (p. 15) Thus, legal structures are a tool which enable regulating entities to facilitate a balance regarding the dual mission focus.

On the other hand, entrepreneurs choosing a legal structure must choose between different frameworks instating certain obligations. These frameworks possess important implications: For instance, the legal structure guides the ways in which a Social Enterprise operates by predetermining certain positions within an organization and setting the rules for governing within a certain framework. Moreover, the availability of different sources of funding is influenced since e.g. the degree of profit orientation can be determined by the legal structure. Additionally, the terms of an investment depends on the legal structure too: An entity with an asset lock, "a limit on dividends payable" (Chew, 2010, p. 613), will have difficulties attracting investors merely interested in financial return and might find the necessary support in less financially motivated investors such as foundations, individual donors or government agencies.

As exemplified, the legal structure influences the way in which an organization operates, the array of possible investments and the terms according to which they are granted. Since these factors influence "the ability of such entities to commence, continue or scale their operations" (TrustLaw, 2013, S. 16), a reflected decision needs to be taken in order to assure a successful business. In an attempt to provide a framework for a Social Entrepreneur to gauge possible effects of respective legal structures, the next chapter will elaborate nine criteria of consideration which should provide support in choosing a suitable organization type.

## **2.3 CRITERIA FOR FINDING SUITABLE LEGAL FORMS**

In an attempt to create a framework for evaluating different legal frameworks, a way to compare them had to be found. After extensive research (TrustLaw (2013), Roger Spear & Samuel Barco Serano (2012) Astrid Coates & Wim Van Opstalnine (2009)), nine criteria were elaborated that enable social entrepreneurs to reflect upon different possibilities for founding their organization: Obligation to pursue a social mission, mission stability, transparency of the business activity, tax advantages, means of financing, signaling effect, costs and effort of founding, scaling-up of the business and corporate governance.

These criteria are to be understood as dimensions of an ideal Social Enterprise allowing a comparison of the relative performance of various legal structures. Their meaning and respective importance will be explained in more detail now:

***OBLIGATION TO PURSUE A SOCIAL MISSION***

This criterion elaborates the link of the enterprise to the social impact dimension. The focal point is the extent to which a legal form conditions the pursuit of a social mission or whether other orientations can be subordinated to the specific legal form too. This addresses the aforementioned dual mission dilemma between social impact and financial profit. Spear & Serrano (p. 115) emphasize that legal structures should instate regulations incentivizing a low-profit approach, as it is “considered inappropriate for a social entrepreneur to profit from addressing social problems.” Thus, possible ways in which to assure the obligation to pursue a social mission will be elaborated.

***MISSION STABILITY***

The second criterion builds upon the first, yet differs in that it seeks to prevent mission drift during the development of the business. For instance, this could include safeguards preventing the legal transformation into a for-profit organization. This could especially be of importance for longer term investments, where impact investors need to be convinced that their investment will not support a solely profit-oriented goal. A possible mechanism in place to avoid mission drift is ensuring that “assets - which may have been accumulated partly through subsidy/grant and through tax breaks - remain in the social enterprise or are passed on to another social enterprise in case of dissolution/failure.” (Spear & Serrano, 2012, p. 115) This is called an asset lock, which establishes the necessity of a social mission in order for the assets to be used, and limits the amount of dividends that can be paid out. Accordingly, it ensures that changing company objectives towards maximizing financial return does not occur to the detriment of the social mission, thus making it one possible strong assurance for mission stability.

***TRANSPARENCY OF THE BUSINESS ACTIVITY***

Whilst the requirement of transparency is not limited to the realm of Social Enterprises, they are of special significance here. Spear and Serrano analyze how demand for transparency has “led to annual reports being more than annual reports, i.e. including some form of annual social report to stakeholders.” (p. 155). To this effect, other Social Enterprises, such as Accsys Technologies (a British chemical group distributing CO2 negative, stable wood for construction purposes), publish annual impact reports in order to transparently assess the impact they were able to achieve. (Accsys Technologies, 2015)

Yet, the demands for transparency reach even further. Therefore, Roger Spear and Samuel Barco Serrano (2012) state that “decisions in governing bodies are [to be] shared” (p. 8) as well. This highlights the general importance of making business activity transparent for stakeholders.



**TAX ADVANTAGES**

Tax advantages address a possible realm of support on behalf of the state. Since Social Enterprises follow the objective of solving pending social problems, the state may choose to subsidize them by lowering their tax burden. Spear & Serrano's research (2012, p. 15) shows that mainly non-profit engendered Social Enterprises benefit from this status.

Yet, this does not allow the conclusion that organizational forms without a favorable tax situation are necessarily excluded from the list of suitable legal structures. Nevertheless, mentioning the tax treatment is an interesting aspect of consideration for social entrepreneurs as it frees resources for other purposes. Hence, legal structures will be analyzed according to this criterion too.

**MEANS OF FINANCING**

Social Enterprises "are financed by a combination of different types of market resources (resulting from the sale of goods and services), non-market resources (government subsidies and private donations) and non-monetary resources (volunteer work)." (OECD, 1999, p. 50) This array of possibilities to finance the business is impacted by the choice of a legal structure, as was previously mentioned in chapter 2.2. Investors, such as foundations, might accordingly prefer to invest in more charitable causes than banks do. Hence, reflections upon which investors are attracted by the respective legal structures are important to conclude potential means of financing.

**SIGNALING EFFECT**

Coates and Van Opstal (2009, pp. 9, 23) address signaling possibilities of legal structures and hint at their importance in the quest of attracting capital. If the legal form sends a trust-worthy signal regarding the social goal of a company, less convincing needs to be done when attracting socially interested investors. Yet, the perceptual effect is not merely limited to attracting funds. A further potential significance arises in establishing collaborations with other organizations who might find it easier to join forces with an entity known to pursue a social mission and not engage in a hostile takeover.

**COSTS AND EFFORT OF FOUNDING**

Founding the organization requires effort, resources and time. The extent thereof is of interest to a Social Entrepreneur and should thus be criteria of consideration. Thereby, it is necessary to emphasize that costs or time-intensity are not necessarily a reason for dismissing the respective legal structure, since the overall assessment might offset certain disadvantages during founding. At the same time, a legal form requiring little effort to prove the importance of the social mission might have negative perceptual consequences, and could thus develop negative implications for the aforementioned signaling effect.

**SCALING-UP THE BUSINESS**

This criterion takes the perspective of a longer time-horizon. It tries to elaborate whether major facilitators or difficulties are in place to grow a business, whilst maintaining the balance between social impact and financial return. Scaling up a smaller business often is a difficulty (compare: TrustLaw (2013, S. 16), Spear and Serrano (2012, p. 90)), and hence is an important point of reflection.

**CORPORATE GOVERNANCE**

The corporate governance of a Social Enterprise is a crucial point when it comes to directing processes and mechanisms of a company, and the extent to which various groups exercise control. Rooting in the aforementioned dual mission dilemma, it is crucial for corporate governance to contribute in maintaining a balance between social impact and financial return. Accordingly, the governance processes should enable well-dosed influencing possibilities for groups advocating either position. Roger Spear and Samuel Barco Serrano (2012, p. 8) for instance also include the appeal to integrate various stakeholders affected by the conduct of business into the governance process. Key actors can be mobilized in that manner.

**2.4 APPLICATION OF THE CRITERIA TO CONVENTIONAL LEGAL FORMS**

Having established nine criteria for reflecting on the suitability of specific legal structures to the needs of Social Enterprises, they shall now help to exemplify why conventional legal frameworks fall short:

In general, conventional legal structures consist of two subgroups; namely private companies (e.g. general partnerships or private limited partnerships) and capital companies (e.g. limited liability companies or public stock corporations). (Social Start-Up Blog, 2013). Whilst smaller variations exist, these legal structures perform poorly in our assessment: There is no stringent obligation to pursue a social mission and no guaranteed stability of the mission – in case the owners of the company wish to change the social impact mission, they generally have no prohibitions to hinder them. Concerning the transparency of the business activity, publicly listed stock corporations are an exemption to some extent, yet, in general, conventional legal structures lack the desirable degree of transparency. Lacking a distinctive feature to differentiate themselves from organizations without a social impact mission, Social Enterprises taking the form of conventional legal forms may not expect tax advantages. This lack of distinctiveness also poses obstacles when attempting to attract certain non-business investors, thus also making signaling difficult. Finally, the founding-phase, scaling-up and corporate governance depend on the specific conventional legal structure. However, the fact that they are not specifically designed for Social Enterprises remains.

Whilst Social Enterprises possessing a conventional legal form are not uncommon, reflecting upon the above analysis underlines the need for more specific legal forms which consider the defined criteria of a social enterprise to a satisfactory degree. These legal forms will be introduced in the following chapter:

### **3 RESEARCH DESIGN**

The empirical part attempts to answer the research question, what legal forms fulfill the specific challenges of a Social Enterprise the most? Therefore, case studies of legal structures specifically designed to satisfy the needs of Social Enterprises were developed. Following the inductive, explorative approach of this paper, we had no reservations concerning the geographical scope and considered various global examples. After extensive research and contacting institutions such as the Federal Department for Development and Corporation or the EMES International Research Network we settled on five case studies, which all possess an innovative approach allowing gaining interesting conclusions:

A low-profit limited liability company, a flexible purpose company, a community interest company as well as tandem structures represent the four first legal vehicles for founding a Social Enterprise. The fifth case study introduces an alternative way of declaring a Social Enterprise by the means of a certificate. Despite the lacking legal character, the assessment of the certificate enables interesting insights worthy to be included in this paper.

