What makes a social enterprise?

Social enterprises generally provide a social or environmental good, based on a sustainable business which does not have to rely on charity or philanthropy for its on-going sustainability. The intention is generally to trade in order to make a surplus. Social entrepreneurs have to consider how a legal structure can encapsulate, protect and maximise the social mission and ensure the assets of the business are predominantly applied for the social good. But they often need to receive a salary and finance the start-up of the new business.

There are a number of legal structures that can be used to run a social enterprise including charitable structures. This article explores some of the issues and options that are available.

Charitable organisations

One of the most common structures is the company limited by guarantee with charitable status. A charitable incorporated organisation is another option – like the company, it offers the benefit of limited liability and charitable status.

There are significant tax advantages that come with charitable status including an exemption from corporation tax on profits and stamp duty, gift aid and rates relief. A charity can trade and can be (and many are) successful social enterprises but only where that trade fulfils the charity's mission.

- Social mission

Charities can only have objects and undertake activities that are exclusively charitable and for the public benefit. Consent from the Charity Commission is required to change the objects. This ensures that the mission and assets are protected and cannot be applied for private gain.

- Payment and private benefit

A social entrepreneur often needs to be paid. A difficulty with the charity model is that trustees are generally unpaid. If the social entrepreneur is appointed as a director/trustee while being paid, the Charity Commission will need to be convinced that there are good reasons for this and that any private benefit is incidental and no more than necessary.

- Investment

If a charity is used as the vehicle for social enterprise, there is limited opportunity for the entrepreneur to raise private 'equity' investment to capitalise the business.

Most private sector organisations raise much of their capital as 'equity' or 'share' capital, increasingly so since the financial meltdown of 2008. This gives an investor a share in the organisation which permits a vote, for example to appoint the board of directors, and a share in the profits. A charity which is a guarantee company or charitable incorporated organisation cannot issue shares and so this option is not available to them. There are a few charities that have a share capital and in limited circumstances can issue shares but these are exceptional.

A charity can borrow money for investment and can agree to repay the loan in a variety of ways including by reference to turnover or profits, but ultimately the loan is repayable and stands as a liability in the organisation's accounts. Some charitable social enterprises may of course access donations or grant funding to help finance their start-up costs.

Company limited by shares

It is possible to establish a company limited by shares to run a social enterprise, much like the well understood trading subsidiary of a charity, and for that company to attract 'private' investment. A charity can part own the company with one or more investors.

There are tax issues to address as if the company is not wholly owned by a charity or charities; the tax advantage of gift aid is likely to be lost. Gift aid allows the company to donate its profits to the charity free of tax thereby sheltering those profits from tax. There are other structural options, such as the use of a limited liability partnership, that may mitigate this but this is beyond the scope of this article.

Community Interest Companies (CIC)

Social entrepreneurs have looked to other legal structures, for example the community interest company, to address some of the concerns raised above.

The CIC is a limited liability company which can be limited by guarantee or by shares. Additional regulations apply to them but the rules are more flexible than for a charity.

From a social entrepreneur's perspective they have several advantages when compared to charities. In particular a CIC:

- must meet the community interest test. This test is easier to satisfy than the requirements for charitable status and means that a wider sphere of activities can be undertaken. A potential change in the mission is still protected by the CIC Regulator.

- directors of a CIC can be paid

- in the case of a share CIC, the company can pay a dividend on its shares, although the amount is capped by law

CICs have a statute imposed 'asset lock' which means that the assets of the company cannot be transferred at an undervalue except to another CIC or a charity.

It is also important to note that there are currently no tax benefits available to CICs which often proves decisive in considering a structure.

Other structures

There are other corporate vehicles that can be used to undertake a social enterprise activity.

A Community Benefit Society can be used but suffers some of the problems faced by charities. They have a less well known legislative and regulatory structure but some of their features enable greater 'equity' funding options.

A standard private company limited by shares allows equity finance and payments to directors. A standard private company limited by guarantee allows payments to directors but no equity finance. While some features of an asset lock can be voluntarily imposed and entrenched it is always open to the shareholders to change this and the organisation's mission.

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