

INTRODUCTION

From boardrooms to business schools, social purpose is all the rage. The Harvard Business Review talks of purpose-driven leadership. The Centre for Social Justice think-tank argues that social purpose can increase a business's earnings.¹ The UK government recently published a review estimating that mission-led businesses represent a combined turnover of £165 billion.

For social entrepreneurs, this is nothing new – mission (social purpose) is at the heart of what they do. Equally, social entrepreneurs know how complex it is to run a business primarily for purpose. As the social venture grows, balancing the competing interests of beneficiaries, customers, employees and investors can become increasingly challenging. Pressure to meet financial targets can become overwhelming and the primacy of the social mission can be forgotten – this can lead to what is known as mission drift.

That is why many social entrepreneurs (and their intermediaries and funders) seek to protect their venture's purpose by adopting a regulated legal structure, such as a charitable company or a Community Interest Company (CIC). Asset locks and limits on the distribution of profits to private individuals are built into these structures, preventing mission drift and excessive private gain.

However, business models that require flexibility in investment options and the ability to scale rapidly often choose a Company Limited by Shares (CLS) structure. It is this greater flexibility, wider access to finance and perceived simplicity that are among the reasons these social entrepreneurs give for this choice.²

We believe that social entrepreneurs should be free to choose whatever legal form is most appropriate for them to maximise their impact, and that they should be supported to best use that structure. For CLS ventures, we believe that this includes them taking steps to protect their social purpose – using so-called **mission locks**.

UnLtd Big Venture Challenge (BVC) programme was funded by the National Lottery through the Big Lottery Fund and launched in 2013 to support ambitious social ventures to become growth and investment-ready. It has enabled us to work closely with 120 social ventures to maximise their impact. We have learnt an enormous amount, including around how mission locks could best support our social ventures' purpose and impact.

Based on this learning, we hypothesised that it would help CLS ventures to become stronger propositions for investment, avoid mission drift and excessive private gain if they had a mission lock in their governing documents. This spotlight paper presents the results of testing that hypothesis.

KEY FINDINGS

Social ventures can use bespoke social mission locks to prevent social mission drift and reduce the risk of private benefit outweighing public benefit.

Social ventures using a CLS structure can attract equity investment and in some instances create greater impact as a result of investment.

UnLtd's approach to supporting CLS ventures through BVC has yielded significant results³.

698 - Average increase in beneficiaries of all BVC ventures 12 months after receiving support

2,826 - Average increase in beneficiaries of CLS ventures supported by BVC 12 months after receiving support

£8,669,877 Total amount of external risk capital BVC has attracted to the social investment sector.

£6,108,877 (70%) Total amount of external risk capital attracted by CLS ventures

£2,561,000 (30%) Total amount of external risk capital attracted by all other legal structures supported.

DEFINITIONS OF COMMON SOCIAL VENTURE STRUCTURES

Company Limited by Shares (CLS) is a limited company owned by its shareholders. Financial liability among shareholders is limited to the value of the shares the shareholder initially invested. By default, profits can be distributed to shareholders as dividends. However, a CLS can choose to specify a social purpose and make commitments related to social impact in its governing documents.

Company Limited by Guarantee (CLG) is a limited company which is run by its members. CLGs cannot attract equity investment as they cannot sell shares. CLGs can raise investment through debt. CLGs are capable of distributing profits to members but this can be prevented by inserting a provision into the company articles.

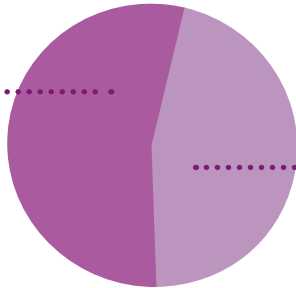
Community Interest Company (CIC) is a limited company that benefits a community or group of beneficiaries. There are different versions of CICs, based on the CLG, CLS or public limited company structures. They require a statement explaining how they benefit their community and are subject to an asset lock limiting the amount of profit that can be distributed to private shareholders. This asset lock also defines what happens to assets in the event of closure. CICs have their own regulator.

BIG VENTURE CHALLENGE SINCE 2013



54%

incorporated as CLS



46%

incorporated as CLG, CIC or Charities

The number of CLGs, CICs and charities has grown in the BVC 2016 cohort. **70%** of the social ventures supported in 2016 were CLGs, CICs or charities, and **30%** were CLS ventures.