The hereafter following examples will be introduced in the following manner: Firstly, a brief introduction to the context – both historically and geographically – is given. Secondly, the criteria elaborated in chapter 2.3 are used to assess the performance of the respective legal form. A summarizing overview including critical comparisons will follow in the synthesis of chapter 0.

## 4 CASE STUDIES

### 4.1 L3C –LOW-PROFIT LIMITED LIABILITY COMPANY

#### 4.1.1 CONTEXTUAL ANALYSIS

One of the best known hybrid corporations in the USA is L3C (TrustLaw, 2013, p.69). L3C is a derivation from LLC (Limited Liability Company) with focus on societal benefits (Atz, Gramlich & Porter, 2012, p.232). In general, the L3C has identical legal and tax purposes except for the special requirements of the company's purpose, which will be explicated in the next sections (Wexler, 2009, p.568). L3C refers to three "L's" of "low-profit", "limited", and "liability" while "C" is to "company" (Wexler, 2009, p.568). The original idea of L3C came from Robert Lang, the CEO of the Mary Elizabeth and Gordon B. Mannweiler Foundation in USA (Rieman, Adelman & Shofler, 2012, p.19). Since the corporations had long been looking for a creative solution to combine the profit orientation and the social purpose, all the other organizations have developed further and applied his idea (Rieman et al., 2012, p.19). Vermont was the first state in the USA which implemented L3C in 2008 (TrustLaw, 2013, p.69). Meanwhile, L3C was introduced in more than 15 states (such as Michigan, Wyoming, North Dakota, etc.) in the USA (TrustLaw, 2013, p.69). The main-expectation about L3C was to attract private foundations as investors (Wexler, 2009, p.575). Essentially, the interpretations of L3C by the criterion means of financing demonstrate whether this expectation is met.

#### 4.1.2 EVALUATION

##### **Obligation to pursue a social mission**

The question this criteria needs to answer is: To what extent does the legal form condition the pursuit of a social mission? L3C is a for-profit company which pursues a social purpose. Consequently, it represents a business model in which the properties of a non-profit-oriented as well as of a profit-oriented organization are united (Rieman et al., 2012, p.19). Assessing the extent to which this legal form conditions the pursuit of a social mission, the following provision is central: The social or charitable purpose has to be defined in the statutes, which requires an explicit identification with a social mission. Thus, the following three provisions of the social mission, described in the articles of incorporation, have to be fulfilled (Esposito, 2012, p.683): (1) An L3C can be established with charitable or educational purpose. (2) Nevertheless, the production of income or well-being represents no significant purpose of an L3C. (3) For an L3C it is similarly not allowed to have a political or legislative purpose. A charitable purpose is thereby defined as being "organized and operated exclusively for religious, charitable, scientific, literacy, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals" (Schmid, 2010, p.3).

One of the objectives of an L3C is to stimulate program-related investments from socially conscious investors and private foundations (Wexler, 2009, p.568). From the perspective of the private foundations, the purpose of the L3C must match the foundation's exempt purposes in order to qualify the investment in an L3C as a program-related investment (Schmidt, 2010, p.4). Whilst more details about program-related investment are explained in the criterion 'means of financing', this hints at an additional way in how to ensure the pursuit of a social mission.

### **Mission stability**

Before analyzing the likelihood of a mission drift, one has to highlight a fluent transition from LLC to L3C: An LLC may change its legal form to an L3C simply by integrating a social purpose in their statutes (TrustLaw, 2013, p.68). In some states, an LLC is automatically qualified as an L3C if the company is based on a charitable purpose (TrustLaw, 2013, p.68). In contrast, if an L3C no longer meets the requirements of the statutes, it will transform to an LLC; granted the LLC requirements are satisfied (Schmidt, 2010, p.6). Therefore, the risk of mission drift is high since it is very simple to change from a social purpose-oriented L3C to a profit-oriented LLC (TrustLaw, 2013, p.68).

### **Transparency of the business activity**

Generally, L3C's have no special disclosure obligations (Reiser, 2012, p.58). The management of the L3C has the same regular documentation requirements as an LLC, which includes the following mandatory documents mainly focused on tax issues: annual state informational filings, annual state franchise tax filings, state and local income and employment tax related filings, federal state and local regulatory filings, and finally federal and state security filings (TrustLaw, 2013, p.55). Unlike other hybrid corporate forms as the FPC (compare Chapter 4.2), the L3C does not include transparency reporting to members, or public disclosure requirements to non-members (Staley, 2012, p.49).

### **Tax advantages**

Despite its charitable purpose, L3C has a profit-making structure. Therefore, it benefits from no tax relief and is treated as an LLC (Wexler, 2009, p.566). The detailed tax situation in the USA is as follows:

An L3C can be treated as either a pass-through entity or as corporation for income tax purposes since the Internal Revenue Service (IRS) does not have a separate classification for either LLC or L3C (TrustLaw, 2013, p.55). Apart from this lack of classification, an L3C is automatically taxed according to the US tax law of pass-through status: The company itself does not pay income tax as all income, expenses, profits and losses are transferred to the shareholders corresponding to their shares (Yunus, 2010, p.128). In such cases, an L3C with a single owner is taxed like a sole proprietorship;

whilst an L3C with more than two owners is taxed as a partnership (TrustLaw, 2013, p.55). Advantages of the pass-through treatment are to avoid double taxation and to deduct losses of the business on the tax returns of the members (TrustLaw, 2013, p.55). In contrast, a disadvantage of this treatment is that each member's share of the L3C's taxable income is taxable, independent of whether this income is distributed by the L3C to its members or not (TrustLaw, 2013, p.55)

### **Financial Sources**

Private foundations have the opportunity to participate in L3Cs with program-related investments (Esposito, 2012, p.683). Program-related investments bare the possibility for grant-making foundations to undertake tax-free investments in socially beneficial businesses, instead of making traditional grants to charities (Esposito, 2012, p.683). These investments include financial sources such as interest-free loans, loans with an interest rate below the market rate, loan guarantees and equity investments of any kind. Thereby, the primary purpose of program-related investment is to achieve non-profit purposes (Rieman et al., 2012, p.19). Income generation or enhancing prosperity would thus not represent a justifiable purpose (Rieman et al., 2012, p.19). The IRS permits the private foundations to make a program-related investment, if they invest annually 5% of the foundation's assets (Esposito, 2012, p.683). Foundations do not want invest in a for-profit social enterprise, otherwise they can lose their tax-exempt status according to the US IRS (Atz et al., 2012, p.233).

A special feature of L3C is the financing through tranches. As an example, one could presuppose three tranches with different investment objectives (TrustLaw, 2013, p.73). The first investment group carries the ultimate financial risk and gets the lowest yields. This group would especially consist of private foundations undertaking program-related investments (Clarke, 2011, p.312). Like the first investment group, the second group is interested in social benefit too, but carries less risk and with the prospect of larger returns. Finally, the third investment group aspires for the highest possible return on investment with the lowest comparative risk (Schmidt, 2010, p.7). By having foundations carry the greatest risks without or very little participation in earnings, the remaining shares become more attractive to other investors as they carry less risk with the prospect of higher return (TrustLaw, 2013, p.73).

Despite the described potential positive effects, tranches might provide an incentive for mission drift, as they also exist in the classical legal form LLC. Should the different investment classes' interest in financial return increase, they merely need to change the according provisions in the statutes (Murray, 2012, p.23). Another criticism concerns tax issues: If the profit-oriented investors are paid by the tranches classification, tax related complications for the program-related investments of private foundations might arise (TrustLaw, 2013, p.73). From the perspective of the tax authorities, those

foundations are meant to invest in favour of profit-oriented investors, since private foundations are legally not allowed to make profits.

These complications contributed to the L3C falling short on its potential to attract various means of financing: On the whole, private foundations have not engaged in L3C-investments by the means of program-related investment (Murray, 2012, p.23).

### **Signalling Effect**

Depending on the state, a company aspiring to gain an L3C-status must include the “L3C” designation in its name (Esposito, 2012, p.683). This allows companies to brand themselves as a company with primary social or charitable purpose other than profit maximization (TrustLaw, 2013, p.68). This demarcation from profit maximization entities may facilitate opportunities for funding and contracts that might not be possible for the classical LLC (Wexler, 2009, p.568). In some states, enterprises must take the L3C designation and if the requirements of a L3C are no longer met, the L3C term has to be omitted from the company name.

Instating L3C as a legal form followed the intention to attract private foundations. Accordingly, one could assume this legal form should signal that program-related investment requirements are fulfilled (Schmidt, 2010, p.5). Nonetheless, many practitioners believe that this signalling effect is not substantial, meaning that L3C has no real advantages over LLC. Moreover, the identification of an L3C can lead to misunderstandings where private foundations believe that their money is invested only for social purposes (Kleinberger, 2010, p.910). The vast majority of foundations are not absolutely convinced of L3C since it is unclear for them what function the L3C has and unclear whether L3C only “creates the illusion of value” (Riemam et al., 2012, p.19). Furthermore, the Internal Revenue Service does not automatically accept investments in an L3C as program-related investment (Riemam et al., 2012, p.19).

### **Costs and effort of founding**

The costs of establishing an L3C depend on the states where the L3C chooses to build its headquarters. In assessing the costs and efforts of founding of an L3C, the question of whether the L3C is newly created or merely emerged from a LLC is crucial:

A newly founded L3C has the same main cost including “attorney fees for the preparation of documents, state filing fees for organization, qualification and securities filings, statutory representation fees for the LLC’s agent for service of process, and any accounting-related fees for taxation-related advice and services” (TrustLaw, 2013, p.71). Attorney fees are thereby determined by the complexity

of the L3C's management, governance distribution, ownership structure and further additional documents (TrustLaw, 2013, p.71). Other costs, such as state filing, are defined by the respective state.

