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BLEND ENTERPRISE AND THE DUAL MISSION DILEMMA

Dana Brakman Reiser*†

INTRODUCTION

This symposium is an incredibly exciting event, coming as it does, less than three years after Vermont's introduction of the L3C concept and in the middle of so many attempts by individual entrepreneurs, social innovators, legislators, and regulators to get a handle on somehow blending the goals of profit and public good. Indeed, I have now said many times that the boundary between charity and business has become a moving target. I see nonprofits engaged in commercial activity, social enterprises of various descriptions, and philanthropy divisions of for-profit companies as all of a piece. They all attempt to use business models and practices to pursue charitable objectives. Combining profit-making and pursuit of social goods comes in many forms and by many names. I try to aggregate the general sense of dual motivation under the tag of "blended enterprise."

To define my terms, when I speak of blended enterprise, I mean an entity that intends to pursue profits and social good both in tandem and by making considered choices to pursue one over the other. Blended enterprises at times will pursue more profits over more social good, and at times will pursue more social good over more profit. A single blended enterprise may do both in different situations. Of course, if the pursuit of profits and social good always aligned and more profits always followed social good and vice versa, the single mission charity or business forms would suffice to house blended enterprises. This perfect alignment, though, is far from realistic. Thus, achieving and governing truly blended enterprise means consistently serving two masters, which is notoriously difficult. This essay will review and compare how traditional charity and business forms, as well as several of the emerging hybrid forms, attempt to structure and solve this dual mission dilemma, and will offer some thoughts on how to improve them.

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I. THE TRADITIONAL ALTERNATIVES

Until recently, the law has compelled those who desire a blended enterprise to adopt either a charity or a business form of governance. Once formed, an entity’s leaders must attempt to use a single mission form to govern their blended enterprise. Yet, neither the traditional charity form—a nonprofit corporation—nor any of the traditional business forms—either incorporated or unincorporated—is particularly well-suited to doing so. Charitable forms are inhospitable because although the law certainly permits charities to earn profits, it bars charities from distributing those profits.1 Entrepreneurs wishing to blend equity finance and social goals must look elsewhere. Additionally, charitable forms’ limited funding streams—from donations, debt-financing, and earned revenue—are precisely what have turned the interest of many social entrepreneurs to blended enterprise.

Likewise, standard business forms align imperfectly with the goals of blended enterprise, due mainly to legal and practical problems incident to their owners’ control. Business organization law generally expects managers of businesses to act to maximize profits for their owners despite occasional exceptions permitting incidental consideration of other constituencies’ interests.2 Of course, there are times when this expectation is undercut or relaxed, such as in corporate law’s permission of corporate charitable contributions or the existence of other-constituency statutes.3 Even in these contexts, however, business managers are permitted to pursue goals in conflict with, or other than, profit-maximization as a sideline rather than as an equally important and parallel goal of the enterprise.4 In addition to legal limits, the market creates serious practical pressure for business managers to maximize profits, rather than pursue social objectives. Failing to do so may result in business reverses and loss of market share, undermine investor-confidence, and perhaps cause managers to lose their

2. See Einer Elhauge, Sacrificing Corporate Profits in the Public Interest, 80 N.Y.U. L. REV. 733, 736 (2005) (“Unless modified by statute, traditional fiduciary duties require corporate managers to further the interests of shareholders, and thus require them to maximize corporate profits subject to the obligation to comply with independent legal constraints.”) (citation omitted).
3. See, e.g., NEV. REV. STAT. ANN. § 78.138(4) (LexisNexis 2004) (“Directors and officers, in exercising their respective powers with a view to the interests of the corporation, may consider . . . (c) The interests of the community and of society . . . .”); N.Y. BUS. CORP. LAW § 717(b) (McKinney 2010); 15 PA. CONS. STAT. ANN. § 1715 (West 2010).
4. See, e.g., NEV. REV. STAT. ANN. § 78.138(1), (4)(LexisNexis 2004) (stating that “Directors and officers shall exercise their powers in good faith and with a view to the interests of the corporation . . . .,” and that they “may consider . . . the interests of the community and of society . . . .”) (emphasis added).
positions. Some, but not all, of this market pressure is blunted for unincorporated and/or privately funded entities.

