

HENRY PETER
LIVIA VENTURA
DELPHINE BOTTGE
VINCENT PFAMMATTER

PROFIT AND NON-PROFIT PURPOSES

Can legal entities serve two masters at once?

How do legal systems in Switzerland and abroad innovate to blend for-profit and non-profit purposes in a common endeavour and serve two masters at once [1]? The present article provides a general overview of various types of hybrid entities and tandem structures in Switzerland and abroad. It also primarily serves as an introduction to three more in-depth analyses on these topics [2].

1. INTRODUCTION

For the last 50 years, our economy has developed through financial capitalism (also referred to as “financialisation”) [3], by virtue of which corporate governance would mandate a maximisation of shareholder value [4].

The 21st century corporate governance has evolved and brought with it a multi-stakeholder approach, which emphasised stakeholder value [5] and long-term, durable, benefits, generally referred to as “sustainability”.

The movement started with corporate social responsibility [6] and the “triple-bottom line” approach [7], which commended corporate governance to include social and environmental concerns, next to profit-making.

The next level, which we have now entered into, intends to blend for-profit and non-profit purposes in one endeavour. In the past decade, boundaries between charity and business have indeed started to move, blend and blur [8]. Non-profit organisations engage in commercial activities, social enterprises and social innovators exist in every industry, and for-profit companies include social and philanthropic activities in their core business [9].

Today’s entrepreneurs have to navigate in a new world, in which realising profits comes together with the urge to create a positive impact. And this also matches the interests of “responsible” investors, which are more likely to invest in companies compliant with environmental, social and governance criteria (ESG). As a matter of fact, the growth of the socially responsible investing (SRI) movement can affect not only the share value of compliant companies but also of non-compliant companies, favouring the return on investment in responsible companies.

The paradigm shift is palpable. Companies are expected to consider the interests of all stakeholders, not only of their shareholders, and a long-termist, sustainable view is expected from management [10].

2. AN IRRESTIBLE EVOLUTION

This trend is strong because our society is redefining how success is perceived in today’s (business) world [11].

The millennials generation of entrepreneurs is more focused on social responsibility, improving society and serving a superior purpose than solely maximizing financial returns [12].

Working for socially conscious companies, even if it means accepting less compensation, has also become an important way to attract and retain talented employees, especially the younger ones [13].

The financial markets and the economy in general are adapting to this new trend, and investors are looking for such opportunities, as they praise them as a value of stable and continuous profit [14].

Hence, legal systems have to follow the trend, evolve and adapt.

3. COMMON CHALLENGES

“Combining profit-making and the pursuit of social goods comes in many forms and by many names” [15]: from social or blended enterprises to hybrid entities, such as benefit corporations, low-profit LLCs or social purpose corporations.

Irrespective of how one labels multi-purpose enterprises, they are all facing similar issues.

First, from a structural point of view, they are compelled to use existing legal structures from the past century which



HENRY PETER,
PROF. DR. IUR., ATTORNEY
AT LAW, LL.M., PARTNER,
KELLERHALS CARRARD,
LAW SCHOOL, UNIVERSITY
OF GENEVA, DIRECTOR
OF THE GENEVA CENTRE
FOR PHILANTHROPY



LIVIA VENTURA,
LAWYER, PHD IN
COMPARATIVE AND
UNIFORM BUSINESS LAW,
ACADEMIC FELLOW
AT THE GENEVA CENTRE
FOR PHILANTHROPY

were not conceived for such multi-purpose models [16]. Hence, they must choose between either (i) a corporate model and try pursuing also a positive impact on the environment and the society, (ii) a charity, and run business activities with it, or (iii) convince legislators to create a new type of legal structure.

Inevitably, a number of questions arise: does the law allow for blending of purposes? Does one necessarily have to choose between running a profit-making business for the sole interests of its shareholders and creating a positive impact on society? This topic is being debated by scholars, some of whom argue that existing entities may very well serve both purposes, without it being necessary to introduce new hybrid type of structures [17].

Second, how can one solve the tensions between the interests of the shareholders, the stakeholders and public utility? Which interest has to be served first?

Third, how can accountability to the public purpose mandate (certification from independent third parties, annual reports published, etc.) be ensured?

Fourth, how can tax, governance and regulatory issues, that necessarily arise when using a structure for a purpose for which it was not planned originally, be resolved?

4. EXISTING LEGAL SOLUTIONS

4.1 A look at what happens around the world: The necessity to overcome the shareholder primacy model in favour of a multi-stakeholder approach has triggered a heated debate on the need (or not) to introduce new organisational forms in order to meet the requests coming from the social enterprise sector.

