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Turning Nonprofits into For-Profits

New hybrid corporate structures allow nonprofits to accept private investment without diluting their missions

By [John Tozzi](#)

The nonprofit [Bikestation](#) reached a crossroads in late 2007. Founded in Long Beach, Calif., in 1996 to design, build, and manage bike transit centers, the 10-employee organization couldn't handle all the calls coming in on its \$300,000 budget, funded mostly through earned income. With little grant funding available, the board determined that the best way to meet demand was to raise money from private investors—which meant turning Bikestation into a for-profit [social venture](#). "We just didn't have the resources to expand the mission and the vision further," says Andréa White-Kjoss, who joined the nonprofit as CEO in 2004.

Social enterprises like Bikestation often don't fit neatly into [existing ownership structures](#). Those that register as nonprofits have trouble tapping private capital to expand, while for-profit companies risk compromising their missions because they must put shareholders' returns first. But [growing interest in hybrid business models](#) has spurred recent efforts at the state level to create new corporate structures that allow entrepreneurs to integrate nonfinancial goals into for-profit businesses. "The intentions of entrepreneurs and investors have evolved over time to include a desire to create social value as well as shareholder value," says Jay Coen Gilbert, co-founder of [B-Lab](#), a Berwyn (Pa.) nonprofit that certifies mission-driven companies. "Corporate law has not evolved to serve these new needs."

One new form, known as the Low-profit Limited Liability Company (or L3C), is intended for companies that put their missions before profits. The structure lets them qualify for ["program-related investments"](#) from foundations—loans or investments that further a foundation's goals and also may yield financial returns. First adopted in Vermont in April 2008, the L3C is now also on the books in Michigan, Utah, and Wyoming. There are 53 L3Cs in Vermont and a handful in other states so far.

In California a separate effort is under way to take "a holistic approach to the real friction points of trying to meld a social mission and a true capitalistic model of a corporation," says R. Todd Johnson, a partner at [Jones Day](#) in Palo Alto. Johnson, along with attorneys Susan Mac Cormac and Derrick Britt, is leading a working group to draft language for the new form and present it to California lawmakers later this year. The rules would address tensions like how to report social impact to shareholders and what happens if the company is acquired or goes public.

"CORPORATE CONSTITUENCY STATUTES"

For now, however, social ventures must find creative ways to straddle the line between nonprofit and for-profit. At Bikestation, the board decided to form a new for-profit company called [Mobis Transportation Alternatives](#). They incorporated Mobis in mid-2008 and raised \$500,000 from angel investors, including the [Tech Coast Angels](#), late last year. Staff members switched to work for the new business, and Mobis licensed the intellectual property from the nonprofit, including the Bikestation name and other proprietary information for creating transit centers. The nonprofit remains essentially a holding company for the intellectual property, though Bikestation plans to use the licensing revenue to make grants. As part of the agreement, the nonprofit got a small ownership stake in the new

Bikestation and controls a seat on the board.

Crafting such ad hoc solutions can be unwieldy—and expensive. "We had lawyers for the nonprofit, we had lawyers for the for-profit, we had lawyers for the investment group, says White-Kjoss." Bikestation's officers were careful to get an independent valuation for the intellectual property they licensed to avoid any appearance of self-dealing. In addition, they incorporated the new company in New York rather than California, because New York is one of 31 states with a "corporate constituency statute." Such laws let company leaders consider the interests of other stakeholders—such as employees or the community—in addition to the narrow financial interest of shareholders.

Of course, approaches to business structure vary. Some nonprofits control 100% of the for-profit enterprise. For example, the [Mozilla Foundation](#) formed a corporate subsidiary in 2005 to handle the [development, marketing, and distribution of the group's open-source software, like Firefox](#), with revenue flowing to the foundation to support Mozilla's open-source mission. Other models split financial returns with outside investors but retain control of the mission through special classes of stock or other agreements written into the company's governing documents. Lee Zimmerman and Brian Anderluh bought [Evergreen Lodge](#), an historic tourist lodge on the edge of Yosemite, in 2001 with a plan to start a summer jobs program for young adults from the Bay Area. They formed an LLC and raised \$15 million in debt and equity from [socially minded investors](#) like [Pacific Community Ventures](#) and [Juma Ventures](#), both nonprofits.

Zimmerman cautioned investors that returns could be diluted because of the company's social mission to hire disadvantaged youths, but he's not certain they will be. "I think that long term we will be able to fund this program and provide near-identical returns as an entity that didn't have this social program," he says. To reassure investors, however, Evergreen Lodge offered to return the initial capital invested once the company could afford to replace it with debt—which Zimmerman expects to happen in two years. Investors will retain ownership and still receive dividends, but they'll be able to get their original money out without selling the company. Since buying the lodge, Zimmerman and Anderluh have expanded it from 18 cabins to 90 and increased revenue from \$500,000 in 2001 to \$5 million in 2008.

For Bikestation, the for-profit model is paying off as well. The new company has increased staff from 10 to 14 and is helping to open four new transit hubs this year, bringing the total to 16. Bikestation won't disclose revenue, but White-Kjoss says it has raised projections for 2009. The company is expanding beyond its traditional customers—cities and transit agencies—to market to universities, corporate campuses, and other developments. "We're able to do what we've been wanting to do for a long time," says White-Kjoss.

[Tozzi](#) covers small business for *BusinessWeek.com*.

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