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Succeeding in Social Enterprise

Emerging Themes: Organizational/Legal Structure

Introduction

We think that great ideas lie behind every great social enterprise. There are a series of important steps to take to turn any idea into a business. One of these is around choosing a legal structure for the business. A common difficulty for social entrepreneurs at the start-up stage is finding the right structure and organizational 'form' that will enable them to achieve their aims and deliver that wonderful idea.

There is a bewildering array of structures available to social enterprises, for example, Community Interest Company (CIC), Charity, Industrial and Provident Society (IPS) to name a few of the most common. Knowing the implications of choosing one of these formats and the pros and cons will help you make the right choice for your business idea.

Common Organizational Structures – Key Features

It is important to state that the concept of 'social enterprise' is not a legal structure itself. It is a general term given to a range of business models. The core, unifying features of social enterprise are social purpose and trading. There are many different organizational structures that can achieve this. In this paper we take a quick look at the advantages and disadvantages of the most common and explore some of the key features relevant to social enterprise. Please note you should always seek professional advice when choosing your organizational format.

Community Interest Company (CIC)

Community Interest Companies (CICs) are, essentially, normal companies but they have special additional features. They are created to conduct business for community benefit and not purely for private advantage. This is achieved by a 'community interest test' and an 'asset lock' which ensure that the CIC is established for community purposes to which the assets and profits are dedicated. Registration of a company as a CIC has to be approved by the CIC Regulator. For more about CICs visit: www.cicregulator.gov.uk.

CICs are usually either companies limited by guarantee or by shares.

A major advantage of CICs is that their directors can be paid a salary. This means that the founders of the CIC can retain strategic control of the enterprise by sitting on the board as paid directors. Other pros include freedom to trade and light touch regulation plus CICs can apply for some grants. CICs with a share structure can also pay a limited dividend to investors. On the downside, CICs have to pay all the usual company taxes and the restrictions about what dividends and profits can be paid can put off some investors. Some trusts and foundations will not support CICs.

Choose the CIC if owning and running the business and being paid is important and you have a clear sense of the community you are working for (geographically or of shared interests).

Charity (Company, Trust or Association)

Many social enterprises also have charitable status. To be a charity your organization must be exclusively charitable and exist for the public benefit. Over the years, a broad range of charitable purposes that provide public benefit have been recognised by the Charity Commission.

Charities can trade to achieve their public benefit and many do so successfully. However, sometimes being a charity is not the best route for many social entrepreneurs because charities have, in most circumstances, volunteer boards of trustees. This means the founders of the charity could not be paid if they wanted to retain strategic control of the charity.

The main advantages of choosing a charitable organization are:

- Tax breaks - charities are usually exempt from corporation tax on profits, can receive business rate reliefs and some VAT exemptions.
- Funding - many trusts will only fund registered charities.
- Public recognition - many surveys show that the public trust charities.

The disadvantages are that charities have restrictions on trading (i.e. you can only do this to achieve your aims unless trading is at a low level or delivered by a trading arm - adding to bureaucracy). Also directors/trustees cannot usually be paid and there is a generally higher level of regulation and scrutiny by the Charity Commission.

Choose Charity if your business model is based on mainly on grants and donations and ownership/salary is less important.

Industrial and Provident Society (IPS)

Industrial and Provident Societies are corporate bodies that conduct trade or business either as a co-operative or for the benefit of the community. They are regulated and registered by the Financial Services Authority rather than Companies House. There are two main forms of IPS:

- The 'bone-fide' co-operative - trading for the mutual benefit of their members.
- The community benefit society - trading to benefit the broader community. These can also be treated as charities for tax purposes.

The key features of IPSs are democratic control (one member, one vote regardless of shareholding); an ability to raise share capital from members and potential profit sharing.

The advantages of IPSs are that they can raise shares from the public (up to a maximum of £20,000 per individual); they can also gain charitable exemptions if they are a community benefit society. The main disadvantages are potentially higher admin costs and sometimes a lack of understanding about the model. There can sometimes be conflicts between workers and the organizations' needs although if properly managed these should not be too much of a problem.

Choose IPS is you want to raise capital from the public and democratic, co-operative control is important to you.

Company Limited by Shares or Guarantee

Companies are one of the most common forms of business model in the private sector and are regulated by Companies House. Companies give the protection of limited liability to their members (either through shares or the guarantee of a minimal sum).

Social enterprises can use the limited company route but would need to write extra clauses in the governing documents (the memorandum and articles of association) to explain their social purposes and any profit distribution clauses. The two most common forms seen for social enterprise limited companies are:

- Company limited by shares (CLS) - shareholders hold shares in the company. Liability limited to the amount unpaid on shares they hold.
- Company limited by guarantee (CLG) - each of the members gives a guarantee for a certain sum if the company is wound up. A CLG cannot raise finance by issuing shares or pay dividends.

Choose the straightforward company structure for simplicity and flexibility but note you will need to demonstrate your social purpose very clearly.

Unincorporated Association

Unincorporated associations are relatively straightforward to run and set up. The members of an unincorporated association make their own rules about running the organization and write these in a constitution. Usually a management committee is selected or elected to run the organization. Unincorporated associations do not need to register with any authority, are unregulated and they can enjoy a great deal of freedom to operate and trade. However, many funders and contractors prefer to deal with incorporated structures and sometimes insurances can be hard to obtain.

Choose the unincorporated association if setting up a smaller more community focused group with limited levels of trading or as a stepping stone onto a more formal structure in future.

Key Point – Incorporated v Unincorporated

Incorporation means creating a legal identity for the business that is distinct from the individual members. This can provide limited liability to debts. An unincorporated organization is simply a collection of its members and their liabilities are unlimited. Seek professional advice for more information on this.

Organizational Structures - Summary

Structure	Key Features	Pros	Cons
Community Interest Company	• Asset lock • Community interest test and statement • Limited by shares or by guarantee	• Easy to set-up • Can pay directors • Light touch regulation • Freedom to trade	• Few tax breaks • Lack of exit for investors
Charitable Company, Trust or Association	• Must exist for charitable purpose with for public benefit • Can be trust, association or incorporated	• Public understanding and trust • More funding options, e.g. trusts and grants • Tax and other benefits	• Restrictions on trading • Trustees/directors cannot usually be paid • Regulatory burden
Industrial and Provident Society	• Regulated by FSA • Community benefit companies or bona fide coops • Incorporated	• Can raise equity type finance • Can gain charitable exemptions • Democratic control	• Possible conflicts • Rules not as flexible as companies • Higher admin costs
Companies	• Overseen by Companies House • Limited by shares or guarantee	• Most commonly recognised legal form in UK • Can raise equity finance from private sources • Freedom to trade	• Cannot raise public finance (unless a PLC) • Restrictions on access to funding • Needs social enterprise clauses
Unincorporated Association	• Informal association • Has a constitution or rules	• Quick to set up • Useful 'halfway house' towards an incorporated structure • No or little regulation	• Not a legal entity in its own right • Members have unlimited liability • May find it harder to enter into contracts

Want to find out more? Contact:

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