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SCALING-UP OR SELLING OUT? DOES NEW ZEALAND COMPANY LAW ADEQUATELY BALANCE THE 'DOUBLE BOTTOM-LINE' WHEN SOCIAL ENTERPRISES RAISE CAPITAL?

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Contents

I INTRODUCTION 4
II SOCIAL ENTERPRISE COMPANIES IN AOTEAROA 6
A Defining Social Enterprise 6
B Choosing the Company Form 8
III THE AMBIGUOUS AREA TRUST PROBLEM 10
A Dis-Consonance from Shareholder Primacy 11
B The Importance of Trust 13
C The Importance of Raising Capital 15
1 Debt-raising 16
2 Equity-raising 16
IV UPHOLDING THE DOUBLE BOTTOM-LINE: LIMITING OWNERSHIP 23
A Concentrating Control and Signalling Trust 24
B Effective Capital Raising through Public Offers? 27
C Equity Crowdfunding: Filling the Funding Gap 29
1 Signalling trust and maintaining mission through crowdfunding 31
2 Does crowdfunding adequately plug the funding gap? 33
V HYBRID STRUCTURES UPHOLDING THE DOUBLE BOTTOM-LINE? 37
A Features of Benefit Corporations and CICs 38
B Do Hybrids Better Signal Trust and Maintain Social Mission? 40
C Better Capital-Raising Potential? 43
D Comparing Social Enterprise Hybrids and the Limiting Ownership Strategy 45
VI PROPOSED PATH AND POTENTIAL REFORM 47
A Assessing the Desirability of Reform 49
B Alternative Mechanisms for Protecting Retail Investors 52
VII CONCLUSION 55
VIII APPENDIX 58
IX BIBLIOGRAPHY 59

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Abstract

This paper examines the unique challenges facing the social enterprise movement in Aotearoa. The most pressing challenge for social enterprise companies is balancing their dual missions – profit-making and social or environmental good – when they attempt to scale-up. The goal of social enterprises, to redeploy traditional company structures for blended altruistic and profit-making purposes, places these organisations in a unique, ambiguous third sector. Maintaining a for-profit purpose raises the pressing question of whether social enterprise companies can be trusted to stay true to their social mission. With mistrust comes limited capital-raising opportunities. Faced with this funding gap, social entrepreneurs must determine how they can achieve their scale-up plans while adequately signalling and committing to entrenching social mission. This paper suggests that social enterprises could pursue either of two strategies: first, social enterprise founders can adopt a strategy of limiting ownership by concentrating voting control with company insiders – issuing non-voting shares on equity crowdfunding platforms; or alternatively, founders may call for the creation of hybrid organisational forms, like benefit corporations and community interest companies, specifically designed to house both social enterprise purposes. Evaluating both options in turn, this paper suggests that the simplest and most workable solution is to pursue the strategy of limiting ownership through equity crowdfunding. By issuing non-voting shares on a platform associated with social good, entrepreneurs can signal and protect their social missions. Crowdfunding, being exempted from the Financial Markets Conduct Act 2013 disclosure obligations, can partially fill the funding gap but limits capital-raises to $2 million per annum. As such, this paper further proposes that minor amendments to the Financial Markets Conduct Act to increase the capital-raising cap can better fill the social enterprise funding gap.

Key words: "social enterprise", "equity crowdfunding", "corporate finance", "Financial Markets Conduct Act 2013".

I Introduction

Society has become more cognisant of complex global problems, such as climate change and the inequalities in wealth and income. As a result, investor and consumer profiles and preferences are shifting; significant shareholdings held by largely passive mutual or pension investment funds are being driven to support companies that exhibit corporate social responsibility, where organisations create policies and practices designed for sustainability and social good.[1] According to Cynthia Williams, "global assets under management with sustainability screens have risen 61% since 2012".[2] As such, a company that has a dominant mutual or pension fund shareholding will possess better corporate social responsibility practices.[3] Responding to and adapting with market demands, large multinationals, like Unilever, are drastically changing their policies and practices in order to increase their financial success in "the industry" of corporate social responsibility.[4] This 'industry' characterisation refers to companies successfully enticing investors and customers by branding their businesses as 'sustainable' without necessarily implementing their sustainable policies and practices.[5]

