Blurring the Boundaries: Emerging Legal Forms for Hybrid Organizations

Implications for Christian Social Entrepreneurs

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Abstract
Hybrid social enterprise organizations, which combine profit and social goals, are one of the emerging trends in the business world. Christians are also using new forms to pursue ministry. This article explores the legal and practical limitations of combining social mission with profit generation in the same organizational structure. This article also addresses some of the broader implications of this trend, especially for Christian social ventures.

Introduction

Until recently, there were only two basic structural choices for an organization: profit or nonprofit. An entity with a charitable social focus would be established as a foundation, nonprofit corporation, or trust. An entity with a product or service to sell would select a for-profit form, perhaps a corporation or limited liability company.[1] But traditional differences between business and charity are eroding. The division between a profit and nonprofit organization is no longer sharp and clear. We now have revenue-generating businesses directing profits to social causes, such as Tom's Shoes, which donates one pair of shoes for every pair sold, with over 1 million shoes given away (Toms, 2011). There are also nonprofit organizations using for-profit business models to supplement their revenue streams, such as Northwest Center, a nonprofit in the Seattle area providing training and support to the disabled. The Center operates a number of businesses services, such as assembly, packaging, document shredding and a commercial laundry, that employ disabled clients and also helps fund the operation (Northwest Center, 2011).

For much of American history, philanthropy was considered the "third sector" of society alongside government and business. As Thomas Billitteri (2007) and others have noted, we may now be seeing an emerging "fourth sector" of social enterprise organizations. These hybrids combine charitable mission, corporate methods and social awareness in unprecedented ways, transcending traditional business and charitable models (Billitteri, 2007, p. 2). The reasons for the emergence of these hybrids are varied, but include recognition that charities can benefit from market efficiencies, the spread of free-market capitalism and its values of entrepreneurship, innovation and self-reliance. Factors supporting the growth of hybrid organizations include globalization with greater access and increased awareness of needs, expanding market opportunities as a result of new technology, and disillusion with the obsession of greed and resulting ethical failures in the traditional business environment.

In his seminal article, "The Meaning of Social Entrepreneurship," J. Gregory Dees (2001) noted that while entrepreneurial solutions to social problems are not an entirely new phenomenon, what has changed is a "blurring of sector boundaries."

> The time is certainly ripe for entrepreneurial approaches to social problems. Many governmental and philanthropic efforts have fallen far short of our expectations. Major social sector institutions are often viewed as inefficient, ineffective and unresponsive. Social entrepreneurs are needed to develop new models for a new century (Dees, p.1, 2001).

If form follows function, we will need new organizational structures for these new hybrids. Or, to use an analogy from the Gospels, we need new wineskins to hold new wine

(Matthew 9:17). To provide a context for this discussion, let us consider the mission of several social entrepreneurs in the Seattle area and review how their organizational structure is working for them.

Vision House provides transitional housing with integrated support services to homeless single mothers and their children and separately to homeless single men recovering from drug and alcohol addiction. The founder and executive director started Vision House as a nonprofit after seeing a documentary on America's homeless children. The initial funding was through government grants and is the primary reason for the nonprofit status (Lucas, 2011).

As initial funding expired, the executive director realized the difficulty of sustaining an entity solely reliant on donations and grants and, as a result, created separate Limited Liability Company (LLC) entities that support the nonprofit. One is a local, upscale daycare facility that includes both underprivileged children of mothers supported by the nonprofit, and children of revenue paying families from the local community. Another LLC is a plumbing business that was created to offset one of the largest operating costs, i.e., plumbing repairs for the transitional housing facilities, as well as the added benefit of providing training and jobs for some of the homeless single men. The LLCs were created to allow for business revenue without jeopardizing the legal nonprofit status, and as a means to offset dependency on donations and grants (Lucas, 2011).

Operation Military Family is a nonprofit founded to support military families. The founder is a former member of the military who recognized that there was an unmet need to address the unique challenges faced by couples serving in the armed services. He also identified the detrimental impact of high divorce rates on the military as an organization. As a result, he formed a nonprofit and created seminars and workshops aimed at providing assistance to military couples. The nonprofit accepts federal grant monies and private donations to support its services. The founder created a separate sole proprietorship to generate additional revenue removed from the nonprofit organization. This includes revenues from book sales and workshops in addition to public speaking fees. The founder finds the nonprofit structure, specifically the myriad regulations, reports, restrictions and fees inherent in the nonprofit structure, to be burdensome (Lucas, 2011).

Vox Legal is a virtual legal firm that also earns the distinction of having earned a certified "Benefit Corporation" designation (or "B Corp," described more fully later in this paper). The founder pursued the certification process to help with branding, as its target clients are social entrepreneurs, but also to help with his own internal decision-making. One area of expertise is advising clients about the various corporate structure options, particularly the B Corp and L3C options. One concern the founder had about the B Corp certification process is how applicable it was to a sole proprietor business and whether the certification process was stringent enough. There is a risk that companies will pursue certification primarily for marketing purposes (Lucas, 2011).

Cedar Park Church in Bothell, Washington, is organized as a traditional nonprofit, but has created several Limited Liability Companies to further support the church ministries. Separate entities within the domain of the larger nonprofit include a mechanics shop, a funeral home and an embryo adoption services organization. Each is a distinct LLC within the domain of the church. The pastor believes that work and business are honorable activities for Christians, as opposed to early Greek and Roman traditions where slaves performed work. He also believes the church should not rely solely on tithing. The reason the entities were created under separate corporate structures was to protect the nonprofit status of the church and not dilute church infrastructure (Lucas, 2011).

For each of these organizations, the legal structure is not a perfect fit. Three of the organizations operate a nonprofit entity for their mission side and a for-profit (sole proprietorship or LLC) for their revenue-generation side. Keeping the models separate in a single organization requires careful attention to the IRS regulatory process, state corporate law requirements and coordination between the two, as well as separate books, accounting systems and boards. Can a legal form be designed that would allow the social mission and revenue stream to reside in the same organization? Is the B Corp certification process the answer or is it marketing hype? Before addressing these questions, it will be useful to clarify terms and consider why the traditional forms are problematic for social hybrids.

