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Choosing the right social enterprise structure

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Traditionally, businesses are set up to make a profit. Not-for-profits are set up to do social good. But what if the objective is to do both?

Social enterprises sit right in the middle of this spectrum—they are a rising group of organisations that want to create profit and social impact.

Starting a social enterprise is a great way to create both financial and social value. However, as with starting any organisation, the first challenge is always choosing the right structure.

What is the right structure for a social enterprise?

In Australia, there are legal structures for corporations making a profit, and for not-for-profits. However, in Australia there is no specific legal structure that is called a ‘social enterprise’ or one that is specifically designed for social enterprises.

Instead, social enterprises must use any of the existing legal structures to achieve their objectives.

Choosing the right structure is an important first step, so it is necessary to make sure the structure complements the purpose, growth strategy and sources of finance the social enterprise would like to pursue.

More importantly, a key question is, *Does the social enterprise want to make a profit?*

This paper looks at some of the most common structures for social enterprises and discusses how some innovative social enterprises are changing the game in this space and using their legal structure creatively to complement their strategy.

There are also other types of legal structures available to social enterprises, for instance, co-operatives and Indigenous Associations, however, only the most common are discussed.

Pty Ltd company

Most social startups and new social enterprises adopt a proprietary limited (Pty Ltd) company structure. This is the most common business structure under which most normal profit-driven businesses operate.

A company is a separate legal identity to its owners, which means that the owners will not be personally liable for any debts that the business incurs.

There are shareholders (the owners of the company) who are paid dividends, while the directors are the people who make the decisions.

A company structure is good if capital needs to be raised to grow a social enterprise because most investors are familiar with the structure.

Companies are regulated by the Australian Securities and Investments Commission (ASIC) under the *Corporations Act 2001*.

Company limited by guarantee

A common option for not-for-profits is a ‘company limited by guarantee’ (CLG) structure.

In a CLG structure, there are no shareholders or dividends. Instead, there are ‘members’ of the association who come together for a purpose that is not profit-driven.

A CLG structure is attractive for government grants and philanthropic donations because it has a social purpose. CLGs are also regulated by ASIC unless they are registered as a charity, in which case they will need to report to the Australian Charities and Not-for-profits Commission instead.

Incorporated association

An incorporated association (IA) is another option for not-for-profits and runs a little like a company.

It is a separate legal identity, and its ‘members’ have rights. However, IAs do not have a right to make a profit the same way as shareholders. Instead, those under an IA structure are driven by purposes and rules, and it is run by an elected management committee and secretary. Therefore, this structure also helps attract grants and donations.

There is a different IA regulator in each state, so relevant information regarding the IA’s purpose and role must be lodged with the relevant one.

[The Australian Charities and Not-for-profits Commission website is a useful source of information on the “different legal requirements imposed by government agencies, at local, state and territory and Commonwealth levels” and the regulation of charities.]

The hybrid structure

While there are structures for not-for-profits on one end, and structures for businesses on the other; social enterprises need to be both at the same time. So, how can this be achieved?

Recently, social enterprises have discovered a new way of looking at this—the hybrid structure. This essentially involved setting up a not-for-profit (CLG or IA structure) and a Pty Ltd company separately.

Under this hybrid structure, the social enterprise typically operates under both entities using a web of legal documents to ensure strong governance.

It can be very tricky to manage two entities, so why do social enterprises do it?

This structure is popular because having a private company on the one hand means that it enables capital to be raised from investors. On the other hand, the CLG structure can also attract grants as well as lower administrative burdens. Again, managing two entities can be a substantial challenge.

A new legal structure?

In the US, there is a ‘benefit corporation’ legal structure that mandates both profit-making *and* creating social impact and value.

In Australia, however, there is no specific legal structure like this, yet some social enterprises are pushing to make this happen.

Example

Australian crowdfunding platform Chuffed is currently pursuing what it calls a ‘social benefit company’ structure.

Essentially, Chuffed is set up as a Pty Ltd company, but the social purpose that drives its social enterprises is embedded in its shareholder agreements and company constitution.

This means that it can make a profit and attract capital investment while still upholding the integrity of its social mission.

Certifications

On top of legal structure or rules embedded in legal documents, certification of a social enterprise may also be a consideration.

In Australia, it is possible to apply for B-Corp certification which is administered by a US-based organisation called B Lab.

To encourage using business as a ‘force for good’, and also push for a Benefit Corporation model in Australia, B Lab certifies social enterprises to verify their leadership credentials in social innovation and entrepreneurship.

Benefit Corporations are active all around the world, with big names such as Ben & Jerry’s, Patagonia and Etsy all certified as B-Corps.

To attract investors, community awareness and also support the move towards a Benefit Corporation model, B-Corp certification is a great way to help a social enterprise’s growth.

What to take away

Choosing the right structure for a social enterprise is important to get right from the outset. The structure will determine what kind of finance can be sourced, whether it is possible to make a profit, and how decisions are made.

In particular, there are a number of regulations stipulating what can and cannot be done, depending on the structure. Therefore, it is necessary to make sure a social enterprise’s structure also suits its long-term strategy.

Further, there are different regulators with a range of reporting obligations and minimum standards.

Finally, the size and financial position of a social enterprise may also influence which structure is most suitable. **FS**

Founded in 2017, Sprintlaw is a new type of law firm that operates completely online and on a fixed-fee basis. Its mission is to make quality legal services faster, simpler and more affordable for small business owners and entrepreneurs.



The quote

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