Creating an L3C by transforming an LLC is less laborious: The existing LLC must merely change the purposes of the corporation since the statutory scheme does not impose new obligations on fiduciaries and disclosure requirements (Reiser, 2012, p.60).

### **Scaling-up the business**

To evaluate the long-time perspective of an L3C, different features must be considered: If the business scales-up, the risk of mission drift is high since it is very simple to change from a social purpose-oriented L3C to a profit-oriented LLC (TrustLaw, 2013, p.68). Theoretically, financing options to grow the business are investments from socially conscious investors and from private foundations (Wexler, 2009, p.568). Since the vast majority of foundations are not absolutely convinced of L3C, the L3Cs do not really benefit from the program-related investments in the long-term. One fact is that particularly small businesses in the USA use L3C as a business form, due to the relatively simple business form regarding the limited liability protection and pass-through tax treatment for its members (Schmidt, 2010, p.5). The newspaper industry is one of those where L3C legal structure is often used (Schmidt, 2010, p.7). An L3C newspaper provides news, opinion pieces and cultural reviews in order to promote community services, but without profit as the primary concern (Schmidt, 2010, p.7). As the example with the newspaper emphasizes, the issue about scaling-up the business is less relevant but it can depend on the business strategy (Schmidt, 2010, p.7).

### **Corporate Governance**

The organizational structure of the L3C is similarly designed to the LLC, giving it flexibility regarding to the corporate governance, management, distribution and ownership structure (TrustLaw, 2013, p.70). This flexibility effectuates that L3C can be governed either directly by its members, by a subset of its members, or by a centralized group of managers who are members, non-members or a combination of both. For the daily business operations, a Chief Executive Officer or a Chief Financial Officer in an LLC can be appointed (TrustLaw, 2013, p.47). Another option is to leave these operations to the members or to the managers of the LLC (TrustLaw, 2013, p.47).

Whilst it is possible to assess a general flexibility concerning corporate governance, some general tensions of Social Enterprises regarding the dual mission dilemma remain: Even though the L3C statutes prioritize the charitable purpose, some scholars criticize the conflict of financial goals and tax-exempt purposes, and the difficulty for the directors to prioritize them (Esposito, 2012, p.687).



Therefore, it is not clear how this goal-conflict influences the L3C governance and the fiduciary duties of L3C managers (Esposito, 2012, p.688).

## **4.2 FPC- FLEXIBLE PURPOSE CORPORATION**

### **4.2.1 CONTEXTUAL ANALYSIS**

FPC was first introduced in 2011 in California, and is a new form of a for-profit organization (TrustLaw, 2013, p.62). Also accepted in the state of New York, it builds upon the L3C described in Chapter 4.1 (Rieman et al., 2012, p.19). Since L3C did not succeed in triggering investments of private foundations, there was a need for another hybrid corporate form which fosters greater acceptance (Rieman et. al., 2012, p.19). The California Working Group for New Corporate Forms thus drafted the Flexible Purpose Corporation as an alternative. FPC and L3C mainly differ in respect to their financing strategy: The L3C is established in order to enable program-related investment from private foundations, whereas the FPC is created to raise equity capital (Esposito, 2012, p.690). Another difference is that an FCP is easily accessible, thereby essentially allowing a wider range of purposes for a broader group of investors (Esposito, 2012, p.690). In an FPC, they can pursue one or more explicitly adopted social or other special objectives in addition to the maximization of profits (TrustLaw, 2013, p.61). Directors and officers of an FPC are therefore allowed to realize one or more specific purposes at the expense of economic value, given the clarity of the purposes in the Articles of Incorporation and the sufficient accountability (TrustLaw, 2013, p.63). As of 2012, eight corporations are registered in California as an FCP in 2012 (TrustLaw, 2013, p.61)

### **4.2.2 EVALUATION**

#### **Obligation to pursue a social mission**

“Do well and do good”- this is the object of the FPC and translates to pursuing a charitable purpose at the expense of company profits, without having to respectively maximize shareholder return (Rieman et al., 2012, p.19). The charitable purpose thereby is defined in the statutes and includes four provisions: (1) The FCP pursues one or more non-profit or public purposes which are pursued by a NPO. (2) The purpose may promote positive effects or minimize negative effects thereby benefiting own employees, suppliers, customers or creditors, (3) or benefiting the community and societal considerations, (4) or the environment (TrustLaw, 2013, p.63-64).

At this point, it is important to highlight a difference to other traditional nonprofits: The FPC has the opportunity to consider the interests of non-shareholder stakeholders such as employers, suppliers etc. as well (Reiser, 2012, p.63). Nevertheless, the charitable purpose must be explicitly formulated in the statutes whereas at least one special purpose must serve the interest of the corporation and its shareholders (Clarke, 2011, p.318). These options regarding the purpose of the organization enable

the flexibility of an FPC (Esposito, 2012, p.689). Additionally, accountability of the FPC to its stakeholders is also ensured through the special reporting requirements, which will further be described under the criterion of transparency (Esposito, 2012, p.691).

### **Mission Stability**

Assessing the possibility of a mission drift, the following aspects need to be mentioned: The specific purposes may be changed or omitted by at least two-thirds of the shareholders or a greater majority, depending on the statutes (Rieman et al., 2012, p.19; TrustLaw, 2013, p.64). Similarly, the directors may suggest alterations to the statutes concerning the special purpose, if two-thirds of the shareholders support their motion (Reiser, 2012, p.64). In general, the broad range of possible special purposes enables the alteration of the purpose within the FPC umbrella – these changes are facilitated by the lack of an established relative importance of the different goals (Reiser, 2012, p.64).

Two scenarios are worth taking a look at: If an FPC merges with a NPO, all shareholders must agree (Rieman et al., 2012, p.20). This is necessary, as a transformation from a profit-oriented to a non-profit status ends shareholders' rights to distributions of dividends (Reiser, 2012, p.64). Therefore, shareholders have additional protections against loss of economic value regarding the FPC transformation (Reiser, 2012, p.64). In contrast, a merger of an FPC and a for-profit company requires at least two-thirds of the shareholders votes (Rieman, 2012, p.20). In addition, shareholders are given dissenters' right to opt-out of certain corporate transactions regarding of any material change in the special purposes set forth in the statutes (TrustLaw, 2013, p. 64). For instance, dissenters, especially large minority shareholder groups, "may opt to have their shares purchased by the corporation for the market value" (Reiser, 2012, p.65).

In conclusion, the mission stability cannot be guaranteed by the means of legal provisions, but depends on the composition of the shareholders as well as their configuration of interests regarding profit-oriented and non-profit-oriented goals.

### **Transparency of the business activity**

The transparency of the social purpose is mainly determined by mandatory reporting requirements. These assess accountability as well as transparency for shareholders (TrustLaw, 2013, p.61). One or more special purposes must be clearly determined in the Articles of Incorporation of the FPC, respectively statutes (TrustLaw, 2013, p.64). The company is thereby required to publish its mandatory reporting on the corporation's website (Esposito, 2012, p.691). This transparency allows insights on the company's success, as measured in its own internal assessment (Rieman et al., 2012, p.20).

Moreover, an annual report for shareholders must be prepared (Rieman et al., 2012, p.20). In this annual report, “certain financial information and [...] a Special Purpose Management Discussion and Analysis (Special Purpose MD&A) related to the entity’s enumerated special purposes” are disclosed (Rieman et al., 2012, p.20). Special Purpose MD&A include short- and long-term goals for the FPC’s special purposes, analysis of any changes for the special purposes, discussion of material actions achieving defined purposes, and the impact of these actions (Rieman et al., 2012, p.20). Furthermore, short- and long-term strategies, as well as capital expenditures for achieving these special purposes, are reported (e.g. a three-year projected budget) (Rieman et al., 2012, p.20).

In addition to the aforementioned transparency-enhancing tools, the Special Purpose Current Reports inform shareholders within 45 days about an actual or planned expenditure for a special purpose (Esposito, 2012, p.691). Whilst this generally allows positive transparency, limitations exist: The Special Purpose MD&A and the Special Purpose Current Reports may be omitted in an FPC with fewer than a 100 shareholders, if at least two-thirds of the shareholders appeal for it (Rieman et al., 2012, p.20).

### **Tax advantages**

Despite the social purpose, there is no tax relief. FPCs have an equal tax treatment as corporations with tax approaches for two different corporation types (TrustLaw, 2013, p.40). The first concerns C-Corporations (general taxation of companies): The corporation’s profits, as well as the dividends, are taxed, hence effectuating double taxation (Clarke, 2011, p.323). The other type exists for the S-Corporation where each shareholder pays taxes only on their own share of company profits, the so called pass-through treatment (compare L3C, Chapter 4.1.2). For the case of an FPC, not all companies are taxed as S-corporations (TrustLaw, 2013, p.40-41). This is due to requirements such as requesting that a corporation is taxed according to S-corporation only if its shareholders consist exclusively of natural persons and are less than 100 shareholders (TrustLaw, 2013, p.40-41).

### **Means of financing**

An FPC provides a variety of options for financing and raising funds as it includes the same options as ordinary corporations, specifically allowing profits as a goal (TrustLaw, 2013, p.67). This possibility makes it unlikely that the private foundations invest in an FPC, as they encounter their own restrictions disallowing them to pursue profits as a dominant goal – this would endanger the tax-exempt status of the foundation (Clarke, 2011, p.323).