Definitions

The founders of these organizations do not necessarily describe themselves as social entrepreneurs nor see themselves as engaging in Business as Mission. However, it is clear that in their passion for solving a social need and focusing on sustainability, they do not fit neatly into the "either or" categories of nonprofit and profit organizations. They are clearly hybrids, but do they need a separate label? Further, is there a difference between a social venture or enterprise, social entrepreneurship and Business as Mission?

One problem in this emerging field of hybrids is a lack of an agreed upon definition (Lucas, 2010). Martin and Osberg (2007) note that "Social Entrepreneurship is attracting growing amounts of talent, money and attention. But along with its increasing popularity has come less certainty about what exactly a social entrepreneur is and does" (p. 29).

Neal Johnson (2009), in his comprehensive text, *Business as Mission,* also acknowledges the definitional challenge: "It is difficult to define exactly what BAM (Business as Mission) means…[and] few really understand how to do it" (p. 27).

Ashoka, a leading association promoting the field of social entrepreneurship, defines the role on their front webpage as "men and women with system changing solutions for the world's most urgent social problems" (2011). The Skoll Foundation, another influential organization in this new field, identifies social entrepreneurs as "society's change agents: creators of innovations that disrupt the status quo and transform our world for the better" (2011).

While there is not complete agreement on the definition of these developing hybrids, we take the position that there are significant distinctions between social enterprise, social entrepreneurship and Business as Mission. We use these definitions:

Social enterprise is a for-profit organization that implements its mission to address a social need through a business format, regardless of its legal structure. The business model need not be original, innovative or unique (Lucas, 2010, p.5).

Social entrepreneurship is a revenue generating, innovative and unique approach to solving a social problem where profits are reinvested in the mission regardless of the distinction between nonprofit or commercial enterprise (Lucas, 2010, p. 5).

Business as Mission is a for-profit commercial business venture that is Christian-led, intentionally devoted to being used as an instrument of God's mission to the world and is operated in a cross-cultural environment, either domestic or international. (Johnson, 2009, p. 27 - 28).[2]

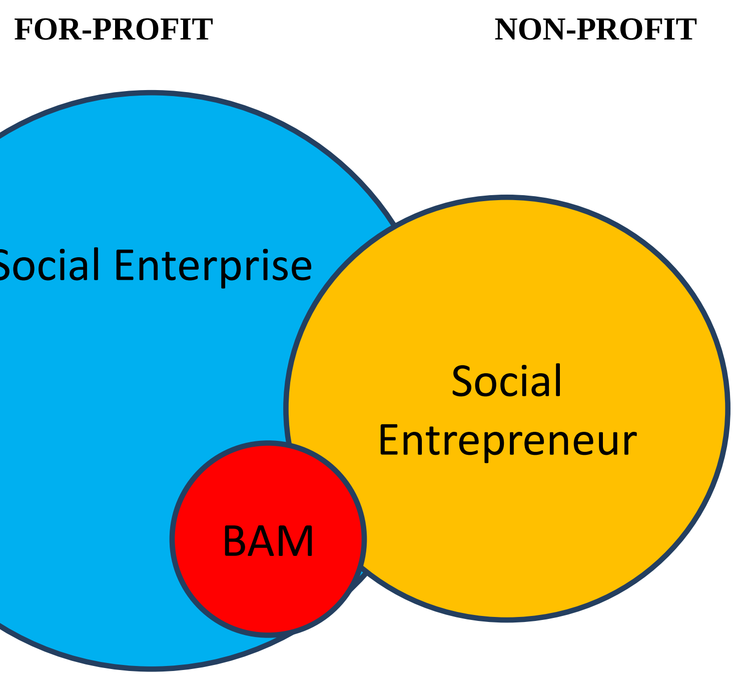
As the chart below demonstrates, social enterprise, social entrepreneurship and Business as Mission all share the common blend of social mission and revenue-generation. However, they differ in several significant ways. Social enterprise and Business as Mission most always use a for-profit business form. Social entrepreneurship is the most flexible as it can use a for-profit or non-profit format. (Revenue generation in the non-profit form means that any profits are returned to the organization). Business as Mission can overlap with social entrepreneurship if it employs an innovative approach.

Table 1 Definitions Chart

	Social Enterprise	**Social Entrepreneur**	**Business as Mission**
Social Mission	**X**	**X**	**X**
Revenue Generator	**X**	**X**	**X**
Innovative		**X**	
Intentional Christian			**X**
Cross-cultural			**X**

The differences can be illustrated in a visual form as follows:

Chart 1 Social Enterprise Forms



Of the three, social enterprise is the broadest concept. Social entrepreneurship is less broad as it requires innovation. Business as Mission is much more exclusive. The terms overlap, however. Business as Mission is a form of social enterprise and, if it is also innovative, would also be considered social entrepreneurship.

Biblical Basis for Hybrids

Regardless of the label placed on these hybrids, Christian entrepreneurs generally credit their faith and personal calling as Christians as a factor in their social focus enterprise (Lucas, 2010). This is not surprising as there is strong scriptural foundation supporting social mission. In particular, the primary characteristics of social hybrids, which are (1) their focus on social mission, and (2) reinvesting profits in the organization instead of pursing personal gain, connect well with biblical values. We also assert that the additional characteristic of social entrepreneurs, (3) using an innovative or unique approach, finds strong support in scripture and Christian theology. The following discussion of the biblical references to these characteristics will have particular relevance for Christians teaching and working in the social entrepreneurship field.

(1) Regarding *social mission*, Scripture is replete with injunctions to maintain the health of the community, especially legal and political systems, to steward the earth and care for the needs of the most vulnerable. This is initially articulated in the context of the Mosaic Law. "Do not take advantage of a widow or an orphan. If you do and they cry out to me, I will certainly hear their cry" (Exodus 22:22)[3]. "Do not deny justice to your poor people in their lawsuits" (Exodus 23:6). "Do not oppress an alien" (Exodus 23:9). "Follow justice and justice alone" (Deut. 16:20). These are just a few representative passages.