Emerging in tandem with the trend of existing corporations adopting 'sustainable practices' is a phenomenon called 'social enterprise'. These organisations go beyond the voluntary practices of corporate social responsibility to pursue a double or triple bottom-line: delivering environmental and/or social good alongside profit generation. In Aotearoa, socially minded entrepreneurs have traditionally sought to 'do well by doing good' through existing organisational structures that emulate altruism, such as charities and cooperatives,

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[1] Cynthia A Williams "Corporate Social Responsibility and Corporate Governance" in Jeffrey N Gordon and Wolf-Georg Ringe (eds) *The Oxford Handbooks of Corporate Law and Governance* (online ed, Oxford University Press, Oxford, 2015) at 635.

[2] At 635.

[3] At 662.

[4] At 635–647; also see for example Unilever "Planet & Society" <www.unilever.com>; and Sam Danley "Unilever announces new sustainability goals" (15 June 2020) Banking Business <www.bakingbusiness.com>.

[5] Alicia E Plerhoples "Can an Old Dog Learn New Tricks – Applying Corporate Law Principles to New Social Enterprise Legislation" (2012) 13(2) Tenn J Bus L 221 at 223.

but are beginning to recognise the benefits of delivering social benefits through the company form. Entrepreneurs are beginning to recognise that incorporation reveals a seemingly limitless potential for business growth.

Despite the increased capital-raising potential of company structures, social enterprises are faced with a unique 'funding gap': they encounter difficulties accessing debt and equity markets due to the perceived 'dis-consonance' between social enterprises' dual missions. There is a wealth of literature examining the social enterprise form and barriers to its success. While many implore for wide-ranging company law reforms, such as the creation of hybrid organisational structures designed to house social enterprise, few present social enterprise founders with practical solutions to their problems in current law and practice. This paper seeks to elucidate the capital-raising trust problem facing social enterprises that take the company form in Aotearoa; how they may signal and maintain their social missions while adequately raising capital. The author will explain how existing company law mechanisms may allow social enterprises to plug their funding gaps without 'selling out'.

Part II of this paper establishes the social enterprise context and the benefits of incorporation. Part III examines social enterprises' perceived trust deficit and the associated limitations or vulnerabilities they face in debt and equity markets. This paper then proposes two potential solutions: Part IV suggests raising capital through the equity market by limiting ownership and issuing dual class shares to public retail investors through equity crowdfunding platforms; and Part V examines whether a hybrid organisational structure would better maintain mission while accessing capital. Finding that hybrid structures do not adequately balance the two social enterprise purposes, Part VI of this paper proposes that social enterprises can better balance their missions and plug the funding gap with existing company law mechanisms, so long as minor reforms to the equity crowdfunding space are made.

II Social Enterprise Companies in Aotearoa

A Defining Social Enterprise

Traditionally, charities and non-profit organisations, with their altruistic purposes, have been used to address social and environmental ills. Historically deriving from religious organisations, charities seek to do good "as such"; their altruistic purposes necessarily correspond with no expectation of return or "personal advantage".[6] Social work conducted without an expectation of reward bolsters the community's trust in charities meaningfully providing social good, further augmented by the government-imposed restrictions on profit-making.[7] The natural corollary is that society generally mistrusts for-profit organisations, such as multinational corporations, claiming to deliver social benefit as their profit-making purpose makes them morally ill-suited to work within the social good space.[8] Arguably, the "greenwashing" and "social washing" of multinational corporations adopting faux-corporate social responsibility practices deepen this mistrust.[9] Social enterprise offers an alternative conception of the suitability of business to facilitate positive social change.

Nicholls and Teasdale suggest that social enterprises arguably operate based on an application of neo-liberal theory. Neoliberalism is often described as a "broad catch-all term",[10] but one that typically refers to reducing the involvement of the state in "economic and social affairs … with confidence in free markets".[11] In a similar fashion, the social enterprise movement holds that social ills cannot be addressed by government and non-profits alone but require assistance from the 'engines of capitalism'.[12] This ultimately

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[6] Matthew Harding "What is the Point of Charity Law?" in Kit Barker and Darryn Jensen (eds) *Private Law: Key Encounters with Public Law* (Cambridge, Cambridge University Press, 2013) 147 at 165.