As experience indicates, conventional financing sources of an FPC are debt and equity financing. Hence, an FPC has the opportunity to raise money through borrowing or selling ownership interests

in the company (TrustLaw, 2012, p.42). If an FPC wants to scale-up, it must decide between these options as to whether to finance through debt or equity (TrustLaw, 2012, p.42). Financing with debt includes only the repayment of the loan with an interest rate, whereas equity financing entails payment of dividends to the shareholders as well voting rights in specific issues that are exemplified under the criterion mission stability (TrustLaw, 2012, p.43). An FPC may be either publicly traded or closely held (Esposito, 2012, p.689).

Whilst one can make general statements regarding the ways of financing, it is not entirely clear to outline all influences the legal form FPC has. In comparison with a standard corporation, investors agree to longer sales cycles and lower return on investment when investing in an FPC, thereby signalling that achieving a social impact is a complementation to financial return (TrustLaw, 2013, p.61).

### **Signalling Effect**

An FPC must include the “FPC” designation in its name (Esposito, 2012, p.689). Corporations brand themselves as social responsible actors and therefore incorporate the social purpose in the corporate structure. Nonetheless, the aim of an FPC is to maximize profit with the pretext of being socially responsible (TrustLaw, 2013, p.61). Since the founders of an FPC have the choice of a broad range of charitable or other purposes, they must clarify their specific purposes to the public and especially to their shareholders (Reiser, 2012, p.68). The management of an FPC are given the flexibility to create various mechanisms to measure the socially responsible corporate activities. Despite these endeavours, the possibility of abuse still exists considering that the director’s liability is low (Esposito, 2012, p.692). For signalling, this diversity of possible purposes creates a certain ambiguity, thus hampering a positive communicative effect.

### **Costs and effort of founding**

The FPCs pay the same amount of fees for filing the articles with the secretary of state as a classical corporation (Rieman et al., 2012, p.19). Also, the requirements for establishing an FPC are similar to those of a corporation, including incorporation documents to be filed in the business filing office of that state (TrustLaw, 2013, p.34). In general, state and federal filings, and the organizational and governance documents, contain the articles of incorporation identifying the type of corporation and its public benefit purpose (Rieman et al., 2012, p.19), identification numbers, information concerning the qualification to do business and further mandatory documents as other corporations (TrustLaw, 2013, p.35). As the amount of necessary documents exemplifies, a considerable effort is to be undertaken to found an FCP.

### **Scaling-up the business**

In the long-run perspective, an FPC possesses several options to scale-up the business: On the one hand, the FPC as a social enterprise can enlarge its business with the same financing options as ordinary corporations through debt or equity (TrustLaw, 2012, p.42; 67). However, it is still unclear what impact the legal form an FPC has in financing and fund raising (TrustLaw, 2013, p.61). On the other hand, when scaling up, the broad range of the special purposes and the change thereof poses a threat (Reiser, 2012, p.64). Therefore, the mission stability depends on the composition of the shareholders, and their social- and profit-oriented mindset. In general, an FPC has the permission to pursue profit and social good at the same time, whereas founders and shareholders guard admission to it (Reiser, 2012, p.63).

### **Corporate Governance**

FPCs have the same rules as other Californian corporations regarding corporate structure (TrustLaw, 2013, p.66). Yet, one difference between FPCs and classical corporations is that the board of directors and management of corporations are protected to pursue one or more charitable or public purposes at the expense of economic value (TrustLaw, 2013, p.61). The director of an FPC who is selected by the board has the liberty to determine short- and long-term prospects (Rieman et al., 2012, p.20). He acts in good faith to meet the best interests of the corporation and its shareholders in the background of satisfying any special purposes from the Articles of Incorporation (Rieman et al., 2012, p.20). In doing so, a director of an FPC can weight specific factors from the statutes which are relevant for him, giving him an important position in corporate governance (Rieman et al., 2012, p.20). The articles may therefore limit the liability of directors for losses, if the director acts in favour of the FCP's purpose (Esposito, 2012, p.689). Furthermore, discharges for the directors are that they are guarded from liability based upon any alleged failure to act, and the stakeholders have no right of action against directors (Esposito, 2012, p.690). Some practitioner notes that the release of the directors' liability permits the directors to experiment more broadly, independent of personal or corporate pursuits (Esposito, 2012, p.692).

## **4.3 CIC-COMMUNITY INTEREST COMPANIES**

Whilst the last two sections analyzed two different US-american hybrid corporate forms, namely L3Cs and FPCs, the next section applies the nine criteria to a legal structure from the U.K.

### **4.3.1 CONTEXTUAL ANALYSIS**

Before the establishment of the Community Interest Companies in the U.K., there was no specific legal form for a social enterprise. Since the traditional English corporate law was not directly applica-

ble for a company with a social purpose, the demand for hybrid corporate forms arose (Esposito, 2012, p.674). Hence, Stephen Lloyd and other creators of the CIC established this new hybrid corporate form in 2005 especially for the social entrepreneurship sector in the U.K. (Esposito, 2012, p.674). Since its establishment, the number of registered CIC increased to over 6'400 from 2005 until April 2012, which is twice as much as the anticipated growth rate (Esposito, 2012, p.677).

A CIC is similar to a public or private limited company with participation of shares or of guarantee (TrustLaw, 2012, p.55). Although a CIC can operate in any economic sector, it has especially succeeded in agriculture, manufacturing, nurseries, and environmental projects like waste recycling, low-carbon micro-generation energy systems, and wind farms (Esposito, 2012, p.678). In comparison with other companies, CIC has special additional features, which ensure that the community benefits (TrustLaw, 2012, p.55). Two of the special features are a Community Interest Test and an asset lock, which shall now flow into the analysis of our nine criteria.

#### **4.3.2 EVALUATION**

##### **Obligation to pursue a social mission**

Any lawful trade activity or enterprise can be organized as a CIC if it has an explicit social mission for the community rather than for its own members and employees (Low, 2006, p.382). The hybrid corporate form CIC is especially designed for enterprises investing their profits and assets for the public good. No restrictions exist in which the field of economic activity is specified, provided the Community Interest Test by the CIC Regulator is passed (Galera & Borzaga, 2009, p.223). "A company satisfies the Community Interest Text if a reasonable person might consider that its activities (or proposed activities) are carried on for the benefit of the community" (BIS, 2013, p.17). To be registered as a CIC, the company must bring the evidence to the Regulator that it will satisfy the Community Interest Test (BIS, 2013, p.17). The CIC Regulator determines whether a company satisfies the test considering facts about: "the purposes for which it is set up; the range of activities in which it will engage; and who will be seen as benefiting from its activities" (BIS, 2013, p.17). This test, by the Regulator, is needed to underline the motivation or purpose of a CIC's activities and how they will reach its goals regarding the benefit of their community (BIS, 2013, p.17). In the course of this, the activity of a CIC can be indirectly beneficial to the community as well. For instance, a CIC manufactures and sells a particular product but it uses the profits from its sales for charitable or community-beneficial purposes (BIS, 2013, p.17). Moreover, CICs complement the government's services at the community level in different areas as childcare, provision, social housing, community transport or leisure. The main group creating CICs are productive non-profit organizations. However, other organizations with a focus on community benefit have the opportunity to be organized as a CIC as well. The accountability within the CIC is limited, on the one hand through the limited shareholder voting power, and

through moderate stakeholder powers on the other hand. Nevertheless, the CIC Regulator oversees all CICs and provides an influence on the pursuit of a social mission (Low, 2006, p.383.)

### **Mission Stability**

For this legal structure, strong guarantees concerning mission stability are in place: A CIC can change its legal form to a charity, to a Community Benefit Society or it may voluntarily dissolve but it cannot transform to a standard limited company, which is, in general, profit-oriented (BIS, 2011, p.3). In addition, a CIC must continue to satisfy the Community Interest Test for as long as it remains a CIC (Wexler, 2006, p.244). An asset lock in a CIC (compare Chapterxx (criteria)) provides additional assurances against mission drift, by ensuring that the investments will be used for the intended purposes. This also gives socially motivated investors greater confidence (Wexler, 2006, p.244). This exemplifies that the focus of a CIC is the benefit of the community rather than private gain (TrustLaw, 2012, p.53). Therefore, invested money in a CIC is forever bound to the benefit of an explicit social mission. If a CIC does not fulfil its community interest, the CIC Regulator has the power to remove or appoint directors, transfer the property or shares of the CIC, or even take further action in the name of the CIC (TrustLaw, 2012, p.55). In this way, the CIC Regulator ensures mission stability and has the capability to take corrective actions.

### **Transparency of the business activity**

The CIC Regulator monitors all CICs in the U.K. Therefore, the directors of the CIC must submit annual reports to this Regulator in order to “confirm that access to the benefits it provides will not be confined to an unduly restricted group” (Esposito, 2012, p.676). The CIC Regulator, who is appointed by the Secretary of State for Business and Innovation, secures the Community Interest Test according to the CIC Regulations so that “a reasonable person might consider activity being carried for the benefit of the community” (Esposito, 2012, p.676). The Community Interest Test entails that the CIC has the obligation to publish an annual community interest company report in which the endeavours for achieving the community interest objectives are documented (TrustLaw, 2012, p.55).

### **Tax advantages**

Despite the specific legal status, CICs have no tax benefits (TrustLaw, 2012, p.57). Therefore, a CIC is treated like other companies with corporation tax on any trading profits, investment income and gains (TrustLaw, 2012, p.57). Even the investors of the CICs do not receive tax relief on their shares of contributions (Wexler, 2006, p.244). Stephen Lloyd, one of the architects of the CIC, advocates the necessity of tax reliefs for social enterprises to stimulate investments in CICs, since socially responsible investors are interested in long term, bond rates of return (Esposito, 2012, p.678). Indeed, the CIC

law does not enable any fiscal advantages, it only provide a flexible legal structure and less regulation compared to charities (Galera & Borzaga, 2009, p.223). In spite of the fiscal disadvantage, the possibility to partially redistribute profits is a compensation, according to Galera & Borzaga (2009, p.223).