To further illustrate how the Mosaic Law encourages societal responsibility to address one issue, the problem of poverty, Christopher J.H. Wright (2004) has commented:

> The law insists that poverty must be addressed and redressed, whatever its causes may be. The series of clauses in Leviticus 25 beginning, 'If one of your countrymen becomes poor…' (vv. 25, 35, 39, 47) give no hint as to possible causes. It is not a matter of assigning blame. The question is, what is now to be done if a brother is in danger of sinking in to poverty?....Those who are required to take action are not necessarily those responsible for the problem (in the sense of being guilty of causing it). But they are responsible under God for those in danger of falling through the cracks of society. Such persons at risk must be restored one way or another (p. 172 – 173).

One of the charges brought by the Old Testament prophets against the nations of Judah and Israel was their failure to defend the vulnerable members of their community. "Woe to those who…deprive the poor of their rights and rob my oppressed people of justice, making widows their prey and robbing the fatherless" (Isaiah 10: 1, 2). "I will be quick to… testify against… those who defraud laborers of their wages, who oppress the widows and the fatherless and deprive aliens of justice" (Malachi 3:5).

In the New Testament, Jesus repeatedly demonstrated his compassion for physical needs by healing the sick and feeding the hungry. In Luke 4:16 – 21, Jesus quoted Isaiah's prophecy as evidence of his authenticity as Messiah:

> "The Spirit of the Lord is on me, because he has anointed me to proclaim good news to the poor. He has sent me to proclaim freedom for the prisoners and recovery of sight for the blind, to set the oppressed free, to proclaim the year of the Lord's favor."

Thus, for Christians, caring for the needs of others is one way to represent Christ in the world. "Religion that God our Father accepts as pure and faultless is this: to look after orphans and widows in their distress and to keep oneself from being polluted by the world" (James 1:27). Of course, Christians have always been active in addressing social needs, founding schools, orphanages and hospitals, and fighting against slavery, sex trafficking and other injustices. What is different about many social missions today is how they have embraced a business model.

(2) A second characteristic of Social Hybrids is that they *seek to generate revenue, but they are not in it just for the money*. They are not motivated by personal wealth or financial gain, although they are committed to using a profitable business model. They are committed to creating an economic engine that will sustain the mission and meet their own personal needs instead of relying exclusively on charitable donations. The first element of this theme – using

resources wisely—has a solid basis in scripture. Abraham, Isaac and Jacob were all successful merchants in the cattle business. "The Lord has blessed my master abundantly," said Abraham's servant in Genesis 24:34, "and he has become wealthy." Proverbs 10:22 promises that "the blessing of the Lord brings wealth, and he adds no trouble to it."

Jesus repeatedly told parables where a business owner ("the Master") is the hero of the story. The parable of the talents in Matthew 25 and the shrewd manager in Luke 16 are just two examples. Jesus also routinely compared business practices, such as assessing risk, making investments and planning for growth, to the nature of faith and discipleship. The parable of the Ten Minas in Luke 19 is illustrative, where the master told his servants to "put this money to work until I come back."

Paul assumed that Christians would be wealthy enough to give generously to provide for the needs of less fortunate members. "[T]hose who are rich in this present world…should be rich in good deeds, and be generous and willing to share" (1 Timothy 6:16, 17).

Yet, Scripture also counsels about the danger of pursuing wealth for its own sake. This is the second part of the element that distinguishes social hybrid pioneers from many business entrepreneurs. *They use business principles as the economic engine for funding the mission, but not to grow rich personally*. In the Sermon on the Mount, Jesus warns his disciples: "Do not store up for yourselves treasures on earth, …but store up for yourselves treasures in heaven" (Matthew 6: 19 -21).

Paul exhorts Timothy to teach others about the risk of seeking riches. "Command those who are rich in this present world not to be arrogant nor to put their hope in wealth, which is so uncertain, but to put their hope in God, who richly provides us with everything for our enjoyment " (1 Timothy 6:17).

James is blunt. “Now listen, you rich people, weep and wail because of the misery that is coming on you. Your wealth has rotted, and moths have eaten your clothes. Your gold and silver are corroded. Their corrosion will testify against you and eat your flesh like fire. You have hoarded wealth in the last days” (James 5: 1 – 3).

The balance between using money yet not being consumed with pursuing it is a difficult task. Yet this seems to be a defining characteristic of leaders in social hybrid organizations. They are following Peter’s admonition: don’t be “greedy for money, but [be] eager to serve” (1 Peter 5:2).

(3) The third characteristic of a Social Entrepreneur is *innovation*, which is defined as finding a unique or creative solution to address a social need.[4] Again, Christians should exemplify this characteristic because creativity is a significant aspect of God’s personality. Of the many attributes that describe God (omniscient, merciful, and more), innovation is illustrated first: “In the beginning, God *created* the heavens and the earth” (Genesis 1:1). The centrality of creativity as an aspect of God’s nature is additionally underscored in Genesis 1:27: “So God *created* man in his own image, in the image of God he *created* him; male and female he *created* them.” We were made to reflect all of God’s nature, including creativity.

The relationship of creativity to Christianity is a far broader topic than can be fully addressed in this article. We are not suggesting that Christians are or should be more creative than nonbelievers. We assert, however, that Christians should affirm and encourage the creative process in every sphere of life, from business to the arts to social sciences. This is because Christians worship the one who imagined the universe and called it into being.

"For by him [Christ Jesus] all things were created: things in heaven and on earth, visible and invisible, whether thrones or powers or rulers or authorities; all things were created by him and for him" (Colossians 1:16).

We also were designed by God to participate in his creation. "For we are God's workmanship, created in Christ Jesus to do good works, which God prepared in advance for us to do" (Ephesians 2:10). This should be a theme verse for Christian Social Entrepreneurs!