MEETING THE SOCIAL INVESTMENT CHALLENGE

Despite improvements made since the creation of Big Society Capital in 2012, social entrepreneurs continue to struggle in sourcing affordable, high-risk capital for early stage ventures. Many look beyond the institutional social investment market, including to angel investors. Big Venture Challenge has shown that many angel investors are interested in social impact, as long as the venture is also a commercially sound proposition.

“That is the position of a lot of commercial investors, what they want to see is sales growth and when they see sales growth they would consider investing.” (Social entrepreneur)

“The fact that there’s a social benefit is a bonus but it’s not something that I would focus on. I’m not in a position where I will say I will only look at ‘social’ deal. This hasn’t changed over the last 12 months.” (Social investor)

CLS ventures can struggle to attract social investment due to a perception that social impact may not be at the core of the venture. Some social investors may be concerned that, unlike a CIC or charity, there is nothing preventing a CLS venture from moving away from its social mission. Others may feel that profit and personal gain are incompatible with creating social impact. This contradiction makes an already challenging task even more difficult.

“Social investors say they want social impact. We have some of the highest social impact and we have a track record, but we can’t get social investors to invest in the CLS structure. They see it as giving equity investors lots of money.” (Social entrepreneur)

The Big Venture Challenge has remained agnostic on legal structure. The learnings gained through the programme have helped us create a process for establishing social mission locks for CLS ventures designed to lock in impact whilst still attracting investment.

Between 2013-2016, social ventures taking part in the Big Venture Challenge raised £8.6 million in external risk capital. Of that total, the 38 CLS social ventures raised £6.1 million – almost three quarters of the total and more than twice the amount raised by all other legal structures combined. CLS ventures raised on average £160,000 of external risk capital compared to an average raise of £71,000 per non-CLS structure.

CASE STUDY



OOMPH!

(Company Limited by Shares)

Ben Allen set up Oomph! in 2011 to improve the quality of life of care home residents across the UK. Oomph! has trained activity co-ordinators in care homes across the UK to deliver exercise and activity classes specially designed for older adults. Their purpose is to enhance the mental stimulation, physical ability and social interactions of older people.

In 2013, Ben received support from UnLtd through the BVC programme. Oomph! inserted a social purpose statement and an operational commitment into their Articles of Association requiring half of Oomph!’s profits to be reinvested in the company or used to advance the social purpose. In addition, the Articles also state that Oomph!’s assets cannot be sold at reduced cost, unless it advances the social purpose or are given to another social sector organisation.

During BVC, Oomph! raised an initial £300,000 from investors and match funding from UnLtd. In 2017, they raised a further £1.5 million to expand their impact. Today, they reach over half a million older people in 1,200 care homes across the UK, with care workers noting significant wellbeing improvement in residents taking part in Oomph!’s classes.

MISSION LOCKS: MEETING THE NEEDS OF SOCIAL ENTREPRENEURS AND INVESTORS

What is a mission lock?

A mission lock is a mechanism to ensure the intended social purpose of a venture remains its primary objective in the long term. UnLtd's approach to social mission locks, developed through BVC, contains two elements:

- A Social Purpose Statement written into governing documents: this means the venture's social purpose is inserted into the objects clause of the venture's Articles of Association. This redefines success for the venture, and creates duties on its directors to make decisions in line with the social purpose.
- An Operational Commitment: a clause is included in the venture's Articles of Association that ensures a substantial proportion of the venture's operations are used to further the social purpose.

It may also involve a third element – entrenchment. To ensure that the first two commitments are secured in the long-term, a mission lock can be further reinforced.

The mission lock can be used by the venture itself to communicate its mission to stakeholders. It can also be used by stakeholders to hold the venture to account. In the case of Big Venture Challenge, we link it to the terms of our grant, put up as match funding against any investment raised.

HOW TO REINFORCE YOUR MISSION LOCK



Supermajority clause

Any change to a company's articles requires a 75% majority. A supermajority clause can be applied to the social mission lock, requiring a higher majority of shareholders for it to be amended or removed, e.g. 90% or even 100%.



Golden share

A third party, usually a charity or other social mission organisation, holds a golden share. This means their consent is required to change specified provisions in a venture's governing documents.



Redeemable golden share

Similar to a golden share, but with the additional effect that the share can be returned to the venture usually after a period of time or particular event. The specific terms are stated in a venture's governing documents.

CASE STUDY



HUMANUTOPIA

(Company Limited by Shares)

Launched in 2004 by former teachers Carlo Missirian and Graham Moore, Humanutopia run life-changing courses for young people in schools to improve confidence, happiness, hope and employability.