In addition, founders of business entities may employ various techniques to establish and attempt to enforce blended mission. Dual-class stock ownership can be used to prevent inroads by groups hostile to a blended mission and to maintain control with founders faithful to it. Google Inc. has this structure, and it is one element of why the “for-profit philanthropy model” might be effective there.\(^5\) Google has committed to using one percent of its equity and profits for philanthropy, but pursues those goals through a philanthropy division of its for-profit corporation.\(^6\) This for-profit philanthropy model, however, is not really a form of blended enterprise as I define it here. Google makes only a small scale commitment to pursue social goals in relation to its profit-making/taking pursuits. Google’s investors might be willing to take this small cut in profits on an otherwise attractive investment for a range of reasons. They may predict they will still make substantial gains over other investment alternatives. They may believe (as does Google) that this expenditure will enhance the brand and therefore profits in other pursuits. They may view Google.org as essentially a savvy technique for engaging in highly speculative, but potentially lucrative, investments outside the company’s traditional sphere.\(^7\) It remains to be seen whether the for-profit philanthropy model can be widely replicated; it may be a unique strategy available only to this unique company.

Other business forms also offer mechanisms for enforcing blended mission. For example, closely held corporations can write shareholder agreements committing their signatories to blended mission and include limitations on transfer of ownership rights.\(^8\) Likewise, in the partnership or LLC forms, at least as a default, ownership transfers may be made subject to severe limitations.\(^9\) Still, no business form can sufficiently protect blended mission—at least not without undermining access to capital.

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8. *See Harwell Wells, The Rise of the Close Corporation and the Making of Corporation Law, 5 BERKELEY BUS. L.J. 263, 275 (2008) (recognizing that since close corporations are often formed by individuals who want to work together, they typically “seek restrictions on transfer of stock so they can control who they have to work with”)* (citation omitted).
9. *See UNIF. P’SHP ACT §§ 502–503 (1997) (permitting transfer of partners’ rights to profits and losses, but not of governance rights without consent of other partners); UNIF. LTD. LIAB. CO. ACT §§ 502(a), (f) (2006) (permitting transfer of member’s economic rights but not rights in management and permitting enforcement of limits on transfer).*
appetites and desires of owners, even founding owners, can shift. Over
time, if a set of owners come to favor profits over social goals, business
organization law will not work to constrain them from obtaining their
preferences.

II. NEW HYBRID FORMS OF ORGANIZATION

Legislation and private innovation now offer hybrid forms of
organization in an attempt to solve the evident mismatch of blended
enterprise with either charity or business forms. These new hybrids are an
important first step, but the journey is far from over. I believe these nascent
forms do not yet sufficiently solve the dual-mission dilemma inherent in
blended enterprise.

A. The Low-Profit Limited Liability Company (L3C)

In the pages of the Vermont Law Review, it seems apropos to begin
with a discussion of the low-profit limited liability company.10 The
Vermont Legislature pioneered the form, which at this writing seven other
U.S. states and two Native American tribes have adopted by substantially
similar legislation.11 L3Cs work on a limited liability company (LLC)
framework, but there are some important tweaks. The L3C must be formed
for educational or charitable purposes, though significant profit-making
activities will not, on their own, undermine meeting this requirement.12

This structure signals acceptance and endorsement of blended
missions. There must be an educational or charitable purpose of an L3C,13
but there also may be significant profit-making activities;14 it is envisioned
that those profits can be distributed to some or all of the L3C's members.

10. In April 2008, Vermont became the first state to adopt legislation creating the low-profit
limited liability company form. See Robert Lang, What is the L3C?: Basic Explanation, AMS. FOR
CMTY. DEV., http://www.americansforcommunitydevelopment.org/downloads/WhatsTheL3C.pdf (last
visited Nov. 1, 2010); Low-Profit Limited Liability Company, VT. SEC’Y OF STATE,
(last visited Nov. 16, 2010) (listing Illinois, Louisiana, Maine, Michigan, North Carolina, Utah, Wyoming, the
Crow Indian Nation of Montana, and the Oglala Sioux Nation as additional jurisdictions that have adopted L3C
legislation).
company as a company which "significantly furthers the accomplishment of one or more charitable or
educational purposes" and "the fact that a person produces significant income or capital appreciation
shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the
production of income").
13. E.g., id. § 3001(27)(A).
14. E.g., id. § 3001(27)(B).
This structure clearly and unequivocally distinguishes itself from a traditional charity, as there is no nondistribution constraint. Indeed, and importantly to my mind, if at some point profits do eclipse social goals, the L3C will simply transform into an LLC with no need for regulatory involvement, indeed with seemingly no other change.\(^\text{15}\)