Further, as Thomas C. Peters has noted,

> There is much more to Christian faith than intellectual assent and moral conformity to the creeds and doctrines. Faith, in fact, embraces imagination….The imagination is to be treasured and nurtured, as it replicates that Divine Creativity to which we owe our hopes, our faith, our joys, our loves and our very lives (Peters, 2000, p.10).

Another indication of why innovation should be a hallmark of Christian endeavors is to reflect on the numerous references to "new" in scripture. This is a theme in the Old and New Testaments. The prophets declare that God is bringing forth "new things" (Isaiah 42:9). We are promised a "new name" (Isa 62: 2), a "new covenant" (Jeremiah 31:31) and a "new heart and a new spirit "(Ezekiel 18:31). In the New Testament, we are presented with the message of "new life" (Acts 5:20). We are promised that " if anyone is in Christ, he is a new creation; the old has gone, the new has come!" (2 Corinthians 5:17). Believers are counseled to "put on the new self, which is being renewed in knowledge in the image of its Creator" (Colossians 3:10). In Christ we have a "new birth "(1 Peter 1:3) and we look forward to a "new heaven and a new earth" (Revelation 21: 1). We worship an inventive, imaginative, bold and creative Heavenly Father, who has proclaimed: "Behold, I am making everything new!" (Revelation 21: 5).

This repeated emphasis on newness is theologically significant. The order and dynamic of "old things" is changing because God has broken into history through the person of Jesus Christ. As Christians, we experience this newness when we come to Christ and are transformed. But this is only the beginning. As Jurgen Moltmann (1997) describes,

> [W]ith Christ in faith, a wholly new life begins. It is not a restored life, and it is not a rejuvenated life either. It is not even a life reborn out of its origin. The resurrection of Christ has no historical prototype. It is something completely new in history. It is the beginning of the new creation of everything…The new birth to eternal life is not 'Paradise Regained.' It reaches forward into the resurrection world which 'no eye has seen, nor ear heard…but God has revealed it to us through the Spirit' (1 Cor. 2:9) (p. 30).

The good news is that we don't need to wait until the future to experience these new things now. Christians have a unique relationship with the Creator and thus should welcome innovation in every arena: businesses, politics, education and especially in our responses to social problems. Christian universities should encourage innovation and entrepreneurship in all disciplines.

Function Determines Form

The form of any organization should support its function. As Reed, Shedd, Morehead and Pagnattaro (2008) discuss, a for-profit entrepreneur must consider at least five factors in selecting an organizational form: cost of creating the organization; continuity or stability; control of decisions; personal liability of the owners; taxation of owner's earnings; and distribution of profits (p. 339).

Similarly, a nonprofit entity has to make choices before selecting a legal form, such as personal liability and tax exemption (Hopkins, 2009, p. 6 – 7). Wexler (2009) has identified five broad categories that Social Entrepreneurs should review in selecting an organizational format: tax, management and control, capital and loans, distribution of funds and liquidation (p. 566). We believe that additional considerations for hybrid organizations should include mission, branding and regulation, based upon research conducted among L3C pioneers in Vermont by Elizabeth Schmidt (2010). She found that social entrepreneurs chose the L3C model because it "fit their mission," was considered "cutting edge" and offered regulatory flexibility (p. 176).[5]

In the chart below, we have identified significant differences between the main organizational models and the new hybrid forms based upon the factors we consider most significant. The models are described in the next section.[6]

Table 2 Comparison of Organizational Models

	For profit Corp	**Nonprofit Corp**	**B Corp**	**L3C**
Mission	Single	Single	Dual	Dual
Market/ Brand	Produces goods or services	Social mission	"better way to do business"	"nonprofit soul"
Resources	Investors/ loans	Donors	Investors/ loans	Investors/ donors
Control	Board	Board	Board	Members
Taxes	Corp tax rate	Tax exempt	Corp tax rate	Members taxed
Risk	Limited liability	Limited liability	Limited liability	Limited liability
Regulation	Low	High	Medium	Low

The Old Wineskins

The most popular legal structures for business organizations are the corporation and the Limited Liability Company. Most nonprofits are organized under a state nonprofit corporation law. How do these models address the concerns of social hybrids described above?

The modern *corporate* structure is an extremely effective way to reduce risk, raise capital and provide management structure for both complex and simple organizations. In their fascinating history of the modern corporation, "The Company," John Micklethwait and Adrian Wooldridge explain how the corporation became one of the West's great competitive advantages, becoming perhaps even "one of the greatest single discoveries of modern times" (2005, p. xxi.).

Corporations compete for investment capital to increase their production capability. This also benefits investors as they can spread out their risk by purchasing small and easily marketable shares. Upon incorporation, the firm becomes a separate legal entity, distinct from the owners or managers (Frarrar and Hannigan, 1998). The "personification of the corporation is significant because it implies a single and unitary source of control over the collective property" (Lan and Heracleous, 2010, p. 295). This control is centralized in a board of directors, who are elected by shareholders. The directors then hire officers to manage the daily affairs of the organization.

Since directors are chosen by shareholders and are using their capital to run the company, they (and the officers) have a fiduciary responsibility toward them. They must act in their best interests. The traditional view of corporate law is that the best interest for shareholders is to receive a positive return on their investment. Thus, the primary obligation of a corporation is to return a profit to shareholders. This was established in a 1919 lawsuit, when the Supreme Court of Michigan rejected Ford Motor Company's decision to reinvest its profits in the business instead of paying dividends to shareholders (Dodge v. Ford Motor Co.). The company was criticized for attempting the run the company like a "semi-eleemosynary [charity] institution and not as a business institution" (1919, p. 683).