[7] Dana Brakman Reiser "Social Enterprise Exits" in *Social Enterprise Law: Trust, Public Benefit and Capital* (online ed, Oxford Scholarship, 2017) at 18.

[8] Billy Matheson *Part of a Larger Whole: 30 Years of Social Enterprise Development in Aotearoa New Zealand* (Report Produced for the Social Enterprise Development Programme, November 2018) at 23.

[9] Plerhoples, above n 5, at 223.

[10] Rajesh Venugopal "Neoliberalism as concept" (2015) 44 Economy and Society 165 at 166.

[11] Nicola Smith "Neoliberalism: political and social science" Britannica <www.britannica.com>.

[12] Heerad Sabeti "The For-benefit Enterprise" *Harvard Business Review* (online ed, November 2011).

requires marketizing civil society and privatising some traditionally public services.[13] Diverging from neoliberalism, the social enterprise movement requires a voluntary seismic shift in traditional business practices and purposes; traditional corporations operate in a supranational arena with abilities to evade domestic regulations that aim to prevent them promulgating environmental and social harm.[14] To combat this, social enterprises go beyond "accommodating" sustainable corporate behaviours but adopt them "as a core purpose",[15] by embracing the amoral business form and remoulding it to trade *for* social purpose.[16] This reflects the reality that "[t]here is no law of nature that states that the corporation must be as it is. In contrast, for nearly all of its 200-year history, the corporation has taken a very different form from how it is today."[17]

The Department of Internal Affairs describes this amended corporate form and details social enterprises as organisations with:[18]

> … a social, cultural, or environmental mission that achieves public or community benefit; [has] a substantial portion of income derived from trade …; and [that reinvests] the majority, or all, of profit/ surplus in the fulfilment of the organisation's mission.

As such, social enterprise targets social problems as "knowledge problems that can be solved by technical innovation".[19] The social enterprise purpose is not solely to make

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[13] Alex Nicholls and Simon Teasdale "Neoliberalism by stealth? Exploring continuity and change within the UK social enterprise policy paradigm" (2016) 45 Policy and Politics 323 at 328.

[14] Robert T Esposito "The Social Enterprise Revolution in Corporate Law: A Primer on Emerging Corporate Entities in Europe and the United States and the Case for the Benefit Corporation" (2013) 4(2) Wm and Mary Bus L Rev 639 at 670.

[15] Regina Robson "A new look at Benefit Corporations: Game Theory and Game Changer" (2015) 52 American Business Law Journal 501 at 534.

[16] Matheson, above n 8, at 18.

[17] Colin Meyer "The Future of the Corporation and the Economics of Purpose" (2020) 58 Journal of Management Studies 887 at 894.

[18] Department of Internal Affairs *Legal Structures for Social Enterprise* (June 2013) [DIA] at 5.

[19] At 19.

financial gain, as in traditional for-profits, but adopts a new corporate purpose; one that aims to benefit shareholders, society, and the environment generally.[20]

B Choosing the Company Form

Aotearoa had an estimated 2,589 social enterprises in 2018 delivering social impact,[21] with these numbers likely to have significantly increased over the past three years. Unlike the United States and the United Kingdom, which now have hybrid organisational structures designed to house social enterprise, the emerging campaign of social entrepreneurs in Aotearoa must make do with the various entities that already exist. Most of these social organisations take the charitable trust form.[22] However, social enterprise *companies* have the potential to act as "disruptors" to the traditional conceptions of the corporate purpose, profit-maximisation.[23]

Social enterprises choose to adopt the charity form due to the benefits of tax-exempt status and strongly entrenched social mission. Achieving this status is not easily realisable for social entrepreneurs who must meet two conditions:[24] (1) "the charity's purpose and activities must be exclusively charitable"; and (2) "none of the charity's income or funds may be used, or be available for use, to benefit any of its members, trustees or associates."[25] Furthermore, while a registered charity *can* entrench mission and raise capital, raising funds remains limited to donations and tax-free income, unlike the company form.[26]

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[20] Meyer, above n 17, at 889.

[21] Konrad Hurren, Hugh Dixon and Dr Ganesh Nana *Making Sense of the Numbers: The number and characteristics of Social Enterprises* (Berl, No 5855, 2018) at ii.

[22] See Appendix for statistical breakdown.