### **Means of financing**

Since CICs are companies with a social purpose, they can either get grants (if specific projects and impact proposition allows for it) or finance their company with shares of external investors (TrustLaw, 2012, p.57). In general, a social entrepreneur of a CIC can choose between two options to limit the CIC, by guarantee or by shares: Limited by guarantee implies that all profits will be reinvested in the company, whereas limited by shares implies equity-financing and the distribution of dividends like a traditional limited company. Nevertheless, the aforementioned asset lock caps dividends at 35% of the aggregate total company profits (Esposito, 2012, p.675).

Moreover, the asset lock cap should impose CIC directors to obtain fair market value on the sale of any CIC asset (Esposito, 2012, p.676-677). In this way, it is prevented that a CIC's assets are traded below-market prices to a for-profit company (Esposito, 2012, p.677). In doing so, the nominal price of shares is defined in the articles of association and shares can also be sold above the nominal value with a premium (TrustLaw, 2012, p.57). Another special feature of the CIC's asset lock is that the profits and assets are "locked" in the CIC. Assets and profits can only be transferred to another company if this company has an asset lock with respect to the benefit of the community as well (TrustLaw, 2012, p.55).

It is important to note that these mentioned safeguards make CIC unattractive for some more financially interested investors. Afterall, the investors hold shares in a CIC but receive only capped dividends (TrustLaw, 2012, p.53). From the perspective of the social entrepreneur, it is thus difficult to raise capital in equity markets due to the dividend-restrictions of the asset lock (Esposito, 2012, p.678).

### **Signalling Effect**

In general, corporations of CICs must have the "CIC" or "Community Interest Company" designation in their titles in order to clarify their status to the public (Wexler, 2006, p.244). The CIC is considered a brand for social enterprises, independent of the field of its economic activity (Galera & Borzaga, 2009, p.223). Signalling-wise, of importance is that the corporation must pass the Community Interest Test. With this test, the CIC Regulator ensures continued public confidence in the CIC brand (Esposito, 2012, p.676). Accordingly, the label "CIC" signals a company whose primary purpose is to provide benefits to the community rather than to its own employees (BIS, 2013, p.17). As mentioned



before, the gains of its activities must be considered to be charitable or satisfy other community benefit purposes (BIS, 2013, p.17). This allows the following conclusion: Since the CICs are strongly monitored by the CIC Regulator, the CIC designation has a great expressiveness of the beneficial mission of a CIC.

### **Costs and effort of founding**

The establishment of a CIC is similar to that of a limited company except for the requirement of a Community Interest Statement describing how they will deliver on a “community purpose” (Esposito, 2012, p.676). This path is also open for existing companies, who can change their legal structure to CIC if they fulfil the respective requirements. This includes a special resolution to modify its articles to specify their transformation to a CIC and the explicit agreement for the CIC Regulations. In addition, the company’s name must be changed in a special resolution thereby obtaining the CIC designation. The registration fees amount to £25 (in 2012, TrustLaw, 2012, p.56) and the registration documents must be handed on to the Companies House, a government registry in the U.K. similar to the Secretaries of State in the USA (Esposito, 2012, p.676) who administer the registrations and authorizes CIC companies (BIS, 2011, p.4). Thereafter, the CIC Regulator oversees all CICs (Esposito, 2012, p.676). If charities convert to a CIC, they will lose their charitable status (TrustLaw, 2012, p.55). In comparison, new organisations submit the registration form with a memorandum and articles of association to the Companies House and pay a filing fee of £35 (in 2012) (TrustLaw, 2012, p.56).<sup>1</sup> Accordingly, one can say that the monetary expenses to found a CIC are limited, yet satisfying the community purpose requirements might entail considerable effort.

### **Scaling-up the business**

To scale-up the business of a CIC, the balance between social impact and financial return is to be considered in the long run. As was mentioned, the specific social orientation of the CICs are not restricted (Galera & Borzaga, 2009, p.223), for as long as they continue to satisfy the Community Interest Test and remain a CIC (Wexler, 2006, p.244). Yet, if a CIC does not fulfil its community interest, the CIC Regulator has the power to intervene in the business of a CIC (TrustLaw, 2012, p.55). Furthermore, a CIC can change its legal form to a charity or a Community Benefit Society, and it may voluntarily dissolve, but it cannot transform to a standard limited company which is profit-oriented (BIS, 2011, p.3) since an “asset lock” on the assets of a CIC ensures that the investments will be used for intended purposes (Wexler, 2006, p.244). In scaling a business, this assurance of a social purpose is important.

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<sup>1</sup> More details about the establishment of a CIC are published on their website <http://www.bis.gov.uk/cicregulator>.

From the financial perspective, a CIC is taxed like other companies with a corporation tax (TrustLaw, 2012, p.57). The investors of the CICs also do not have tax relief on their shares (Wexler, 2006, p.244). Despite the fiscal disadvantage, the possibility to partially redistribute profits compensates it (Galera & Borzaga, 2009, p.223). One disadvantage from the perspective of the shareholders is that the dividends are “capped” (due to the asset lock) at 35% of the aggregate total company profits (Esposito, 2012, p.675). This limitation might be a drawback of a CIC, since for a social enterprise in its start-up phase, it is very essential to grow through a variety of capital structures. Yet, the mentioned limitation makes it difficult to raise capital in equity markets (Esposito, 2012, p.678).

### **Corporate Governance**

In principle, the CIC is organized as a limited company where the corporate governance is primarily attributed to the board of directors who are restricted by regulations, ensuring the community interests defined in the statutes (Esposito, 2012, p.675). Compared with other hybrid corporate forms such as L3C and FPC in the USA, CICs are strongly regulated and controlled externally through the CIC Regulator (Esposito, 2012, p.676). The CIC Regulator correspondingly has great power over CICs, as it can intervene in an individual CIC operation, order independent audits, commence civil proceedings, remove directors and elect a new manager (Esposito, 2012, p.676).

Moreover, it is interesting to note that stakeholder groups are not necessarily involved in the decision-making processes of a CIC – this is the case in other social cooperatives, branding the term stakeholder governance (Esposito, 2012, p.677). Nevertheless, the CIC Regulator may incorporate stakeholders with voluntary integration techniques, such as circulating a newsletter, stakeholder meetings and interactive websites, or they may even have specific stakeholders partake in certain decisions (Esposito, 2012, p.677). All mentioned corporate governance elements ensure a focus of decision-making on community interests rather than financial returns for shareholders (Low, 2006, p.383).

## **4.4 TANDEM STRUCTURE**

Part of this research paper is to show innovative ways of dealing with legal structures. Since a few promising specific legal frameworks for SEs have been introduced, the aim now is to present a tandem structure with two legal frameworks under one overarching organisation<sup>2</sup>. It is obvious that with such a structure, one is able to integrate two distinctive models and their respective advantages. Thus, it is of high relevance to show the basic legal conditions for such a framework and then to present a practical example of such a tandem organization. Since our real life cases are based in Switzer-

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<sup>2</sup> Often tandem structures are also described as hybrids. In this paper tandem structures are defined by a combination of two separate frameworks, which are distinct from each other.

land, we will therefore focus on legal conditions applicable in this context. There will be no historical analysis of the two frameworks, since, for the reader, it is of higher importance to get an idea on how such a structure is applied empirically.

#### **4.4.1 LEGAL CONDITIONS**

The European Commission (2014) writes in its country report on SEs in Switzerland that “a number of organisations operate with a hybrid structure, usually combining a for-profit legal form (such as a share company) with an association or foundation” (p. 16). This observation serves as a focal point in the following analysis. For this reason, the two distinct frameworks are briefly introduced and it is explained how they can be organizationally structured in order to create a benefit for SEs. Since the real life cases of SV Group and BOOKBRIDGE are organized as a foundation and a company limited by shares, the subsequent analysis will target these two frameworks. However, Caprez (2010) explains that SEs also often use associations in combination with a for-profit legal framework (p. 51). Associations are thus also a viable option for a tandem structure. Nevertheless, there is a certain reluctance from institutional donors as well as banks towards associations. This is mainly because associations have a weak signalling effect in terms of stability and liability (Caprez, p. 44). Associations are loosely regulated and therefore indicate a possible uncertainty for institutional donors (Caprez, p. 46)<sup>3</sup>. For these reasons and for the sake of the argument, this paper will focus on foundations rather than associations.

#### **4.4.2 FOUNDATION**

As Lang and Schnieper (2006) remark, foundations are defined in many different ways across countries and cultures (p. 31). It is thus crucial to explain with which understanding of foundation one works. Lang and Schnieper propose, that a foundation “in ihrer Grundform auf dem Transfer von Eigentum eines Geldgebers an eine unabhängige Institution mit der Auflage, dieses Vermögen und die daraus erwirtschafteten Erträge für einen spezifischen Zweck über einen oftmals unbegrenzten Zeitraum zu verwenden” (p. 31). Lang and Schnieper further explain that foundations are non-membership based and thus have no shares in any sense, but rather assets with a specific purpose (p. 33). That purpose is upheld under very strict circumstances and slightly changeable every ten years (Caprez, 2010, p. 50). In terms of governance, foundations are only obliged to have a board of trustees, which enables the organization to act efficiently and effectively (Caprez, p. 49).

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<sup>3</sup> For further information and research: Müller & Schmid, 2007, p. 274 ff.