One of the tensions in corporate governance and the corporate social responsibility movement is how to balance the primary obligation of maximizing shareholder wealth with obligations to employees, customers, suppliers, and other stakeholders. Milton Friedman is most famously quoted on this issue:

> There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud. (1970, p. 8)

Under this traditional view of shareholder primacy, there is no legal legitimacy to maintain a dual mission, or for the company to sacrifice shareholder interests for those of other stakeholders. Officers and directors are limited by their responsibility as *agents acting on behalf of shareholders* (Lan and Heracleous, 2010, p. 297). An alternative view posits that directors and officers are instead *agents of the corporation*, which would allow them to consider broader stakeholder interest in their management decisions, beyond just maximizing shareholder return (Lan and Heracleous, 2010, p. 300). The view of director primacy is potentially bolstered by another legal principle, the Business Judgment Rule, in which courts defer to a good-faith decision made by a Board of Directors under a shareholder challenge (Branson, 2002, p. 631).

Additionally, some states have passed Constituency statutes, which specifically authorize directors to consider other interests besides just stakeholders, such as those of employees, suppliers, creditors, customers, the economy of the community and societal interests, particularly in the context of a hostile takeover in which community jobs would be sacrificed (Bretsen, 2006).[7]

In a 2006 article in the *Journal of Biblical Integration of Business*, Bretsen argued that the combination of the Director Primacy theory, Business Judgment Rule and Constituency Statutes would together allow sufficient flexibility for a social enterprise, such as a Christian company operating as a Business as Mission, to pursue its spiritual and social bottom lines while using a traditional corporate model. However, he also acknowledged that a publically traded corporation attempting to operate as a "faithful business" (Bretsen's phrase for Business as Mission) will likely face issues related to takeover proposals, where another entity attempts to gain control of a corporation through the purchase or exchange of stock. (p. 69). Yet, while Constituency Statutes may provide a safety net for a Christian hybrid, not all states have these. Bretson's article was written before the increased popularity of social hybrids and the emergence of the B Corp and LC3 models.

For smaller social hybrid corporations that do not rely on investment capital, the shareholder versus stakeholder dilemma may not be an issue at all. But even if maximizing shareholder returns is not a concern, the corporate model does not help the social entrepreneur's need to *brand* the organization as a hybrid. There is no way to get around the obvious fact that a corporation "is designed to make money" (Mickelthwait and Wooldridge, 2005, p 191). There is also no mechanism for a for-profit to acknowledge contributions as tax deductible or to obtain some of the beneficial tax treatments allocated to nonprofits.

Another popular organizational structure is the *Limited Liability Company (LLC)*, which blends the benefits of corporations and partnerships. Like a corporation, the LLC offers limited liability to its owners. Like a partnership, owners, which are called members (not shareholders), can craft a membership agreement that divides management responsibilities, as well as profits and losses, as they wish. Members are taxed individually, similarly to the partnership model.

The main benefit of the LLC model to social hybrids is its flexibility. A social enterprise LLC could consist of for-profit and nonprofit members, with the potential to allow for-profit members to share in the profits while allowing nonprofit members to retain decision-making power (Kelley, 2009). The pass-through tax features of the LLC may be attractive to social enterprises that prefer the individual tax rates. The form is available in all states and there is a settled body of state and tax law about LLCs. Although LLC membership agreements can be complicated, most attorneys who work in this area are familiar with the model.

The problem with using the LLC form for social hybrids is primarily branding. "LLC" signals a for-profit organization. Under IRS regulations, it will not qualify for charitable grants. It may also be challenging to convince socially responsible investors that the hybrid is committed to a social mission.

Is the *nonprofit corporation* model a good fit? Historically, a nonprofit structure has been the only choice for organizations focused on social mission. But does it meet the needs of hybrids? The main characteristic of an organization that is qualified as a nonprofit under Internal Revenue Code regulations is that it is "barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees" (Hopkins, 2009, p. 6). This is known as the "private inurement doctrine." The purpose of the rule is to ensure that a charitable organization is serving public interests, not private interests.

This does not mean that a nonprofit organization cannot generate a profit. They can engage in commercial activities if this will enable them to achieve their charitable purpose. What they can not do is transfer the profits to private individuals, such as paying an executive director an excessive and unreasonable salary. "The existence of a single commercial or otherwise nonexempt and substantial purpose will destroy or prevent the [tax] exemption" (Hopkins, 2009, p. 52-3). A non-profit entity is thus prohibited from pursuing a dual mission.

In addition, in order for the nonprofit to qualify as tax-exempt, and be able to receive contributions that are tax deductible, the organization must comply with IRS reporting regulations. These include a comprehensive initial filing and annual compliance filings of Form 990. As Hopkins reports, when the IRS revised the 990 Form in 2007, the nonprofit community was stunned. "If this is the annual return we will have to file, we don't want to be tax-exempt anymore" (Hopkins, p. 115). Thus, the nonprofit model, with its limits on revenue production, owner control and excessive regulation is also not a good fit for many social hybrid organizations.

The New Wineskins

Social Hybrid pioneers have lamented the shortcomings of the traditional for-profit and nonprofit models described above. If only the benefits of each could be combined and the detriments eliminated! This is the motivation behind two new organizational forms explicitly created for social hybrids: the Benefit Corporation ("B Corp") and the Low-Profit Limited Liability Corporation ("L3C"). Although other organizational models have been proposed, such as the Flexible Purpose Corporation in California and the Socially Responsible Business Corporation in Minnesota and Hawaii, so far, only B Corp and L3C statutes have been enacted.[8]

These seem to be gaining wider acceptance, although they still do not address all of the concerns of social hybrids.

The *B Corp* is both a corporate form under state law and a certification process. Under the corporation model, a B Corp is incorporated in a state with a B Corp statute, and is treated similarly to a regular corporation for liability, tax and governance purposes. States that have enacted the B Corp structure include Maryland (effective in October 2010) and Vermont (effective July 2011), with other states considering the model or a similar concept (Douglas, 2010). The difference in the B Corp structure is that the incorporation documents include a general and specific social benefit mission statement. In the Maryland statute, a general public benefit is defined as "a material, positive impact on society and the environment, as measured by a third-party standard, through activities that promote a combination of specific public benefits" (Md. Corporations Code Annotations, Section 6C-1c). The third-party entity or person must be independent of the benefit corporation and follow a transparent, publicly available standard. A B Corp can also identify a specific public benefit, such as:

- Providing individuals or communities with beneficial products or services;
- Promoting economic opportunities beyond the creation of jobs;
- Promoting the arts, sciences or advancement of knowledge;
- Increasing the flow of capital to entities with a public benefit purpose; or
- The accomplishment of any other particular benefit for society or the environment (Md. Corporations Code Annotations, Section 6C-1d).

