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PERSPECTIVE

Leveraging corporate structure for impact

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Selecting the right entity structure for a mission-driven business can be daunting. For-profit social enterprises can now choose from a variety of forms that enable them to balance social and environmental benefits with the pursuit of profits. Each entity type offers different mechanisms to ensure a focus on impact and economic sustainability.

While traditional entity forms already allow boards and management to emphasize environmental and social goals to varying degrees, new types of entities that bind the company to its social or environmental mission are gaining traction across the country. Below we summarize the different forms that entrepreneurs and investors alike should consider to help save our planet and improve the lives of its population.

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Traditional Corporation

Popular with companies and investors, the traditional Delaware or California corporation can work well for social enterprises. This is a comfortable choice because investors are familiar with the structure, a solid body of case law exists that helps govern corporate behavior, and it is the easiest model to engage in M&A, or to take public. Critics who claim that the corporate model is "broken" stress shareholder primacy and, in fact, the directors of a corporation have a fiduciary duty to enhance or in some cases maximize shareholder value. Therefore, it is important for these social enterprises to pursue their mission in a way that does not significantly or negatively impact profitability. Further, for a growing number of entrepreneurs and investors, impact goals and investor returns are not mutually exclusive, and in many cases a focus on ESG can enhance profits. For those who want "mission lock," impact goals can be emphasized by both founders/employees and investors via the use of mission-oriented shareholder rights in charter and shareholder agreements, license agreements, and carefully drafted provisions of convertible notes, SAFEs, and equity agreements.

Limited Liability Company

The LLC form allows founders and investors considerable flexibility in embedding mission into a company, including by adjustment to fiduciary duties in some states. In Delaware, the LLC's Operating Agreement can permit social enterprises to prioritize mission over financial returns, returns over mission, and everything in between. For example, founders can structure distribution of returns to certain mission-aligned investors first or last; equity holders can stack the board with directors who support the social mission or have a member-managed LLC; and employees and investors can agree to modify liquidation, voting provisions, and operations to ensure mission-focus.

Public Benefit Corporation (PBC) (Delaware)

Effective in Delaware as of 2015, this legal entity is obligated to promote a stockholder-agreed public benefit in addition to financial returns. Directors and management of a PBC have a duty to balance shareholder interests with the company's identified public benefit(s) (as set forth in the charter), and to take into consideration those employees and third parties affected by the company's actions. Boards and management have additional protection from liability while they weigh the different — and possibly competing — interests. Additionally, at least every two years, the company must provide a report to shareholders (which may also be made public, but is not required to be made public) detailing the promotion of the public benefit(s) and the interests of those affected by the company's actions. This form is designed for companies that may go public or engage in M&A, though to date only one PBC has gone public (Laureate Education) and there have been a limited number of M&A transactions.

Social Purpose Corporation (SPC) (California)

Effective in California as of 2012, the California SPC (originally titled the Flexible Purpose Corporation or FPC) is similar to the PBC in that it requires the board and management to consider specific shareholder-agreed environmental or social factors in addition to shareholder value when making corporate decisions. And, as in the PBC, boards and management have additional insulation from shareholder liability in balancing competing interests. This entity also has more robust reporting requirements than does a traditional corporation or a PBC, with disclosures to the public required each year, helping ensure the company remains transparent and focused on impact goals.

Other Benefit Corporation

Benefit corporation legislation exists in 35 states as of publication, with significant variations from state to state. Some follow the PBC/SPC model with a shareholder-agreed mission, while others (including the California Benefit Corporation) follow the "model" benefit corporation structure developed by the nonprofit organization B Lab which includes within the statute itself a long list of social and environmental objectives to which the board and management have a fiduciary duty. Benefit corporations, generally, are required to recognize a public benefit as one of their corporate purposes. Key provisions, which differ from state to state, include the inclusion of a benefit director to serve on the board, the nature of benefit enforcement proceedings pursuant to which shareholders or third parties can sue to enforce the mission, whether appraisal rights are available for dissenting shareholders in conversion or sale, and varying shareholder approval thresholds to alter the benefit corporation's mission or convert into or out of benefit corporation status.

Low-Profit Limited Liability Company (L3C)

The first of the new business forms to appear on the scene (back in 2009), the L3C form legally obligates the company to advance its impact goals over profitability and is a good choice for social entrepreneurs who strongly prioritize mission; the for-profit form allows for broader access to capital in lieu of a tax-exempt entity. The L3C is designed to attract program-related investments from foundations, and currently exists in eight states. This entity is typically viewed as an extension of philanthropy and is not a good option for businesses wishing to attract capital that requires a return on investment.

Public Benefit Limited Liability Company (PBLLC)

Created less than a year ago in Delaware, this is the newest business form available to social enterprises. This form closely tracks the PBC legislation, requiring the PBLLC to include one or more specific public benefits in its certificate of formation. The members and/or managers must operate the PBLLC in a manner that balances the pecuniary interests of the equityholders, the best interests of those materially affected by the PBLLC's conduct, and the specific public benefit(s) set forth in the PBLLC's certificate of formation.

Hybrid/Tandem Structure

A "hybrid" or "tandem" corporate structure refers to a close relationship between nonprofit and for-profit entities established via equity ownership, governance control, funding, or contract. These structures provide versatility and flexibility for the business in pursuing both financial and social returns, and allows access to the widest pool of capital, including equity investments, debt, and charitable donations. However, these forms are not for the faint of heart or underfunded; the establishment and operation of hybrids can be quite complex and require good governance and careful documentation and tracking of the flow of funds, intellectual property, services, and resources between the two entities.

One Note About "B-Corp"

It's worth noting that a "B-Corp" or "B Corporation" is not a legal form but a third-party certification administered by the nonprofit B Lab. If a company promotes itself as a B-Corp, it has completed a self-audit, applied for certification, and entered into a licensing agreement with B Lab to use the mark similar to the Good Housekeeping Seal or LEED certification.

The terms may be new to some, but social enterprises and impact investors have been around for decades — absent the trendy names. The increased focus on environmental, social, and governance goals for corporations has produced a menu of corporate form options available for entrepreneurs who wish to generate profit while pursuing impact. Deciding which entity is best for you should balance factors specific to your business model with short-term and long-term goals.

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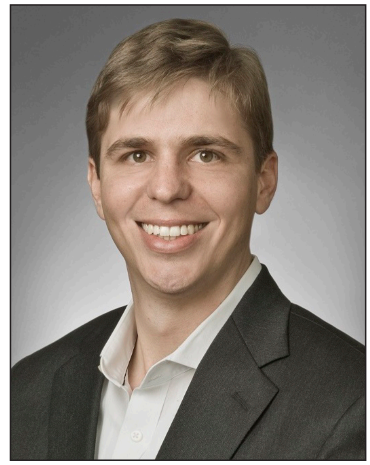

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