

**Social Firms UK Annual Conference**  
**Shaping The Future: Supportive Employment, Successful**  
**Businesses**  
**27 June 2006**

**WORKSHOP 7: Choosing The Right Legal Structure For Your**  
**Social Firm**

**Facilitated by Geof Cox, Economic Partnerships**

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**Introduction**

The workshop did a round robin of introductions and reasons for attendance.

The issues that participants were interested in were:

- Methodology around choosing a legal structure
- Detail of differences between structures
- Externalisation – e.g. establishing a project from parent charity or local authority
- Not for Profit – issue of paid directors
- Community Interest Companies
- Mi Enterprises

**Externalisation – from parent charity - Guide to Charities Starting Social Firms**

Establishing a social firm from a parent charity. Geof explained he had just published a new publication that covers many of the issues raised by charities and is called “A Guide to Charities Starting Social Firms. This is available from Social Firms UK.

**Externalisation – From local authorities.**

Best approach is to set a new legal structure with funding “outside of the local authority” and then to transfer staff and service users over to it. The issues for the Local Authority with externalisation are around:

- Care
- Staff pensions
- Culture change

In his experience every externalisation that works needs an “entrepreneur” with vision and energy to lead the change. Ideally someone recruited externally with good trade and managerial skills.

**Methodology – Choosing a legal structure**

Social firms/social enterprises are set up with a variety of legal structures and to decide which legal structure one must explore which business model is most suitable for the organisation. One needs to look at a number of issues:

Who are the members  
Who are the directors  
What will happen to profits

These are important questions to ask and will help to determine the structure adopted by the group. In some cases you may need more than one structure to be able to do what you

want to do. For example co-ops and social firms may wish to have paid directors on the board (co-ops and most social firms work on the principle that workers can have representation on the management committee). As a charity you cannot do this. To set up a social firm with worker/stakeholder representation you could set up a structure, which allowed paid workers on the board and then work through a charitable organisation to put in bids for work. The charity will then contract with the social firm to carry out the work.

Host charity	Submits proposal Subcontracts work to Social Firm/ Co-operative
Social Firm/Co-operative Paid Directors	Writes proposal with project budget and Host charity submits proposal

So what kind of structure is suitable for a social firm? Social firms can trade under charity law but are not completely free to trade. Under charity law they must involve “beneficiaries”. For example Reclaim had an office in Nottingham but there were no people based there with a disability. It raises the question as to whether or not the work carried out in Nottingham was “charitable” under the law. Another example was one of the business making phone calls about container waste and making a profit out of the deal that was agreed. It did not involve anyone with a disability but it make a good profit. Was this charitable. Technically no it was not.

Business is more regulated now than before and needs skilled professionals to support and run them. This is a real issue for many charities and social enterprises.

Not for profit is a term that comes from the States and actually has no specific meaning in English law.

Issue - Directors of charities cannot be paid. However if you are trading and need to expand you may need the expertise of paid directors.

What is the social firm business proposition? A social firm is a viable business with higher staff costs operating in the market place. Which is why you need to attract grants at start up phase. So you want to be not for profit but not a charity to operate. Options:

Possible to use a company limited by guarantee structure and put rules into it to prevent distribution of the profits to members/directors and give procedures when there is a conflict of interest for workers on the Board i.e. for discussion of wages/salaries. You can download this structure from the Social Firms UK website. Its rules state that how you can distribute profits, that on dissolution of the company remaining assets will pass to a similar organisation not to members and under it workers can be on the Board of Directors paid or unpaid. Note, however the company could change the rules so that members could benefit from the company.

Many trusts and charities will accept this model but not all.

The new Community Interest Company (CIC) takes this model one step further by having an external regulator who will ensure that companies set up under this model remain “not for profit”. It has been designed as a structure for small social enterprises and could be used for social firms.

Differences between the two models of CIC

Company Limited by Guarantee: Directors/Member do not put their own money into the company. In the event of dissolution they each contribute £1.00. The £1.00 share is given personally and cannot be bought and sold in the market place.

Share Company: Set up as a company with shares. Shareholders put in an upfront investment. Each share is a negotiable instrument and a means for getting money in and out of the company.

Main issues about which one to choose are: What kind of business are you planning to set up:

- Philanthropic – Guarantee company
- Commercial – Share company

In the share issue version of the CIC the company can issue shares and pay a dividend. It is more tax efficient and has a cap on the amount of return it pays. At present it pays a limited return on the investment. At present shareholders can receive up to 5% above base rate. There is also a global limit on the amount of profit that can be distributed. Café Direct raised £5 million using these model-selling shares to people who wanted to support their work.

### **Main Points for Social Firms**

1. For social firms charities are often not the route to go down. It is possible to construct a structure that gives the freedom to be commercial with a company limited by guarantee model.
2. CIC – Share company – this is a most interesting model and should enable social firms to do most of what they want to do:
  - Pay directors
  - Reassure trusts/charities that the company will remain “not for profit”
  - Raise money
  - Possibly may attract rate relief

CIC is recognised in law as a social enterprise legal structure and will enable the enterprise to access most of the important advantages of being a charity and be able to access loans for commercial use.

Social firms have stakeholder groups on the board, which usually consist of:

- People with a disability;
- Parents/Carers; Supporters and
- Representatives of funders/trusts.

The corporate structure created by setting up the company gives the members limited liability in law. The Directors have legal responsibilities to understand and run the business properly and be knowledgeable about employment of staff, health and safety etc.

There is currently a culture change in the Third Sector. The charitable sector is becoming more “entrepreneurial”.

### **mi Enterprise**

A new social firm model. This model tried to address the issues of how to become self-employed when you are on benefits. It is called supported self-employment and the idea is that the person makes this transition over a very long time. John Pitts in partnership with the Benefits agency and Business Links have developed a new model. Geof has worked with them and designed it. John’s idea is that you have a support structure for those who want to gradually get back into work. They are working towards getting the company structure recognised by the Inland Revenue. Then a social firm would be set up to support those who want to go down this route.

**27.6.06**