In addition, the B Corp must report annually to shareholders on the organization's progress in pursuing its goals. The third-party standard review also reports on the status of the missions and additionally evaluates whether the corporation has considered stakeholder interests in its decision-making. The business is additionally assessed on whether it is complying with best practices pertaining to employment and environmental standards. A nonprofit entity, the B Lab, is available as the certifying organization, although others could qualify for this as well (B Corporation: Become a B Corporation, 2011).

The B Corp certification route is available to businesses that are already incorporated or do not wish to incorporate in Maryland, Vermont or other states that have a B corporation statute. Under this process, the business must first complete a self-assessment which addresses such issues as governance (“Has the company explicitly integrated social mission into its written corporate mission?), compensation (“Is a living wage paid to all full-time and part-time employees?”), work environment (“Is there a formal method by which employees can raise complaints without fear of reprisal?”), community relationships, energy usage and so on (B Corporation, “Become a B Corporation,” 2011). The B Lab, a nonprofit company, reviews this initial assessment and determines whether or not the business meets the qualifications. Periodic and comprehensive audits are planned to ensure compliance. Once a company becomes certified, they join the “B community” and are encouraged to share resources and discounts with other B Corp businesses. There are 419 businesses certified as of May 27, 2011 (B Corporation: B Community, 2011).

The new model has attracted favorable reviews. “Is the Benefit Corporation Really Such a Big Deal?” asks corporate philanthropy attorney Allen Bromberger. “In a word, yes…for a new breed of companies that want to do both [profit and social mission], the new form offers something unique” (Para. 2, 2010).

The Washington Post reported on January 24, 2011:

> [The B Corporation]…is new ground, but it can play a more important role in compelling entrepreneurs to do social good while they make a profit," (Duncan, 2011).[9]

Seattle attorney Brian Howe chose the B Lab certification for his law firm because it identifies his business as both cutting-edge and focused on social mission. Others point to the possibility of attracting socially conscious investors. There is also a “B community” that offers discounts on goods or services to other B companies. Additionally, working in a B-certified firm may boost employee morale (B Corporation: The Business Case, 2011).

The B Corp and B Lab certification should help hybrid organizations with branding, although the concept is so new that many people are not aware of it. Other potential drawbacks are that the concept is untested. The law is somewhat imprecise and can be confusing. There is obviously a lack of interpretative law and no set standards yet on best practices. Investors may be reluctant to participate in ventures where their interests are not placed first. Enterprises that may attract contributions will not be able to provide tax deductions. Finally, there is an additional layer of analysis for management to consider, that of stakeholder interest (Wexler, 2009).

Another new option available to social hybrids is the *Low Profit Limited Liability Company* (“L3C”), a variant of the limited liability corporation. This retains the flexibility of the limited liability company (LLC) but was created especially for a hybrid organization, hence the “low profit” label. Its unofficial motto is “the for-profit with a non-profit soul” (Schmidt 2010, p. 164). The other unique feature of the L3C is that it was designed to qualify for “program related investment” loans from private foundations, based upon Internal Revenue Code requirements. These investment loans would allow foundations to advance social benefit goals, such as building affordable housing, charter schools, alternative energy facilities, health care facilities in depressed neighborhoods, and so on. The model was first adopted in Vermont in April 2008. Since then, legislators in several other states, including Illinois, Michigan, Wyoming, Louisiana and North Carolina have also passed a Low-Profit Limited Liability Act (Schmidt 2010).

The L3C model has received both rave reviews and strong criticism. Its strong point is its branding, particularly the tag line, "the for-profit with the nonprofit soul." In research conducted among the early adopters of the L3C in Vermont, Elizabeth Schmidt reported that most were attracted to the form by its branding potential.

> According to several LC3 pioneers, a social-hybrid business form is both a perfect fit for their organizations and a perfect fit for our times. The L3C was created for organizations that want to operate at the intersection of mission and profit….We have been trying to…weave together 50+ years of for-profit, nonprofit and government agency experience. In [their] minds, there is no better way to do that than with the LC3 (Schmidt, 2010, p.182).

Criticism of L3Cs primarily focuses on the challenge of compliance with the IRS Program Related Investment ("PRI") rules. A PRI is an investment made by a charitable foundation to further a tax exempt purpose of the foundation. It can be a loan, a loan guarantee, or other transaction, as long as it meets three requirements: 1) the primary purpose will accomplish a charitable purpose, 2) no significant purpose includes the production of income or appreciation of property and 3) it does not involve lobbying or participation in a political campaign (Schmidt, 2010, p. 165).

Law Professor Daniel S. Kleinberger argues that private foundation investments in L3Cs "will not have any PRI-related advantage over investment in ordinary LLCs" because the PRI rules still do not allow for foundations to invest in a private benefit organization as this would be a violation of the private inurement doctrine described. (2010, p. 37 – 38). Additionally, the L3C statute contradicts itself. In order to attract foundation Program Related Investments, the legislation states that "no significant purpose of the company [can be] the production of income" yet the L3C is still designed to be a low *profit* limited liability company (Kleinberger, 2010, p. 37 – 38). Clearly, as with any new legislation, there are details to be worked out.

Implications

Aside from the benefits and detriments discussed above, what are potential consequences from these new organizational forms? We identify six possible outcomes that merit further research and discussion. Some of these implications are of particular concern for Christians engaged in Social Enterprises and Christian business schools.