The L3C adopts the LLC governance framework with virtually no changes.\(^\text{16}\) This framework is one marked by extreme flexibility. LLCs, and by extension L3Cs, can adopt one of two default governance alternatives: a member-managed model or a manager-managed model.\(^\text{17}\) In addition, an L3C may extensively vary whichever model it chooses under an operating agreement.\(^\text{18}\) Presumably, an L3C could impose an obligation on its managers to pursue both profit and social good in such an agreement. What happens, though, if internal consensus on the wisdom of blended mission breaks down? How will these obligations be enforced when there is no regulator and transformation to an LLC is both easy and costless?\(^\text{19}\)

Whoever undertakes the management role in an L3C is subject to fiduciary obligations of care and loyalty extending to the L3C and its members.\(^\text{20}\) However, fiduciaries are permitted to act in their own self-interest, so long as they do not compete with the L3C, act as an adversary, or breach obligations of good faith and fair dealing.\(^\text{21}\) The original Uniform Limited Liability Company Act provides an example of an LLC member who votes against a proposal that the LLC open a shopping mall in competition with the member’s own shopping mall.\(^\text{22}\) Likewise, would a member or manager of an L3C be permitted to act in her own interest and vote to move to a predominantly profit-pursuing model? Perhaps it would breach the duty of good faith if the member or manager were to do so, if this duty were interpreted to require fidelity to the blended mission concept.\(^\text{23}\) But this outcome is far from clear today. The fact that an L3C may transform immediately and without penalty into an LLC\(^\text{24}\) also suggests such a vote would not be problematic.

\(^{15}\) E.g., id. § 3001(27)(D) (“If a company . . . ceases to satisfy the [L3C requirements], it shall immediately cease to be a low-profit limited liability company, but . . . will continue to exist as a limited liability company.”).

\(^{16}\) VT. SEC’Y OF STATE, supra note 10.\(^\text{16}\)

\(^{17}\) UNIF. LTD. LIAB. CO. ACT § 407 (2006).\(^\text{17}\)

\(^{18}\) See id. § 110 (discussing the scope, function, and limitations of an operating agreement).\(^\text{18}\)

\(^{19}\) Id. § 409(a)–(c), (g).\(^\text{19}\)

\(^{20}\) Id. § 409(d).\(^\text{20}\)

\(^{21}\) Id. § 409 cmt. (1996 version).\(^\text{21}\)

\(^{22}\) For a thorough discussion of fiduciary duties within the L3C context, see John Tyler, Negating the Legal Problem of Having “Two Masters”: A Framework for L3C Fiduciary Duties and Accountability, 35 VT. L. REV. 117 (2010) (published in this book).\(^\text{22}\)

\(^{23}\) See VT. STAT. ANN. tit. 11, § 3001(27)(D) (2009).\(^\text{23}\)
Some who offer financing ideas for the L3C suggest using various classes or tranches of L3C members to solve this governance quandary. An L3C may allocate members’ different levels of investment and governance rights—different from each other and different from other members. Perhaps it would be possible to allocate control to a member or group of members with the proper incentives to enforce blended mission. Who would that group be?

For example, consider the three-tranche L3C structure commonly suggested. In the equity tranche, private foundations making program-related investments (PRIs) are statutorily proscribed from investing with a predominant profit motive. These private foundations may be offered residual profits, but little or no midstream profits, and their financial interests will be junior to all other creditors and members. These foundations will, however, be endowed with dominant rights in governing the organization. As the foundations’ interest in profits would be either remote or nonexistent, they could perhaps be counted on to prevent a move towards a single-minded profit orientation. In addition, the IRS’s interest in policing PRIs could offer a form of shadow regulation. But, this placement of sole or dominant governance interests in the hands of a private foundation, which seemingly is interested in investing for little return, is unlikely to protect blended mission. At best, it would protect social mission.

