

## **Social Businesses—Searching for a Statutory Format**

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The law, by its nature, divides the world in a dichotomous manner: permitted and forbidden, obligation and right, legal and illegal. This division creates a welcome certainty in most areas in life, steers human conduct, and regulates the coexistence of millions of people in defined geographical districts, which are becoming increasingly crowded.

This dichotomy also characterizes the attitude of law towards corporations and differentiates between profit-making corporations and nonprofit corporations—NPOs – Associations and Public Benefit Companies.

This is how a company's purpose is defined under Section 11a of the Israeli Companies Law 5769-1999: "The purpose of a company is to operate according to business considerations in order to maximize its profits; in the framework of these considerations, it is possible to take account, among other things, of the interests of its creditors, its employees, and the public. Likewise, a company is allowed to donate a reasonable sum to a worthy cause."

In contrast, Section 1 of the Israeli Nonprofit Associations Law 5754-1980, defines the purpose of an NPO as "a legal objective that is not intended to distribute profits among its members and whose primary aim is not generating profits." In addition, Section 345a(a) of the Israeli Companies Law 5769-1999 states that "a public benefit company is one whose bylaws define public objective only as that bar the distribution of profits or distributions of another type to its shareholders."

It seems, then, that the law stipulates that profit-oriented activity take place in a company framework, while nonprofit activity for social and public purposes is conducted in NPOs – Associations and Public Benefit Companies. The second aspect of this definition is the ban on a company's engaging in significant activity for purposes other than profit, and, on the other hand, the prohibition that the chief objective of NPOs be the generation of profits or distribution of direct or indirect

profits to members of the Associations or to the shareholders of the Public Benefit Companies.

This legal status exists not only in Israel but also world-wide. It reflects the distinction made in practice between activities for public benefit and those aimed at making a profit. This distinction, between profit-making organizations and nonprofit corporations, serves as a significant regulatory tool used by enforcement agencies to distinguish between the different types of activity. In Israel, for instance, the Registrar of Associations and the Income Tax authorities verify that Associations or Public Benefit Companies are indeed, nonprofit and that their activities are not a cover for business activity. From the other side, the Registrar of Companies and the Value Added Tax Division, each in its field, identify and classify as nonprofit entities companies whose primary purpose is not to generate profits and whose core activity is not business-oriented.

At the basis of this division and distinction between profit-making and nonprofit organizations is the notion that involvement in public goals, in advancing public and social interests, and in solving social problems is the exclusive domain of the government sector and of Third Sector organizations, operating by means of Associations or Public Benefit Companies, and is outside the pale for commercial businesses.

Over the years, however, in light of the tremendous increase in the needs of the world's population and the ever-diminishing resources, the impossibility of supplying human society's growing demand for food and water, employment and education, medicine and energy, as well as public needs such as environmental protection and protecting planet earth, an awareness has emerged that it is not possible to place the exclusive responsibility for finding solutions to these difficult problems on the shoulders of the government and NPOs. The business sector, as a global economic motor, also bears a share of the responsibility to develop solutions to these crucial issues.

This awareness has engendered the approach that recognizes the responsibility of commercial corporations. While these corporations' bottom line is still the profits line, they have begun to consider issues of fairness and ethical conduct, human rights and employees' rights, sustainability and obligations to other interested parties, besides the interests of their owners.

In the context of the growing needs mentioned above, and, as a counterweight, the traditional dichotomous division into businesses and NPOs, Nobel Peace Prize laureate Muhammad Yunus came up with the idea of “social businesses.” These businesses have a corporate structure and use business strategies for social goals, are community-owned, do not distribute profits, and at most return their initial investment to investors.

While there is no single definition of social businesses and consensus about Yunus’s definition, many perceive these businesses as having a “double bottom line”—fiscal profit and social profit, and some say even triple—including environmental profit. In any case, even the most reductive definition of a social business includes the basic requirement that it promote solutions to economic-social-environmental issues.

The social businesses are creating a new corporate reality, which does not recognize the borders set by the old definitions. They operate in the regular market, employ business strategies, and, in pursuit of their goals, address social and environmental issues. In contrast to NPOs- Associations or Public Benefit Companies, a significant number of these businesses do not waive their shareholders’ option to receive dividends.

The major significance of these businesses is that they shatter the traditional divide between the sectors in terms of social responsibility, inasmuch as entities affiliated with the business sector endeavor to advance social goals and do not abandon society’s needs to the exclusive province of the government and Third Sector organizations. Some see this as the creation of a new Fourth Sector, alongside the traditional three.

Today, dozens of social businesses operate in Israel in diverse fields. Their primary function is to provide employment solutions for individuals with disabilities and women from the Arab or Orthodox sector, teens at risk, and other socially excluded populations. These businesses have various corporate structures—some are set up as companies and others as business initiatives of NPOs- Associations or Public Benefit Companies. As all over the world, the phenomenon of social businesses has also acquired a foothold in Israel. In addition to the many social businesses founded every year, an incubator, a school, and a research center for social businesses have also been established.

The activity of social businesses in the existing legal frameworks is incompatible with the relevant corporation laws; even if they are not treated as law breakers, it is clear that the existing statutory format is not suited to the goals of social businesses and how they operate. This problem—that is, the lack of a legal format for the activity of these social businesses—is not unique to Israel, where the scope of such businesses is still relatively small. Attempts to solve this issue preoccupy governments and courts all over the world.

In the fourth quarter of 2011, California and New York joined other US states and passed laws recognizing a new type of company, called “benefit corporations.” These corporations are regular companies that are required to satisfy the following conditions: a significant proportion of their goals is to influence society or the environment; they must provide a broader definition of their obligations of trust vis-à-vis their employees, the community, and the environment when taking decisions; and they have an increased reporting requirement, which mandates that they issue public reports, written by a third party using objective tools, about their performance in the social and environmental arenas. New York and California joined Vermont and Maryland, where similar laws were enacted in 2010, and New Jersey, Virginia, and Hawaii, which passed similar laws in 2011. Comparable bills are under discussion in Colorado, Michigan, Pennsylvania, and North Carolina.

This corporate format has joined another category of companies, defined by the legislatures of several US states as the “low-profit limited liability Company,” or L3C. These companies have no general requirement that maximization of profits be their sole or at least their main goal. They have both a primary objective—social or environmental—and a secondary objective of turning a profit. Legislation that recognizes this type of company has been enacted in Illinois, Michigan, Utah, Wyoming, Vermont, North Carolina, Rhode Island, Louisiana, and Maine.

In Great Britain, too, the issue has been addressed by Parliament in the Community Interest Company (CIC) Law. This legislation allows the corporate format to be used to deal with public and economic challenges.

We need to learn from these jurisdictions in order to deal with this issue in the statutory and regulatory arenas in Israel in the coming years. There is room to define social businesses, adopting the existing definitions and restrictions found elsewhere in the world or devising alternative formulas. Also needed is a new definition by the regulatory bodies of these social businesses, including with regard to taxation, so that

it will be possible to relate differentially to such businesses. This will facilitate and encourage the fascinating emergence of hybrid corporations, which are changing the borders of the existing sectors, redefining the limits of responsibility for social problems, and shattering the sacrosanct principle of maximizing profits for the benefit of the corporation's founders and shareholders.

With proper guidance and encouragement by means of various governmental mechanisms, such as tax breaks and investment funds, it will be possible to create a significant economic tool that will certainly help us deal with the social and economic challenges we face.