1. *States will continue to compete with innovative organizational models.*

We believe this is a positive development. State governments have routinely functioned as laboratories for new laws, and the same will be true for both the B Corp and L3C models. Maryland is already proclaiming itself as the "Delaware" of B corporations (B Corp Blog, 2011). Competition among states to attract socially responsible businesses is a good strategy for states, signaling a climate that is both business-friendly and socially progressive. There is also some potential for additional revenue, particularly for states that are able to offer the most attractive package, although it is unlikely that another state will be able to match the "cottage industry" of corporate governance support that Delaware has established for many years.

There is also a benefit in allowing multiple models to spring up that can be tested by early adopting states. As already discussed, there are problems with both the B Corp and L3C laws. States that have not already adopted a social hybrid form would do well to watch how the laws work out in other states. If the critics of the current L3C model are right, they will be vindicated in tax court cases and other litigation. After a few years, these issues should get sorted out and L3C state law will either be modified or scrapped altogether. The benefits to the early adopters are already taken. States without an L3C, B Corp or other hybrid model should wait until the potential problems with these models get resolved.

2. *There will be more variations in tax policies for nonprofits and social hybrids.*

We expect that policy makers will become more interested in the opportunities for additional tax revenue from nonprofits as well as a sliding scale of tax breaks for social benefit hybrids. Why should socially beneficial for-profit companies not enjoy some of the tax benefits available to nonprofits? Why not have for-profit charities? A 2007 article in the Virginia Law Review argues that organizational form is not a logical reason for the government to base tax subsidies for charitable activities.

> Existing theories of nonprofit status are not persuasive justifications for coupling the nonprofit form and tax breaks for community-benefit activities. The government should not condition such breaks on taking the nonprofit form, that is, complying with the nondistribution constraint. Exclusively subsidizing this form distorts entrepreneurs' incentives and encourages inefficient production (Malani and Posner, 2007, p.2023).

Others have challenged this view. A 2010 article in the Michigan Law Review counters that there are a host of public policy reasons to keep the current system. One is that giving a tax break to for-profit charities would be a nightmare to administrate and "would create new avenues for tax avoidance" (Hines, Horwitz and Nichols, 2010, p. 1214 – 1215). Extending tax breaks to socially beneficial for-profits may eventually lead to a reduction in the deductibility of contributions, further eroding contribution levels and charitable activity. In other words, if we "mess" with the system, there is a risk that everyone loses.

Nonprofits have already begun to feel the pinch of new fees and taxes from local governments desperate for cash. The Wall Street Journal reported in December 2010 that a number of cities, including Houston, Minneapolis and Richmond, among others, are finding creative ways to address budgetary shortfalls. Taxing nonprofits "marks a sharp departure from long-standing tax exemptions mandated by state law or adopted on the theory that churches, schools and charitable organizations work alongside governments to provide services to the community." (Dugan, 2010).

This may be only the beginning. Despite the historical tradition and oversight challenges, governments may welcome the opportunity to expand the tax base. Why not offer a sliding tax scale based on social benefit? An efficient nonprofit may qualify at the 90% tax-free rate, with less efficient nonprofits taxed at 80%. Social hybrid organizations should pay a lower tax rate than the business corporation rate. Again, this would add more complexities to the system, but that's never slowed Congressional or IRS regulators. If there really is no logical reason to base tax-exemption on organizational structure (profit v. nonprofit), then a change in tax policy is inevitable.

3. Responsible businesses will feel pressured to pursue social mission.

This is not a good development. If we value social entrepreneurs or Business as Mission organizations more highly than ordinary revenue-generating companies, we will perpetuate the dualism between sacred and secular that has plagued modern Christianity, especially in the business arena. Not everyone is called to be an entrepreneur nor are all gifted with the abilities required for effective social mission. Christian business students in particular should be encouraged to be 'salt and light' in the business world and participate in the honorable pursuit of capital. The entirety of Business is a ministry, as it provides goods and services, employment, and economic vibrancy. As the Christian Business Faculty Association and others continue to develop a Business as Mission theology and curriculum, we should guard against establishing a hierarchy where the ordinary business discipline becomes a second-class citizen.

4. Churches and Christian missions will turn to social ventures to generate revenue.

This is good news. Encouraging revenue-generating models to assist churches and Christian mission organizations will open up more opportunities for ministry and innovation. These groups need not be completely dependent on dwindling contributions. The New York Times recently reported that there has been a huge decline in private foundation funding as a result of the economic crisis and increased IRS scrutiny (Sullivan 2011). Another recent study reported that giving to churches overall declined to 2.4 percent of a donor's income, lower than during the first years of the Great Depression (Bunte, 2010).

New churches and other mission startups will especially benefit from operating a social hybrid organization. If a new pastor, or founding team, is engaged in a revenue-generating business while planting a new church, they will already be connecting with and serving the very community they are attempting to reach. This could even change how we “do” church. Churches and other missions groups that use a social hybrid structure will have incorporated an outreach into the beginning “DNA” of the organization. Serving the community will not just be a “tacked on” activity. Seminaries, Schools of Ministry, denominational church headquarters and mission-sending organizations should pay particular attention to how this development impacts their selection and training of new pastors and missionaries.

5. *Branding for social hybrids will continue to be confusing.*

Branding is not just an issue for public relations or marketing, but is more definitional for social hybrids: what are these entities? This is problematic not just for potential customers and clients, but also for investors, donors, board members and the integrity of the hybrid organization itself. The risk is not just that this is a new model and people do not understand what hybrids do; but that structures for legal and financial accountability are not in place. While B Corporations and L3Cs are an attempt in this direction, it will take time – and mistakes, failures, and lawsuits – before some of the details get sorted out regarding how these new creatures are to function.

One key indicator to watch is investment in hybrids. In an article in the online journal Inc.com, Suzi Sosa noted that capital is not yet flowing into hybrid organizations because investment funding requires transparency and certainty, which hybrids still lack. “[W]ithout widespread legal infrastructure to codify decision-making authority, the risk of weak accountability is too high” for investment in hybrid organizations (2010, para. 8). There are a handful of funds that are attracting interest, such as SOCAP (Social Capital Markets, “At the Intersection of Money and Meaning”) and the Global Impact Investing Rating System. Kevin Jones, founder of Good Capital and a co-founder of the SOCAP conference, believes we are in a new era. In an interview with the Bay Citizen before the fall 2010 SOCAP conference in San Francisco, he explained, “There is a changing investor mindset. There is a true moral hunger for a new asset class” (Weber, 2010). Yet, as the interviewer wryly noted, “it remains an open question how quickly that moral hunger will translate into signatures on checks” (Weber, 2010).