Another possibility would be to place predominant governance rights and the responsibility of guarding blended mission with a class of L3C members whose own interests are blended—perhaps foundation investors interested in some return (though lower than market) combined with social good. Alternatively, this role could be allocated to a broader class of investors seeking a socially responsible investment—individual investors or non-foundation institutions. These investors could be provided some below-market level return, which accompanied with the psychic returns, would entice them to invest. I hypothesize this is a more likely position for foundations than being interested solely in offering a donation to an entity.
that will ultimately make profits for its other investors to the exclusion of them. In addition, one or a small group of sophisticated foundations would have a much greater capacity to play this enforcement role than a diffuse class of socially responsible investors.

Still, there are serious problems with the L3C solving the dual mission dilemma using either of these techniques. First and foremost, none of this is mandatory—the hallmark of the L3C is its flexibility. While an L3C form would allow its adopters to use either technique, they need not undertake any mechanism to enforce blended mission. Second, there is no clear regulatory backstop for this governance regime. Perhaps the IRS would act as a shadow regulator, though it is unclear whether the IRS would be equipped to enforce blended mission or would be interested in doing so. Although far from certain, challenges against an L3C fiduciary’s obligations could entail some duty to maintain or enforce blended mission. Third, I am skeptical that if an L3C allocates complete or dominant control to foundations or socially-responsible investors, it would be able to successfully market memberships to others seeking market-rate returns without offering significant security to those investors. Furthermore, if substantial security is available to attract these investors, wouldn’t forming as a charity or business and selling true debt to these investors be easier and more appropriate?

Establishing some method for enforcing blended mission, either by fiat through imposition of specialized fiduciary obligations, or structurally by requiring governance rights to be sited with some appropriately-incentivized group, would improve the L3C’s claim to a position as a home for blended enterprise. This claim would be further enhanced if some limited regulatory role were envisioned to back it up. However, either of these attempts to resolve the dual mission dilemma may ultimately undermine the L3C’s ability to increase the capital available to pursue social goals.

B. The Community Interest Company (CIC)

A similar lesson can be gleaned from the very different experience of the United Kingdom’s community interest company. The CIC operates on a company framework and can be limited by shares. This structure envisions

27. See Tyler, supra note 22, at 156 (postulating that traditional fiduciary duty enforcement mechanisms—including derivate suits, fraud claims, ultra vires acts, and veil piercing—could be used to ensure that an L3C entity remains faithful to its stated charitable purpose).

a quasi-equity investor entitled to dividends. These investors are only quasi-equity investors for two important reasons. First, the CIC is an asset locked entity; it may distribute its assets on dissolution only to a charity or another CIC, keeping them in the community benefit stream. Second, there are various strict limits on midstream profit distributions to shareholders. Due to recent changes in regulation, the limits differ depending on when the shares were issued. Shares issued before April 6, 2010 may not yield dividends greater than five percent over the Bank of England base lending rate, which is currently set at half a percent. For shares issued after April 6, 2010, “[t]he share dividend cap shall be 20 percent of the paid up value of a share in a relevant company.” Also, the total annual dividend declared for all shares may not exceed thirty-five percent of distributable profits, and dividend capacity may be carried over for only a limited number of years. Profit-taking is envisioned, but the extent of such profit-taking is limited.

In addition, a CIC must pursue social goals that a reasonable person would see as benefitting the community. This requirement casts a substantially larger net than would the U.K. definition of charity, but clearly envisions an entity with some serious social goals. All of these significant obligations are overseen by a dedicated, “light touch” Regulator. Again,
we see a hybridization of significant social goals and private profit-taking, distinguishing the CIC from single mission charity or business forms.

As noted, CIC governance operates on the model of a company. In a CIC limited by shares, the shareholders will elect directors, will be owed fiduciary duties, and may (though to a considerably narrower extent than in the United States) be able to pursue remedies derivatively. Additionally, regulations require CICs to provide a role for non-shareholder stakeholders in governance, and report to the Regulator annually on their efforts to do so.