#### 4.4.3 COMPANY LIMITED BY SHARES

The company limited by shares (CLS) is the typical legal framework used by for-profit enterprises in Switzerland<sup>4</sup>. Such companies are usually founded to create revenue to the shareholders in the form of dividends or other potential gains (EU Commission, 2014, p. 24). The CLS is liable to its assets and has its own legal entity, which makes it a secure and stable way of conducting business (Jesgarzewski, 2012, p. 213). In terms of governance, members of a CLS are also shareholders and constitute the supreme governing body of the enterprise in general meetings. In these meetings, a board of directors is nominated and they are responsible for the management and administration of the organization (EU Commission, 2014, p. 26).

#### 4.4.4 ORGANIZATIONAL STRUCTURE

After a short introduction to the two different legal frameworks, one might now ask how such a tandem is organized to represent a SE. Mittermaier and Neugart (2011) argue that for a SE, it is crucial to know how these legal frameworks relate to each other. This is mainly for the reason that “control by the for-profit entity over the charity is typically not a good fit for a social enterprise tandem” (p. 6). Mittermaier and Neugart state that such a structure is typical for a company foundation, but “makes it difficult for the charity to demonstrate sufficient independence and focus on its own charitable goals” (p. 6). They suggest that tandem SEs should be organized in a way in which “the charity holds some or all of the equity in a for profit subsidiary, and thus has some or total control over the for profit (p. 6). Hence, in the case of Switzerland, the foundation [Stiftung] should be in total or partial control over the CLS [Aktiengesellschaft]. This is possible through the foundation holding all or parts of the shares of the company. Here, it is important to note that the Swiss law allows shares with privileged voting rights (EU Commission, 2014, p. 29). The foundation should thus have voting, as well as financial shares, to control the CLS side of the tandem. In order to analyze such a tandem structure according to the criteria presented in chapter 2, it is helpful to use real life cases as a reference point, since such tandem structures obviously depend heavily on the organization applying them. The following two subchapters therefore include two case studies of companies that can be distinguished mostly by size. In showing a start-up (BOOKBRIDGE) and a multinational organization (SV Group), the authors hope to find empirical evidences for the subsequent analysis.

#### 4.4.5 BOOKBRIDGE

BOOKBRIDGE (2014) writes in its social report that it “is a social business whose vision is worldwide educational equality – irrespective of religious, ethnic, economic or geographical considerations” (p. 3). A distinctive feature about BOOKBRIDGE is its aim to help learning centers in developing countries

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<sup>4</sup> This inquiry will draw no distinction between a CLS [Aktiengesellschaft] and a limited liability company [GmbH] since it is assumed that they are comparable (Jesgarzewski, 2012, p. 213).

to be self-sustaining and hence sustainable. In order to succeed, BOOKBRIDGE offers professionals in developed countries the opportunity to attend a program that intends to “combine hands-on learning in management with a real business impact project to shape a new generation of leaders and create sustainable social impact” (p. 27). During that program, these professionals have to build a new learning center and in doing so, they apply their knowledge directly on a real life case.

BOOKBRIDGE is structured with a foundation as the main acting entity and a CLS under its full control conducting the courses for the professionals<sup>5</sup>. The reasons for this structure are mainly to receive tax-free donations through the non-profit foundation and to work entrepreneurially as a CLS (p. 34). The foundation had a starting capital of 50'000 CHF and the CLS of 100'000 EUR, which was enabled through donations and investors respectively. The organization attracts possible investors in two ways: One can donate directly to the foundation or one can provide financial support through soft loans. This enables investors to choose which type of investment they want to provide, and attracts a wide range of interested parties. Nevertheless, there is no possibility of getting a return on an investment in the form of dividends. The only shareholder of the CLS is the foundation and thus all profits of the CLS are returned to the foundation. In doing so, BOOKBRIDGE tries to attract a specific kind of investors, namely, social impact investors.

In terms of governance, the founder of the organization has the chair of both the foundation and the CLS. BOOKBRIDGE itself observes a possible conflict of interest and will try to solve it in the near future. Since the purpose of the foundation is changeable only under very strict circumstances, governance of the organization has to align with that purpose.

#### 4.4.6 SV GROUP

SV Group is a company that manages gastronomy and hotel services in different business areas in Switzerland, Austria and Germany (SV Group, 2014, p. 1). Founded 1914 as an association by Else Züblin-Spiller, the aim of Schweizer Verband Soldatenwohl was to provide staff restaurants for Swiss soldiers. The association grew continually over decades with an expansion into Germany and new services focusing on new customers. In the year 1999, the association decided to adapt its legal status to the professional work environment they maintained. In creating an ideational foundation and a market-based CLS, one was sure to get a specific solution to upcoming challenges (SV Stiftung, 2015, n.P.). The SV Stiftung [foundation] is, in this case, a controlling shareholder of the SV Group AG [CLS] (SV Stiftung, 2014, p. 8). The foundation controls 88,9 % of the SV Group AG (SV Group, 2014, p. 34). With this type of corporate governance, the foundation can be described as a “Unternehmensträgerstiftung” (Lang & Schnieper, 2006, p. 40). One of the main differences to BOOKBRIDGE is

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<sup>5</sup> In this case, CLS is referring to a GmbH.

the fact that the foundation does not hold all shares of the CLS. This of course attracts not only loan investors, but also investors who are interested in buying equity. The SV Group does not indicate the exact amount of dividends distributed, but with a net profit of over 9 Mio. CHF in the year 2013, one can expect that some of the profits have been distributed also to minority shareholders (SV Group, 2014, p. 38).

In terms of governance, while the foundation and the CLS are clearly separated legally, a certain transparent dialogue is administered. All meetings are declared in the annual reports and potential interest conflicts are avoided (SV Stiftung, 2014, p. 8).

#### **4.4.7 EVALUATION**

After introducing the concept of a tandem structure and providing empirical evidences, this type of legal framework is now being evaluated according to the criteria in chapter 2.3.

##### **Obligation to pursue a social mission**

The tandem structure of foundation-CLS is well prepared to address the dual mission dilemma. With the foundation being obliged to follow a certain purpose, social impact can be guaranteed and legally protected. It is of course crucial what kind of purpose is being pursued. There are of course tandems that do not pursue a social mission. Foundation law in Switzerland does not oblige to pursue a social mission necessarily. In our real life cases, both tandems pursued a social mission and thus one is tempted to state, that foundations typically pursue a social mission although no legal obligation exists that guarantees it. The CLS on the other hand is able to be market-oriented and thus competitive. With the foundation being the controlling shareholder of the CLS, profits are reinvested and the entrepreneurs can achieve no private profits. The SV Group differs under that certain viewpoint by allowing investors to buy equity. In this case, shareholders are profiting with returns on their capital. Nevertheless, the SV Stiftung can control who is managing the SV Group AG through their shares. A low-profit approach is furthermore relative when all of the profit ends up in the foundation, which is obliged to pursue a social impact.

##### **Mission stability**

Mission stability is guaranteed with the foundation as the main actor. A foundation is impersonal, as the assets are set with a certain purpose. This purpose can be changed every 10 years only under very strict rules. Since that purpose includes controlling the CLS, the tandem structure can be characterized as very stable and sustainable. It is crucial though, that the foundation not only holds the majority of shares of a CLS, but also the majority of voting rights.

**Transparency of the business activity**

Since the tandem structure itself has no legal personality, the transparency regulations of the respective legal frameworks, the foundation and the CLS, are to be applied. From an empirical viewpoint, both BOOKBRIDGE and SV Group present multifaceted information about their business activities, as well as corporate governance and their purpose. In the case of SV Stiftung, there is a lack of financial information, in particular how much of the profits of SV Group they receive and how its assets are composed. Since the SV Stiftung does not receive any donations apart from the profits of the SV Group, such information is not necessarily needed in terms of transparency. BOOKBRIDGE, on the other hand, provides a specific social impact report overarching the whole tandem (BOOKBRIDGE, 2014, p. 4). This of course is not a legal necessity, but fulfills the criteria's description in full.

**Tax advantages**

The tandem structure does not provide a specific tax advantage, since there is no specific legislation for that kind of organization. However, BOOKBRIDGE receives tax-exempt donations via its foundation and thus funds its activities partially with a tax-exempt status. However, business activities conducted with the CLS are taxed normally. This provides the tandem structure with a challenge, since the profits gained by the CLS are transferred into the foundation, and thus are reinvested with a social purpose. BOOKBRIDGE GmbH [CLS] says little about their tax payments, but since 2014 was their first year with a profit, one can expect that tax payments will follow (BOOKBRIDGE, 2014, P. 45). SV Group AG [CLS] indicates their tax payments in the annual report (SV Group, 2014, p. 38). Hence, the tandem structure grants no specific tax advantages, but opens some possibilities of tax reduction through measures that can be legally taken.

**Means of financing**

In terms of financing, a tandem structure presents many viable options for the social entrepreneur. Both empirical examples indicate some of these possibilities. An observation can be made though, that it is very difficult to attract both ends of the spectrum. Equity investors in a CLS and investors who donate to a foundation have very different mindsets. To attract both extreme ends is not simply a sign of strength, but can be seen as a sign of weakness since there could be a lack of stringency. The empirical cases show exactly that. BOOKBRIDGE attracts investors that provide soft loans and donations. SV Group invites investors who contribute loans and equity. With the tandem structure, the social entrepreneur is free to choose how to position the organization and can also choose which type of investors to attract. In this sense, the tandem structure is very suited in terms of financing for social enterprises.

**Signaling effect**

Since the tandem structure has no specific legal framework, the tandem structure itself does not provide any signaling effect. Potential investors have to investigate an organization with a tandem structure first in order to understand the consequences of their investment. Such organizations can differ greatly in terms of governance, financial linkages, investment opportunities and tax advantages. With this in mind, one can conclude that tandem structures possess no signaling effect.