Reluctant investment is only a symptom of underlying issues that board members of hybrid organizations will need to wrestle with. Board members will face multiple challenges in defining the dual mission and sorting priorities.

6. Hybrid organizations will find it challenging to do dual missions well.

Related to the definitional branding issue described above, this challenge gets to the heart of what social hybrids truly want to do, which is the dual mission. Is it really possible for an organization to generate revenue and meet their social mission equally well? When there is a decision regarding costs or quality or growth, which bottom line will win out: mission or profit? It is challenging enough for a single-focus organization to stay on-track with their mission. Having a dual mission compounds the decision-making, the stakes, and the complexity of operation. “Mixing mission and money is tricky business, requiring strong leadership to articulate and maintain clear priorities and accountability” (Sosa, 2010, para. 12).

Some hybrids have already given up. Unitus, a Seattle nonprofit (“innovative solutions to global poverty”) shut down its microloan venture capital arm and laid off employees in a surprise announcement in July 2010 (Holtzman, 2010). Another example is GlobalGiving, which the New York Times reported failed to generate sufficient profits from its technology platform partner, ManyFutures (Strom, 2010). If neither side of a social hybrid is achieving its mission, pulling them apart can be even harder. Laura Callanan, a consultant with McKinsey &

Company's social sector office has commented, "When everything is going well, everyone is getting along and interests are aligned. But when financial challenges hit, the fact that there are different objectives creates questions about how the pain is shared" (Strom, 2010).

Despite this daunting task and the challenges that hybrid organizations and their entrepreneurial founders face, we are optimistic about the future of this field. We believe that the positive benefits of social hybrid structures outweigh the negatives. We also see new opportunities for business schools to teach and encourage social entrepreneurs as part of the regular business curriculum. Social Entrepreneurship is all about innovation, the ability to see what needs to change and to see change as an opportunity, not a threat. William Pollard, the 19th century English clergyman, once said, "Without change there is no innovation, creativity, or incentive for improvement. Those who initiate change will have a better opportunity to manage the change that is inevitable" (Brainy Quote, 2011).

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[1] Other business structure formats are partnership, limited liability partnership and sole proprietor.

[2] Johnson also differentiates among ministry from "outsiders" (non-business Christians) to those inside the business world; ministry within the marketplace, by Christians in business to others in business; and ministry through the marketplace, where Christian business people use business to help others in a cross-cultural or international context. Johnson would limit Business as Mission to this last group. Other authors use slightly different terminology, such as "Great Commission Companies," in the Rundle and Steffen book of the same name. A "Great Commission Company" is a "socially responsible, income-producing business managed by kingdom professionals and created for the specific purpose of glorifying God and promoting the growth and multiplication of local churches in the least-evangelized and least-developed parts of the world" (2003, p. 41). Stephen Bretsen prefers the term "Faithful Business," defined as a "firm holistically integrating Christian theological and social principles with its business operations for the glory of God" (n.d., p. 124)

[3] All scripture is from the New International Version, 2011, retrieved from http://www.biblegateway.com/versions/New-International-Version-NIV-Bible/

[4] The innovation need not be a dramatic breakthrough, such as a new patent. It could simply be the application of a concept from one field to another or in a new location.

[5] The most common reason for selecting the L3C entity was that they hoped to receive Program Related Investment funds, even though none of the respondents in the survey received any PRI funds (Schmidt, 2010).

[6] The Appendix includes a list of questions we wrote for an entrepreneur to consider under each category.

[7] Most Contingency statutes were enacted to protect directors who reject a hostile takeover bid, so that local jobs can be protected. See Bretsen's article for a fuller discussion.

[8] As of February 1, 2011. The California bill was introduced in 2010. The Minnesota bill was proposed in 2007 and the Hawaii bill in 2006.

[9] Current media reports on B Corp and B Certification process can be assessed at the B Corporation media link at http://www.bcorporation.net/media

Appendix

Questions to Help Entrepreneurs Select an Organizational Form

Mission

1. Who are we?
2. What do we do?
3. Who do we serve primarily? Secondarily?
4. Are we crossing cultural or internationally boundaries?
5. What are our goals?
6. What are our priorities?
7. How will we measure success?
8. How can we demonstrate that we have met our mission?

Market and Brand

9. Who are our stakeholders? (clients, employees, vendors, investors, etc)
10. Will our stakeholders understand who we are?
11. How do we want others to see us? Do we want others to know we are primarily a revenue-producing entity or a nonprofit that can give tax deductions for contributions? Are we a cutting-edge hybrid that combines revenue production with social mission?
12. What do our investors or donors want from us? Return on equity? Charitable tax Deduction? Confirmation of mission?

Resources

13. What are our sources of funding? (revenue, donations, investment, loans)
14. What additional resources do we need for growth?
15. Will we have different categories of investors? Will we be able to attract Program Related Investments from Foundations?

Control

16. Who is in charge of our direction? (founder, board, owners or members)
17. How will we make decisions?
18. Whom are we accountable to?
19. What if we want to change direction?
20. What does the founder want to personally get out of this?
21. What if the founder leaves, dies or wants to sell?

Taxes

22. Do we need or want to avoid tax liability?
23. Are we prepared to comply with regulatory rules for 501(c)(3) organizations?

Risk

24. What's our liability risk? Do we need or want to limit personal liability?
25. Do we need to separate out the more risky aspects of the business?

Regulation

26. Are we prepared to comply with extensive IRS regulation (for nonprofits) or an outside auditing process (for B Corp certification)?
27. How quickly do we want to establish our organization?
28. What is our preference regarding organizational structure? Do we care about simplicity? Complexity? Flexibility?