In 2014 they received support as part of UnLtd's BVC programme to insert a social mission lock into their Articles of Association. With help from BVC's legal partners, they specified a social purpose in their objects clause, inserted an operational commitment to reinvest a percentage of profits into delivering social impact and used a 'golden share' to ensure that the social mission will be Humanutopia's primary focus in the long-term.

"A ground breaking 'golden share' scenario helped shape our mission lock and road to social investment."
(Carlo Missirian, 2016)

They went on to raise £175,000 from investors, including match funding from UnLtd. Extra investment helped them to scale and they have now supported 240,000 students and 25,000 staff in schools across the UK.

Since 2015, CLS ventures wishing to access BVC match funding have been required to have a social mission lock embedded and entrenched (where appropriate) in their governing documents, ensuring that their social mission remains at the forefront of their venture.

In many instances, UnLtd found social mission locks to be important in institutional investors' decisions to invest, and that social entrepreneurs found the social mission lock support crucial for attracting these investors.

"In order to get social investment we had to change the Articles and structure of the company to warrant being called a social enterprise. This golden share and asset lock unequivocally created enough of a social lock that suits us, suits the growth of the company but also suits social investment." (Social entrepreneur)

Social entrepreneurs from CLS ventures suggested that a social mission lock reassured them that the social venture's legacy will remain impactful. Embedding a social mission into the venture makes the priorities of the venture absolutely clear when engaging potential investors.

“The danger is that investors or future Directors might be tempted to encourage the organisation to move away from its initial social mission. The mission lock provides a way of ensuring that doesn't happen. I prefer a mission lock (ensured through a Golden Share) as it allows the holder to exercise a degree of pragmatism on a case by case basis, which I think is more workable than anything more rigid.” (Social entrepreneur)

To support ventures to create social mission locks that work with their commercial models, BVC ventures were supported by a Venture Manager. Venture Managers work through a 'social mission locking risk register' with social entrepreneurs.

This process helps define key risks, questions and considerations for social entrepreneurs in relation to the risk of social mission drift, and helps to identify appropriate social mission locks that take the particular circumstances of their ventures into account.

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1. See respectively www.hbr.org/2014/05/from-purpose-to-impact; www.gov.uk/government/news/building-a-country-that-works-for-everyone-independent-panel-publishes-report-on-putting-values-at-the-heart-of-our-businesses; www.centreforsocialjustice.org.uk/library/everyones-business-making-business-work.
2. UnLtd's Findings Paper 7 "Pushing Boundaries", www.unltd.org.uk/2014/04/10/findings-7-pushing-boundaries.
3. Data based on median beneficiary numbers.

CASE STUDY



SCHOOL SPACE

(Company Limited by Shares)

Set up in 2012 by Jemma Phibbs and James Lloyd, School Space helps schools unlock their entrepreneurial potential by generating more funds through hiring out their out-of-use spaces. They put schools at the heart of the community by renting out facilities to local clubs, community groups and businesses. In 2016, Jemma and James received support from UnLtd to help get School Space investment-ready.

School Space inserted a social purpose statement into their Articles of Association and an operational commitment requiring that at least 60% of the properties they work with to be state schools. This was further entrenched by a supermajority clause, requiring 90% of shareholding to agree to amendments to the mission lock. While on the BVC programme they raised £320,000 from investors and match funding from UnLtd.

FIVE QUESTIONS TO ASK WHEN ESTABLISHING A MISSION LOCK

Is the social impact aligned with the growth of the business?

It's important to ensure that social impact remains the primary purpose of the social venture. Consider whether there is alignment between the impact created and the business model. If there is a pivot risk, a social mission lock can assure the primary purpose of the social venture.

Is there a risk of the product or service being priced at a level which excludes the beneficiary?

In some cases, a venture's business model means that beneficiaries are also the paying customers for the product or service. If the social impact depends on certain beneficiary groups being able to access the product or service, it may help to make a commitment to accessible pricing for these groups in the social mission lock.

Are the owners, directors or executive team paying themselves above market rate?

A social mission lock can help to ensure that remuneration does not result in unnecessary or excessive private gain.

Do investors stand to gain significantly from exiting the business?

A social mission lock can apply conditions related to the exit of investors, which reduce the risk of excessive private gain and maximise the social benefit of any market appreciation.

Are there excessive net profits being realised by the business?

The level of net profit being realised and the use of this money should be considered. Review how much will be distributed to owners and how much reinvested to further the social mission.