**Costs and effort of founding**

Setting up a tandem structure demands time, resources and effort of the social entrepreneur. One has to take into account that both legal frameworks need to be understood in order to build such a tandem. Legal consultancies are probably required to manage all the possibilities and their consequences. The founding process thus is crucial for such a tandem, since the tandem itself is very stable and sustainable afterwards. Decisions taken at this stage have severe consequences later.

**Scaling-up the business**

The empirical examples show how a tandem structure is not a dead end, but that both start-ups and multinationals use this kind of arrangement. With the CLS part of the organization, growth is in its own hands and the organization is not necessarily in need of further donations. BOOKBRIDGE, of course as a start-up, is in a necessity to get additional donations. The SV Group shows on the other hand, that with a good business case, such investments are not necessary over time.

**Corporate Governance**

In terms of corporate governance, the tandem structure is very suited for SEs. Since there is a legal separation between the foundation and the CLS, these two organizations practice a particular control over each other with the foundation being the main actor. The dual mission dilemma is therefore solved in the sense that the social impact is generally in control over market-based activities. Hence, the tandem structure grants specific opportunities in terms of corporate governance which should be highlighted.

**4.5 ALTERNATIVE DECLARATIONS: B CORPORATION****4.5.1 CONTEXTUAL ANALYSIS**

As already mentioned, this chapter is included in the research, since it is assumed that it enables interesting insights worthy to be mentioned. This chapter thus introduces the certification “B Corporation” which is awarded to ordinary business firms by the private, non-profit organization “B Lab” (El-



Shawarby, Hussein, Serrano & Spear, 2012, p. 73)<sup>6</sup>. B Lab was founded in 2006 and aimed at “building a community of Certified B Corporations that meet rigorous standards of social and environmental performance and that legally expand their corporate responsibilities to include consideration of diverse stakeholder interests to help consumers, investors, employees, and policymakers tell the difference between ‘good companies’ and just good marketing” (Klaber, Marquis, & Thomason, 2010, p. 1). Instead of awaiting policy changes, B Lab should create a brand for SEs that serves as a sort of umbrella for different movements, and thus helps SEs to find recognition cross-culturally (p. 4). Interested companies are therefore not bound to a particular legal framework, but must instead follow the rules of the certification process of B Lab in order to be branded as B Corporation (Reiser, 2012b, p. 731). This certification process includes 4 stages:

1. Take and pass the B Impact Ratings System assessment.
2. Adopt the B Corporation Legal Framework, which requires companies to incorporate certain provisions in their charter and governance documents.
3. Sign a term sheet agreement with B Lab.
4. Pay certain fees. (TrustLaw, 2013, p. 92)

#### **4.5.2 EVALUATION**

Although the B Corporation is a certification rather than a specific legal framework bound to particular national laws, this inquiry includes an evaluation of the certification according to the criteria in chapter 2.3. It is crucial to note that since these criteria are based on the assumption that legal frameworks are assessed, certain criteria are difficult to apply to a certification.

##### **Obligation to pursue a social mission**

In order to be certified as a B Corporation by B Lab, an enterprise has to fulfill an assessment to show how it “uses the power of business to solve social and environmental problems” (Reiser, 2011, p. 594). This assessment is conducted through a scale varying from 0 – 200. Enterprises have to fulfill a minimum score of 80 to be eligible to license the B Corporation certification. Reiser (2010) emphasizes that these ratings “heavily weight questions about how the applicant integrates its business and social goals, including relationships with employees, suppliers, local communities, and the environment” (p. 642). Hence, one can conclude that the certification B Corporation provides, results in an obligation to pursue a social mission.

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<sup>6</sup> The certification „B Corporation“ must be distinguished from certain legal frameworks applicable in particular states of the USA (TrustLaw, 2013, p. 92)

**Mission stability**

In adopting certain legal standards set by B Lab, the certification should help to include sustainability into the DNA of a company (B Lab, 2015a, n.p.). The obligation to pursue a social mission is thus maintained by the adoption of legal requirements of a company set by the B Lab. These requirements should minimize the risks of mission drift. Although such legal requirements are of course needed to provide sustainability of an enterprise' purpose, it is nevertheless unclear how the certification helps to avoid mission drift practically. In the case of a liquidation, according to B Lab, the company has the option to "retain or remove certification directly prior or after a sale depending on the current and new owners' preferences" (B Lab, n.D., p. 2). Furthermore, although B Lab audits 20 percent of the certified companies every two years, the question remains what happens in the case of a lack of performance (Reiser, 2011, p. 602). To avoid a mission drift, investors, entrepreneurs and other shareholders together should tie capital, equity and other investments to a certain purpose. Since the B Corporation certification is not bound to a particular legal framework, it is highly questionable how an obligation to a social mission is maintained case by case.

**Transparency of the business activity**

In terms of transparency, the certification assesses how the enterprise provides transparency of the business activity. The impact report conducted each year shows how the enterprise performed in that aspect. It is obvious that in order to be certified, an enterprise needs to grant information about its business activity to B Lab. Nevertheless, since transparency is only one of many elements in the impact report, the question arises how transparency is provided through the certification. Companies are not obliged to conduct a social impact report to their stakeholders. However, B Lab guarantees a minimal limit of transparency in making reports publically accessible.

**Tax advantages**

Since taxes are based on legal statutes, the certification itself does not grant any tax advantages or a tax-exempt status<sup>7</sup>. The certification process however can oblige a company to adapt a new legal framework in some cases, and thus can facilitate tax advantages (Reiser, 2010, p. 639-641).

**Means of Financing**

As Reiser (2010) points out correctly, "whether the B corporation form will increase the financing available for blended entities depends largely on the success of its branding efforts and the size of the market for investments such as these" (p. 650). Therefore, the certification can, if well branded,

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<sup>7</sup> An exception is the city of Philadelphia in the USA, which grants tax breaks for certified B Corporations (Klaiber, Marquis & Thomason, 2010, p. 8).

have a positive effect on the means of financing. In the worst case, there seems to be no obvious negative impact on financing if the certification is not well branded. It is nevertheless questionable whether the certification facilitates access to funding of market-rate investors or just helps to “draw in new investment capital only from the socially-motivated category of investors” (Reiser, 2011, p. 621).

### **Signaling effect**

It is not a trivial task to assess the signaling effect of B Corporations worldwide. The certification has gradually grown over the last 10 years and today incorporates 1'257 corporations in over 41 countries and 121 industries (B Lab, 2015, n.p.). Since the main goal of the certification is to build a brand for social enterprises, it is assumed that B Lab focuses on building that brand as one of their main tasks. The signaling effect is obviously very strong in comparison with other national legal frameworks. With its worldwide application, the certification succeeds in building an umbrella for SEs that surpasses national legislation.

### **Costs and effort of founding**

The costs of becoming a certified B Corporation depends on annual sales and thus on the company applying (B Lab, 2015, n.p.). A certification has the big advantage of being managed by B Lab, and therefore no additional fees apply with law consultancies and other service providers. The certification process may cost the company extra when having to adapt to certain legal requirements and other preconditions. However, the certification seems to be a comparatively reasonable acquisition for a SE that wants to license the trademark “certified B Corporation”.

### **Scaling-up the business**

The certification does facilitate, through branding, access to new investors. How this helps a company in scaling-up however is another question. Since B Lab evaluates the companies annually according to the impact report standards, incentives are provided for the enterprise to grow the business, while maintaining the balance between social impact and financial return.

### **Corporate Governance**

In order to be eligible to license the B Corporation trademark, “corporations must amend their organic documents to include language instructing directors to consider interests beyond those of shareholders in carrying out their duties” (Reiser, 2010, p. 639). Corporate governance should hence include some prerequisites that are set by B Lab and need to be adopted before certification. However, if the shareholders of a CLS decide to change corporate governance and thus lose the certifica-

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tion, there is no obvious measure that can be taken by stakeholders, B Lab, or other actors to prevent it.

## 5 SYNTHESIS

After having elaborated the performance of four different legal structures and one alternative way to found and communicate a Social Enterprise, this chapter condenses the findings into a synthesis. Following the research question of the thesis, insights concerning the suitability of the specific legal structures as Social Enterprises are elaborated. In addition, recommendations for creating suitable legal structures are highlighted. As to provide an overview of the five case studies and their performance regarding the nine criteria elaborated in chapter 2.3, a chart was created. In order to provide an intuitive way to grasp whether a certain performance is positive, color-coding was applied. Using red, yellow and green for negative, mediocre and positive performance respectively, the follow picture emerges:

	<b>L3C</b>	<b>FPC</b>	<b>CIC</b>	<b>Tandem incl. a foundation</b>	<b>B Corp</b>
<b>Obligation to pursue a social mission</b>	Social mission has to be included in the statutes Three eligibility-criteria have to be fulfilled	Social mission must be well defined Four eligibility-criteria need to be fulfilled	Control provided with Community Interest Test under the surveillance of the CIC Regulator CIC Regulator influential, providing guidance	Social impact can be guaranteed and legally implemented as foundation needs to pursue a certain purpose, but there is no legal obligation to do so.	Certification assesses and requires the pursuit of a social mission
<b>Mission stability</b>	No major obstacles in changing legal status and becoming a LLC	Depends on shareholders as they may change the specific purpose given the necessary majority	CIC must continue to satisfy the Community Interest Test Prohibitions against changing a CIC into a for-profit business CIC Regulator can take corrective action	Foundation exercises strong control making it difficult to alter the social mission focus	As to be awarded the certification certain impact obligation need to be included Yet the underlying legal structures exercise the main influence
<b>Transparency of the business activity</b>	Mandatory documents mainly concerning tax issues have to be disclosed	Mandatory documents have to be shared on the company's website Annual reports include assessment of the FCP's performance in regard to the special purposes Special Purpose current Reports	Annual community interest reporting provides transparency	Transparency regulations of the respective legal sub-entities apply	B Lab guarantees a minimal threshold of transparency in making reports publically accessible Certification itself is a way to communicate social mission focus transparently
<b>Tax advantages</b>	No tax relief	No tax relief	No tax relief	No tax relief with the exemptions of donations to the foundation-entity	No legal status of the certification, hence no tax relief
<b>Means of financing</b>	Possibility of program-related investments (PRI)	Different possibilities exist, with practical prob-	Capped dividends effected by the asset lock make	Possibility to attract various investors given broad	Little correlation, yet certification can have a

	for private foundations and tranches encounter problems in reality	lems due to the possibility of a change in the social mission focus	CIC less attractive to financially oriented investors	set-up with to combined legal entities; empirically organizations focus on either end	positive effect on attracting socially oriented investors
<b>Signaling effect</b>	Designation include in company name Signaling of low-profit and limited liability dimensions encounter problems in reality	Designation included in company name Diversity of special purposes creates ambiguity and reduces positive communicative effect	Designation included in company name CIC Regulator assures social impact focus which is a strong signal	Lacking a specific legal structure, the tandem does not provide any signaling effect Potential investors need to investigate to understand company	As a worldwide brand the certification exercises a strong signaling effect
<b>Costs and effort of founding</b>	Inexpensive if LLC serves as the basis for transformation; Otherwise normal effort	Effort includes a multitude of documents	Monetary costs insignificant, yet considerable effort to proof social mission	Time, resources and effort required to understand and set up both legal frameworks	Fees depend on annual sales
<b>Scaling Up the business</b>	Difficult to assess a strong correlation between legal form and challenges during scaling-up	Difficult to assess a strong correlation between legal form and challenges during scaling-up	Obligation to repeatedly undertake Community Interest Test assures impact mission focus Failing to attract equity investors as a practical difficulty	Challenges depend on specific tandem configuration A good dynamic between the two legal sub-entities with their respective focus might arise	Not strongly dependent or influenced by certification
<b>Corporate Governance</b>	Flexibility in how to set up governance	Director is a leading figure exercising considerable weight	Board of directors in charge, but external influence of the CIC Regulator. Various measures ensure decisions in favor of the community	Foundation exercises main control ensuring a social impact focus, but both legal entities exercise control over their respective parts	Some prerequisites exist that need to be adopted before getting the certification; Otherwise dependent on the specific legal structure

Starting the assessment with the two first case studies of the L3C and FPC, their color-coding makes it apparent that these legal structures come with certain difficulties for Social Enterprises. Whilst the L3C had problems in attracting private financing, the FPC attempted to respond to the short-coming of the L3C using a flexible purpose approach. In general, both legal structures find their major weakness in the fact that they cannot prevent a mission drift. With mediocre performance in most of the other dimensions, their suitability for Social Enterprises is compromised.

In asking how the L3C and FPC might be altered in order to perform better given the nine criteria, the other legal structures provide inspiration. Before moving on to a specific aspect, the following insight needs to be emphasized: The experience of the L3C, specifically its failed attempt to trigger private investments, highlights how difficult it is for law-making entities to trigger behavioral responses by modifying legal structures. This complexity, when trying to trigger behavioral changes, is also apparent in the FPC: The flexibility of the purpose comes along with an uncertainty concerning the continuation of the social mission, thereby adversely incentivizing investors. This causes the aforementioned lack of investing-behavior.

One way to counter the lack of mission security of an L3C and an FPC arises in CICs: external influence. The CIC Regulator obtains a position where he can ensure a social conduct of business, if necessary with the means of corrective actions or influencing corporate governance. The CIC's color-coding represents this positive performance in the mentioned criteria. Furthermore, the asset lock needs to be mentioned as an interesting tool to guarantee a primary focus on social impact. Whilst these aspects successfully create a strong signal for the pursuit of a social mission, they intimidate more financially interested investors. Thus, the CIC faces limitations concerning possible ways in which to finance their venture.

At this point we can formulate an interim finding of the synthesis: Not only do Social Entrepreneurs face a dual mission dilemma in their daily business, law-making entities also seem to encounter the trade off between social mission focus and financial return. The CIC, for instance, chooses to give significant weight to the social dimension of its organization. This happened partly to the detriment of the financial dimension: When it comes to generating and distributing revenues or ways in which to financially support the organization, difficulties exist (e.g. due to the asset lock). L3C and FCP, on the other hand, attempt to make private investing more attractive, allowing for flexible purposes of the business. Whilst it was debated if this focus on more financially beneficial aspects was successful, it certainly affected the stability of the social mission negatively. Hence, we can conclude that the dual mission dilemma is very present in assessing legal structures to their suitability for Social Enterprises.



Moreover, tandems including the element of a foundation seem to perform well for Social Enterprises. Granted that the for-profit entity is subordinated to the non-profit foundation, a social mission can be secured over time. The duality of two organizations under one umbrella also allows for flexibility in attracting different investors. Whilst no complete tax-relief can be achieved, the tandems perform best in regard to the tax criteria. This needs to be highlighted, as no other discussed legal structure provides a relief of the tax burden. These aspects allow the conclusion that the tandem has many positive attributes making it a suitable choice for Social Enterprises. Nevertheless, a lacking signaling effect and the extensive costs and efforts during founding remains as negative aspects.

Using the example of tandems, a further point can be emphasized: Tandem structures might be in need of legal support making them a recognizable legal structure with an according signaling effect. Given that they do perform positively in all but that effect and the costs and effort of founding, law-making entities might assist in appropriate ways: For instance, they could ease the amount of paperwork to be undertaken or create government-institutes assisting in the respective procedures. Moreover, by elaborating a strong brand for these tandems and actively promoting them, governments will facilitate signaling.

In signaling, the certification B Corp provides a good example. As was noted earlier, this alternative way to establish a Social Enterprise was included due to its innovative approach in attesting the social nature of a business. Accordingly, it should serve as an inspiration for other legal frameworks. Moreover, Social Entrepreneurs who chose to create their Social Enterprise with a legal structure underperforming in regard to signaling may use this certificate as a way to compensate weaknesses of their legal structure. Hence, this synthesis also highlights the important inspirational role and the compensatory possibilities of the certifications.

Finally, a finding concerning transparency is introduced: Some organizations such as an FPC, a CIC or tandems undertake more effort in this realm. Whilst, in general, we can summarize both a duty element – assuring the viable, ethically correct conduct of business – and a communicative element of transparency, their performance varies: The duty element is fulfilled due to respective legal obligations. Yet, for the communicative element and its influence on signaling, no identifiable positive effect was found – FPC and Tandems signaling issues accordingly could not be substantially influenced by the means of transparency.

## 6 CONCLUSION

This analysis was intended to answer the research question: What legal forms overcome the specific challenges of a social enterprise the most? In order to solve this inquiry, the aim was first to define what social enterprises are and to find out what specific challenges arise for such organizations. In the next step and according to these findings, nine distinct criteria were outlined and explained. The main inquiry of five legal frameworks corresponded to these criteria and thus evaluated their suitability for social enterprises. After this detailed research, the findings were drafted together in a synthesis and the legal frameworks could therefore be compared directly with each other.

The research showed that the challenges for legal frameworks are apparent, and thus some frameworks are not suited to solve these issues. In particular, the L3C and the subsequent FPC perform weakly according to the criteria. This weak performance demonstrates another observation: National legislation bodies have, in general, major difficulties in providing good responses to the rise of social enterprises. This mainly, since not only social enterprises face difficulties in dealing with the dual mission dilemma, but also law-making entities seem to be confronted with a trade off between a social mission focus and financial return. Other legal frameworks are more promising. In providing external public regulation and observation, the CIC framework is better suited to ensure mission stability. Tandems, on the other hand, provide the social entrepreneur with a wide range of possibilities in terms of financing, while maintaining a rigid organizational structure and protected mission stability. While tandem structures fail to present a signaling effect due to the missing distinct legal framework, the certification B Corporation by B Lab is mainly granting exactly that feature. Since social impact investors are eager to identify social enterprises more quickly, such a component must be crucial for a social entrepreneur when choosing a legal framework.

The last point raised also indicates a possible solution to the issues posed by the tandem structure. When having another close look at the synthesis, one observes that the certification performs well where the tandem performs weak. Since these two frameworks are not mutually exclusive but can rather be applied simultaneously, such a combination could entail promising elements and would of course accomplish good results in almost all mentioned criteria. Especially for the case of Switzerland, this joint venture could be a valid solution and overcome the missing specific legal framework for social enterprises in the national company law.

It is important to mention at this point, that this inquiry only investigated a small amount of possible legal frameworks available around the world. Institutions, research associations and law consultant companies like the EU Commission, EMES international research network and Adler & Colvin, have already done a significant amount of research. This inquiry aimed at comparing some promising legal

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frameworks across national boundaries according to a set of criteria applicable to social enterprises worldwide. Thus, this research paper must be seen as additional help and guidance for social entrepreneurs to the already existing information.

The analysis presented the reader with detailed information and many findings. Nevertheless, further research has to be done to assist social entrepreneurs in pursuing their social mission and creating an impact. Since the tandem structure in this research investigated the applicability of Swiss company law, it would be of interest to analyze how other national regulations permit such organizational structure and how these findings correspond to the ones proposed in this analysis. How much potential do tandem structures have internationally in solving the issues at stake?

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