[23] Niki Mandow "The future of business: Being good to your core" (31 May 2021) Newsroom <https://newsroom.co.nz>.

[24] Dana Brakman Reiser and Steven A Dean "Hunting the Stag with Fly Paper: A Hybrid Financial Instrument for Social Enterprise" (2013) 54 BC L Rev 1495 at 1502.

[25] Inland Revenue Department "Tax exemptions and donee status for charities or businesses operating for charities" (21 July 2021) Inland Revenue <www.ird.govt.nz>.

[26] Brakman Reiser and Dean "Hunting the Stag with Fly Paper: A Hybrid Financial Instrument for Social Enterprise", above n 24, at 1503.

Registering a company through the Companies Act 1993 incurs some minor administration and compliance costs, but there are various benefits of incorporation that would draw social enterprise founders to this form. The Companies Act sets out the respective relationships within a company that can afford certain protections to the founder, who is likely to be both majority shareholder and a director. First, registering a company creates a legal entity, separate from shareholders, that can perpetually operate in its own name.[27] A separate identity provides social enterprises with a lasting legacy. Secondly, the word 'limited' should not be undervalued; shareholders in a registered limited liability company are only liable for paying the cost of their shares.[28] If the social enterprise fails, the founder as shareholder will usually be protected from direct liability to company creditors.[29] In a similar vein, as the company owns all assets and the shareholders only have a residual claim, registration creates "entity partitioning or strong form entity shielding" where the shareholders cannot use or dispose of the company assets as if they were their own.[30]

Although there is nothing "inherent in the LLC [limited liability company] structure" to lock in social mission,[31] LLCs allow social enterprises to pursue their social and profit-making purposes better than charities due to the form's apparent flexibility. A company is easily created (by registering on the Companies Register) and by voluntarily adopting a constitution that can modify many of the Companies Act default rules, a social enterprise can attempt to signal a commitment to social good. For example, "the constitution can prohibit any change to a company's objectives unless agreed to by a specified majority of shareholders."[32] Finally, as LLCs are traditionally viewed as profit-making structures, adopting their form makes it comparatively easier (though not completely) to attract

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[27] Susan Watson and Lynne Taylor (eds) *Corporate Law in New Zealand* (Thomson Reuters, Wellington, 2018) at 4.

[28] Peter Watts, Neil Campbell and Christopher Hare *Company Law in New Zealand* (2nd ed, Lexis Nexis, 2015) at 39.

[29] There are very limited circumstances in which a founder, as a director, will be liable to company creditors, for example, if securing a bank loan required the founder to use personal assets as security.

[30] Watson and Taylor, above n 27, at 4.

[31] Dr Jane Horan and others *Structuring for Impact: Evolving Legal Structures for Business in Aotearoa* (Report Produced for Social Enterprise Sector Development Programme, 2019) at 16.

[32] DIA, above n 18, at 9 and 14.

investment, when compared with charitable trusts, if they possess "an attractive business case".[33] Unlike charities, the potential for distributing profit among participants allows social enterprises to raise capital through the equity market.

As such, the flexibility, limited liability and capital-raising potential associated with the company form are strong motivators for social enterprise founders to seek social impact through the company form. With this in mind, the following sections of this paper will examine the ability of social enterprise companies to successfully pursue their dual missions.

III The Ambiguous Area Trust Problem

Despite the many benefits described in Part II, a social enterprise is not guaranteed to succeed by simply adopting the company form. A social enterprise's capital-raising and social impact realisation depends on its ability to navigate a unique trust problem associated with operating within the ambiguous third sector where company law norms come into perceived conflict with social enterprise purposes.

Operating as an LLC presents some tensions for social enterprise observers and market participants who, as previously established, may view this form to be amoral.[34] Some may view the profit drive that accompanies social enterprise to conflict with their entity's core social purpose or mission. By pursuing both categories of social good and profit, social enterprises rest in an ambiguous area.[35] Occupying this ambiguous space creates issues of "dis-consonance" and consequently, mistrust. Dis-consonance pertains to the conflict between the social enterprise's missions; possessing both social and profit-making purposes may "pull an organisation in different directions",[36] away from the shareholder primacy norm.

[33] At 15.

[34] Matheson, above n 8, at 18.

[35] Plerhoples, above n 5, at 223.