The combination of company law and additional CIC content establishes governance techniques addressed to enforcing blended mission. The community benefit requirement and asset lock require a CIC to pre-commit to social goals and irretrievably dedicate a substantial part of its assets to their pursuit. All the while, however, dividends to shareholders are specifically contemplated. Nonetheless, shareholders are not the sole relevant constituency to a CIC’s leaders, as other stakeholders must be involved in (or at least informed about) governance. Moreover, CIC shareholders may be particularly likely to use their clout to enforce blended mission. CIC investors are a group with truly blended goals, having voted with their dollars by investing them in an entity offering limited potential investment gains, but potentially offsetting social gains. In addition, the CIC form envisions a public backstop for enforcement of blended mission. The dedicated Regulator supervises registration and annual reporting, and is authorized to “investigate complaints” and “act if it is found that a CIC is not working in the interest of the community or that the profit/asset lock is not being observed.”

In a CIC, the community benefit requirement, asset lock, and dividend caps all structurally enforce a commitment to social goals. Internal constituencies and external regulation are empowered to police. Perhaps CIC shareholders (if they can be found in large numbers) will be committed to enforcing dual mission. The external regulator, though it seems to emphasize enforcing social goals, as would an empowered donor-type private foundation.

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40. As fiduciaries of the company, directors must exercise their management and supervisory duties with “reasonable care, skill and diligence” and avoid conflicts of interest or other situations of potential disloyalty. Companies Act, 2006, c. 46, §§ 170–177 (U.K.).
41. INFORMATION AND GUIDANCE NOTES, supra note 30, at § 9.2.
42. FREQUENTLY ASKED QUESTIONS, supra note 32, at 17.
43. Id. at 12.
44. Id.
entity tranche in an L3C. Maybe the idea in both instances is that the market will be sufficient motivation to pursue profits? Perhaps.

Another problem is that although the CIC offers a range of potentially effective tools to enforce social mission, the same fear regarding fleeing capital raised with regard to the L3C appears to have come to pass in the CIC. The CIC form has struggled to find acceptance among founders, who perceive that they, in turn, will have trouble obtaining capital.\textsuperscript{45} Perhaps the elusive blended mission investor crowd is too small, or maybe it is just the current financial climate—time will tell. But, the CIC may be evidence that a statute can go too far in enforcing blended mission (or at least one half of it) to the detriment of the original goal of getting more funding for social purposes.\textsuperscript{46}

\textbf{C. The B Corporation}

The final organizational form I want to touch on brings us back to the traditional business forms—the "B Corporation." The "B" or "for-benefit" designation is available for a variety of business organizational forms. For brevity's sake, I will simplify and address only the B Corporation here.\textsuperscript{47} The B Corporation uses the standard state law-defined, for-profit corporation as a model, but tweaks the model to pursue a more blended mission.

For example, the private, nonprofit B Lab offers to license its "B" trademark to companies who meet various requirements showing they "use[] the power of business to solve social and environmental problems."\textsuperscript{48}

\textsuperscript{45} The CIC Regulator recently sought input on whether the dividend caps have impeded the CIC's ability to attract investments and should be changed. See THE REGULATOR OF COMMUNITY INTEREST COMPANIES, CONSULTATION ON THE DIVIDEND AND INTEREST CAPS 3 (Mar. 30, 2009), available at http://www.cicregulator.gov.uk/%27Caps%27%20Consultation%20V00.01SO.pdf. The responses that the Regulator received demonstrated frustration with the dividend caps. Financiers reported that the caps "unduly limit[] incentive to those that might make an equity investment" and non-CIC social enterprises suggested that the caps did affect their decision not to organize as a CIC. THE REGULATOR OF COMMUNITY INTEREST COMPANIES, SUMMARY OF THE RESPONSES TO THE CONSULTATION ON THE DIVIDEND AND INTEREST CAPS 5–6 (Oct. 2009), available at http://www.cicregulator.gov.uk/Summary%20of%20Responses%20V00.01SO.pdf. The Regulator responded by changing the dividend cap to "20 percent of the paid up value of a share" for shares issued after April 6, 2010. NOTICES UNDER THE COMPANIES ACT, supra note 34.

\textsuperscript{46} Brakman Reiser, supra note 28, at 649, 651–52, 654.

\textsuperscript{47} B Lab offers similar tools for entities formed as sole proprietorships, limited liability companies, and general, limited, or limited liability partnerships.