This led, on the one hand, to the creation of several assessment standards available on the market (such as the B-Lab “benefit impact assessment”, which is used to certify companies as “B Corporation” or “Certified B Corporation”) and, on the other, to the introduction of new organisational forms in different countries.

With regard to the latter, the most relevant innovations have been produced in some states of the USA, where new hybrid entities have been introduced, blurring the line between profit and non-profit ventures. Examples are the “low-profit limited liability company” (L3C), the “flexible” or “social purpose corporation” (SPC), and the benefit corporation.

The benefit corporation, born in Maryland in 2010 and now regulated by over 34 US states, is undoubtedly the most successful and globally recognised hybrid legal form.

Benefit corporations are for-profit corporations whose purpose, in addition to producing profits, is to reduce negative externalities and generate a positive impact on the environ-

ment, society, workers, and the community in which they operate (“public benefit”). Benefit corporations differ from traditional business corporations in entity purpose, directors’ accountability, and transparency, but not in taxation.

As a matter of fact, the benefit corporation model has been the subject of legal transplants in Italy, with the introduction of the “*società benefit*” in 2016, and Colombia, where in July 2018 the “*sociedades comerciales de Beneficio e Interés Colectivo*” (BIC), also known as “*Empresas B*”, were introduced.

Looking at the existing statutes, the main features of these new hybrid organisational forms designed for social enterprise can be identified by:

- i) dual-purpose clauses, which combine profit-making with the pursuit of a public benefit;
- ii) the fiduciary duties of the directors, who are required to consider the impact of their decisions not only on the company and the shareholders, but also on other stakeholders (such as workers, customers, communities, suppliers and the environment);
- iii) transparency requirements, since all companies, even those sticking to the “for benefit” model, must produce an annual report on their social and environmental performance, the trend being to assess them against a third-party standard;
- iv) no tax advantages, at least so far and in most countries.

Nowadays other countries are also considering the possible introduction of a similar hybrid legal form. The introduction of a new hybrid entity designed for social enterprises can have a number of positive effects, such as supporting business companies in building public trust, credibility, and the confidence of consumers, investors and employees, as well as providing an innovative policy tool that can help governments address seismic changes in the economic environment, while supporting social protection, employment and inclusive growth.

Are we facing the birth of a new uniform transnational model of a “*for-benefit* company”? The answer will be provided by the market, but it is possible to say that the introduction of a well-known and recognised international hybrid entity model may play an important role in the development of the fourth sector in a global market perspective and in the growth of the branding aspect of these companies.

This topic will be further developed in the paper by Dr. Ventura Livia, p. 170 ff.

4.2 Hybrid entities in Switzerland: It is generally agreed that Swiss law does not contain a dedicated legal form for hy-



DELPHINE BOTTGE,
ATTORNEY-AT-LAW,
PARTNER, BOTTGE &
ASSOCIÉS, ACADEMIC
FELLOW AT THE GENEVA
CENTRE FOR
PHILANTHROPY



VINCENT PFAMMATTER,
LL.M. (UC BERKELEY),
ATTORNEY-AT-LAW,
PARTNER, SIGMA
LEGAL, GENEVA,
ACADEMIC FELLOW AT THE
GENEVA CENTRE FOR
PHILANTHROPY

brid entities or benefit corporations. Entrepreneurs must therefore choose either a corporate structure or a charity, while none has initially been thought to serve such dual purposes.

Typical business forms (LLC or LTD [18]) have to abide by the legal constraints deriving from the Swiss Code of Obligations, fiduciary duties and market pressure to perform. There are, however, solutions to overcome these challenges, such as adapting the statutes and governance structure, and the flexibility of Swiss law allows entrepreneurs to go quite far in reaching hybridity with a corporate structure. Another widely unexplored, but existing option, is to set up a non-profit corporation as contemplated by Article 620 al. 3 SCO [19].

The cooperative (Art. 828 SCO) is an interesting option when it comes to pursuing for- and non-profit purposes at the same time, in particular given that (i) it may pursue various purposes, and (ii) it is not centred on profit-making but is nevertheless authorised to distribute (limited) dividends.

The last option consists in setting up a charity, generally a foundation or an association [20], and carrying out a commercial activity through such an entity. Here, one has however to face limitations imposed by the tax authorities regarding revenue-generating activities of tax-exempted entities. Besides, such structures are also improper for investors, given that no financial returns on investments are possible and that they have no share capital. Workarounds are therefore limited to having an ancillary commercial activity, or to working in combination with another entity, typically detained by the non-profit one (see § 4.3 hereafter).