[36] Curtis Child "Social enterprise and the dilemmas of hybrid organisations" in David Billis and Colin Rochester (eds) *Handbook on Hybrid Organisations* (Edward Elgar Publishing, United Kingdom, 2020) 206 at 208.

A Dis-Consonance from Shareholder Primacy

By adopting the company form, social enterprises must navigate existing company law principles, like shareholder primacy. Before enactment of the Companies Act in 1993, the law was "reasonably clear": shareholders dictated the purpose of the company and the substance of directors' duties.[37] The default position was for company directors to pursue the enrichment of the company's shareholders. This was accompanied by a practice of court deference to directors' business judgment decisions so that directors could manage the company to the end of increasing *shareholder* wealth as they saw fit.[38] This default appears to sit uneasily with the Privy Council's decision in *Lee v Lee's Air Farming* which upheld the separate legal personality principle established in *Salomon v Salomon & Co*; a company is not synonymous with its shareholders but is a distinct entity in its own right.[39] Accordingly, most directors' duties are owed to the company,[40] including the s 131 duty of directors to act "in the best interests of the *company*."[41] More recently, a Bill has been put before Parliament to clarify the interests a director may take into account when making management decisions, such as "environmental impacts, good corporate ethics, being a good employer, and the interests of the wider community."[42]

Despite this apparent re-conceptualisation of the sources and subjects of director duties, proposed Companies Act reform, and the fact that shareholders do not have a role in the day-to-day management of a company, the Companies Act has upheld the "continuing supremacy of shareholder interests" by reserving shareholders default powers and remedies.[43] The most impactful shareholder power is the requirement that all "major

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[37] Peter Watts, Neil Campbell and Christopher Hare, above n 28, at 375–376.

[38] At 376. Directors freedom does not allow for breaches of the fiduciary duty of loyalty.

[39] See Watson and Taylor, above n 27, at 56; *Salomon v Salomon & Co* [1897] AC 22 (HL); and *Lee v Lee's Air Farming* [1961] NZLR 325 (PC).

[40] See *Yan v Mainzeal Property and Construction Limited (In Liquidation)* [2021] NZCA 99 at [216]; and see for example Companies Act ss 131, 133 and 134.

[41] Mark Fenwick and others "The Future of Capitalism: 'Un-Corporating' Corporate Governance" in Susan Watson (ed) *The Changing Landscape of Corporate Law* (Centre for Commercial and Corporate Law Inc, Christchurch, 2017) 63 (emphasis added).

[42] Companies (Directors' Duties) Amendment Bill 2021.

[43] Watts, Campbell and Hare, above n 28, at 384.

transactions” be approved by a special resolution of shareholders (75 per cent majority of voting shareholders).[44] The definition of a major transaction is extensive, including:[45]

> (a) the acquisition [or disposal] of, or an agreement to acquire [or dispose of] … assets the value of which is more than half the value of the company’s assets before acquisition”; or
> (b) …
> (c) a transaction that has or is likely to have the effect of the company acquiring rights or interests or incurring obligations or liabilities … the value of which is more than half the value of the company’s assets before the transaction.

The Law Commission recommended that special resolution approval is not required if a company’s constitution allows for entry into major transactions.[46] This has been departed from in the current Act.

Shareholders also possess director appointment and dismissal powers, the ability to liquidate a company through special resolution (even if solvent),[47] and remedies of “unfair prejudice”[48] and derivative actions.[49] From a practical perspective, the accountability owed by directors to shareholders, particularly through dismissal powers, means that “in essence, directors are appointed by shareholders to manage the company on their behalf and for their benefit.”[50] It is therefore unsurprising that directors “… will act in shareholders’ interests in order to avoid being sued or voted out of office”.[51]

Although the directors’ duties in the Companies Act have not actively been used to force social enterprise directors to pursue shareholders’ pecuniary interests in the courts (largely

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[44] Companies Act, s 129.
[45] Section 129(2)(a)–(c).
[46] Law Commission *Company Law Reform: Transition and Revision* (NZLC R16, September 1990) at 244.
[47] Watts, Campbell and Hare, above n 28, at 384.
[48] Companies Act, s 174.
[49] Section 165.
[50] *Yan v Mainzeal Property and Construction Limited (In Liquidation)*, above n 40, at [214].
[51] Williams, above n 1, at 665–666.

due to the low number of social enterprises currently taking company form in Aotearoa), the special place held by shareholders and the threat from the powers they have creates a perceived risk that directors will make decisions to protect themselves against potential liability and consequently pull social enterprises from their initial benevolent social purposes towards profit-making. The interests of social enterprise shareholders are likely to align with the altruistic purposes of social enterprise founders, but investment in companies nevertheless comes with an expectation of financial return. This raises the question of whether social enterprises, as pastiche organisations, can be *trusted* to stay true to their mission as they scale-up and accumulate shareholders.