In mid-April 2010, Maryland became the first state to adopt a statutory "benefit corporation" modeled on B Lab's concept. See Diane Mastrull, \textit{Maryland Adopts New Socially Aware
A B Corporation must incorporate or reincorporate in a state with a so-called “other constituency” statute, which permits corporate directors to consider non-shareholder interests in making their decisions. The corporation must also go further and amend its bylaws to require directors to take into account such interests, including broad social and environmental concerns. These new obligations, though, are enforceable only through the typical for-profit corporate mechanism of suits by shareholders or through a B Lab audit, which may revoke the right to license and use the B trademark.

The B Corporation offers weaker structural enforcement of blended mission than the CIC. It incorporates a requirement to pursue social goals into fiduciary mandates, but only shareholders can enforce these mandates. The same shareholders could be bought off by offering them part of the uncapped and unlocked profits that pursuing only profit might generate. In this context, B Lab serves as an external private regulator, but is faced with a difficult challenge: B Lab must find a way to become a serious enforcer of blended mission. B Lab must establish “B” as a powerful mark for consumers, investors, and business partners, but certification must not become so onerous that it loses its attraction for founders of blended enterprises. Without enough certified B Corporations, no one will know or

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*Corporation Law, PHILA. INQ., Apr. 15, 2010, at C01. The new law did not take effect until October 2010, and the contours and enforcement regime, if any, for this new form have not yet become clear. Consideration of its merits, as distinct from the privately-certified B Corporation, will be addressed in future work.

49. See About B Corp., B LAB, http://www.bcorporation.net/about (last visited Nov. 1, 2010) (noting that to become a B Corporation, an entity must amend its “corporate governing documents to incorporate the interests of employees, community and the environment”).

50. For example, a B Corporation in New York must amend its articles of incorporation to include the following language:

   In discharging his or her duties, and in determining what is in the best interests of the Company and its shareholders, a Director shall consider such factors as the Director deems relevant, including, but not limited to, the long-term prospects and interests of the Company and its shareholders, and the social, economic, legal, or other effects of any action on the current and retired employees, the suppliers and customers of the Company or its subsidiaries, and the communities and society in which the Company or its subsidiaries operate, (collectively, with the shareholders, the “Stakeholders”), together with the short-term, as well as long-term, interests of its shareholders and the effect of the Company’s operations (and its subsidiaries’ operations) on the environment and the economy of the state, the region and the nation.


51. *Audits, B LAB, http://www.bcorporation.net/index.cfm/fuseaction/content.page/nodeID/62e0a177-6625-4373-9142-01e788e468cd (last visited Nov. 1, 2010). Although the audit process exists, it is relatively new. At this writing, B Lab had only completed the first two years’ audits and all certified entities passed. *Id.*
care about the B Corporation trademark. We will need to wait and see whether B Lab becomes an active and effective regulator.

III. CONCLUSION

The ultimate question must be “how can we effectively enforce a dual mission?” Unfortunately, the law has not yet provided a definitive answer. At the moment, the L3C does not require any form of blended mission enforcement. New adopters of the L3C form should experiment with incorporating mechanisms into law and practice regulating L3C governance. The CIC seems to enforce social goals quite rigorously, but not blended mission, and it will choke off interest by profit-motivated investors if it goes too far. The Regulator has undertaken review of the form and made a few midstream corrections. This effort is laudable and should be continually monitored. Perhaps tinkering with the dividend or asset lock restrictions or other components of the form will reveal the way to enforce blended mission and reach the elusive market of blended mission investors. I am skeptical as to whether the B Corporation’s changes to fiduciary obligation will sufficiently enforce blended mission, whether achieved through private certification or new state corporate forms drawing on B Lab’s for-benefit concept. From this experiment, we will learn much about the viability of a certification model in this area. B Lab must thread the needle between being a strict enough enforcer and certifying enough entities to create the network effects needed for the B trademark to become a viable brand.

We are at the beginning of an exciting journey, and these attempts should be applauded. At the moment, experimentation with hybrid forms is rife, and hopefully it will lead to a winnowing of forms. In order for an effective hybrid form to emerge, however, its crafters will have to create a governance solution to the dual mission dilemma.