This topic will be further developed in the paper by Vincent Pfammatter, p. 175 ff. hereunder.

4.3 Tandem solution: foundation ownership: Shareholder foundations (or holding foundations) are foundations holding a significant stake in one or more corporation(s) which operate(s) a commercial business.

Thus, the shareholder foundation does not have a specific legal status, but is a matter of fact characterised by the holding of such an interest.

Compared with northern European countries, holding foundations are still quite unusual in Switzerland, although they have existed for decades. Swiss law does not limit the possible purposes of foundations, as expressly confirmed by the Supreme Federal Court [21]. Shareholder foundations can therefore have a wide range of purposes from philanthropic to economic, including mixed purposes.

Nowadays, this tandem solution appears to be particularly innovative as it matches the contemporary trend to blend economic activities and philanthropic missions.

By transferring the ownership of their business to a foundation, entrepreneurs renounce getting access to the financial profits they could have earned. Irrespective of their motivations (family considerations, business or philanthropic objectives), they potentially generate a virtuous model in several ways.

The foundation protects, for the long term, the capital (or at least the control) of the company which has been irrevocably and inalienably transferred to it and excludes the possibility of hostile takeovers. Thus, it offers a model of stable ownership which allows a long-term vision and encourages the stakeholders (employees and partners) to be more involved and engaged within the company. Moreover, the value created may directly contribute to the general interest since it is the performance of the company which will directly feed, through dividends, the capacity of the foundation to implement or fund philanthropic projects.

Foundation ownership deserves to be developed and explored alongside the new proposed structures, as an innovative model to address the paradigm shift that is currently occurring.

This topic will be further developed in the paper of Delphine Bottge, p. 180 ff. ■

Footnotes: 1) Wording inspired by the article of Brakman Reiser Dana, *Blended Enterprise and the Dual Mission Dilemma*, Brooklyn Law School, BrooklynWorks, 35 Vermont Law Review, 2010, p. 105 et seq. 2) These topics will be further developed in the papers by Ventura, Livia Delphine Bottge and Vincent Pfammatter published in the same edition of Expert Focus. 3) Kim Suntae, Karlesky Matthew, Myers Christopher, Schiffling Todd, *Why Companies are becoming B Corporations*, Harvard Business Review, 17 June 2016. 4) Amiram Gill, *Corporate Governance and Social Responsibility: A Research Agenda*, Berkeley Journal of International Law, Vol. 26, 2008, p. 457; Friedman Milton, *The Social Responsibility of Business is to increase its profits*, The New York Times Magazine, 13 September 1970. 5) Evan William M., Freeman R. Edward, *A stakeholder theory of the modern corporation: Kantian capitalism, Ethical theory and Business*, Tom L. Beauchamp, Norman E. Bowie (editors), 4th edition, 1993. 6) “The concept of corporate social responsibility is the idea that private companies are supposed to care not only about short-term profit in the interest of their shareholders and management, but also about other stakeholders and sustainable development”, Henry Peter, Guillaume Jacquemet, *Corporate Social Responsibility*, Sustainable Development et Corporate Governance: quelles correlations?, SZW/RSDA 3/2015, p. 170. 7) John Elkington, *Cannibals with Forks: The Triple Bottom Line of the 21st Century Business*, Oxford, Capston Publishing, 1997. 8) Porter Michael E., Kramer Mark R., *Creating Shared Value, How to reinvent capitalism – and unleash a wave of innovation and growth*, Harvard Business Review, January-February 2011, p. 7; Sabeti Heerad, *The For-Benefit Enterprise*, Harvard Business Review, November 2011. 9) Brakman Reiser Dana, op. cit. 10) Chloé F. Smith, *Corporate Social responsibility et durabilité*, in Expert Focus, 6–7, 2016, p. 471 et seq. See also the Paris Agreement of the UN FCCC on greenhouse-gas-emissions mitigation. 11) Kim Suntae, Karlesky Matthew, Myers Christopher, Schiffling Todd, op. cit. 12) See Deloitte, *Millennial Innovation survey*, January 2013, available on <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/About-Deloitte/dtl-crs-millennial-innovation-survey-2013.pdf>, at 9. 13) Surowiecki James, *Companies with benefits*, The New Yorker, 4 August 2014; Ramus Catherine A., *Including Corporate Social Responsibility, Environmental Sustainability, and Ethics, Calibrating MBA Job Preferences*, Footnotes: Stanford University Graduate School of Business, Research Paper No. 1981,

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