B The Importance of Trust

The blurred core of the for-profit/non-profit dichotomy has "raised serious questions related to trust and trustworthiness" through a fear of social enterprise dis-consonance.[52] Eat My Lunch, a social enterprise in Aotearoa, adopted an LLC structure to avoid the funding and innovation restrictions associated with charitable status – the view that charities lack business acumen and will therefore be less successful – but left the community "confounded" that it did not pursue its social mission through a charity structure. The company has faced accusations of 'social-washing' and calls for more transparency.[53] By possessing both profit-making and social purposes, the community and commentators fear that organisations, like Eat My Lunch, will be pulled in two directions and ultimately, towards profit-making if shareholders induce directors to act in the best *economic* interests of the company.[54] The trust lacuna arises regardless of whether concrete examples of social enterprises drifting from their mission in Aotearoa exist, as it is "conventional wisdom that when social entrepreneurs accept capital from investors, they take the first step down a slippery slope towards wholeheartedly embracing a profit motive."[55] Given that 'perception' is often considered 'reality', social judgement can

[52] Pam Seanor and Julia Meaton "Learning from failure, ambiguity and trust in social enterprise" (2008) 4 Social Enterprise Journal 24 at 29.
[53] Horan and others, above n 31, at 17.
[54] Child, above n 36, at 208; and Companies Act, s 131.
[55] Brakman Reiser, above n 24, at 1496.

present significant challenges to social enterprises trying to balance long-term economic viability with delivering their mission.

Game theory, "a set of tools and a language for describing and predicting strategic behaviour",[56] provides an illustrative explanation of the importance of trust for social enterprises. The 'stag hunt dilemma' requires each player to collaborate and remain focused on hunting the stag, instead of diverting off and hunting hares. Unless both players can establish trust that they will both pursue the ultimate purpose, they will pursue their own purpose of lesser value.[57] Similarly, social enterprise founders and potential investors must establish that both parties will use the for-profit form for social good. A benevolent investor in social enterprise would be ill-advised to invest in an organisation that claims to pursue a social mission but fails to strongly signal that it will *maintain* that promise. Similarly, a social enterprise founder would be unwise to accept investment from and devolve control to an investor who plans to divert the business from its social mission towards profit-maximisation or an ulterior purpose.[58]

Therefore, establishing trust requires enacting an appropriate signal or "focal point" that ensures participants will act similarly.[59] In the New Zealand marketplace, where no specific legal structures designed for social enterprise exist, the law has maintained two salient focal points: for-profit and non-profit organisations.[60] Adopting the company form comes with the difficulty of determining which traditional company law principles apply to the novel social enterprise context. Without an appropriate signal or focal point that encourages potential investors and customers to trust that the social enterprise will pursue both of its core goals – delivering profit and maintaining "credible commitments" to social purpose[61]

[56] Robson, above n 15, at 527.
[57] Brackman Reiser "Social Enterprise Exits", above n 7, at 12.
[58] At 12–13.
[59] Robson, above n 15, at 503.
[60] At 533.
[61] Dana Brakman Reiser "Governing and Financing Blended Enterprise" (2010) 85 Chi Kent L Rev 619 at 619.

– or navigate the perceived conflicts, social enterprises like Eat My Lunch may struggle to get investors and customers 'on board'.

Although gaining and imparting trust is inherently important to social enterprises when raising capital in the ambiguous third sector,[62] ironically, investor and customer perceptions that social enterprise companies are at risk of mission-drift towards profit-making frustrate the ability of social enterprises to *secure* capital and profit. The following section will examine this particular social enterprise vulnerability; how the trust lacuna impacts the ability of social enterprise companies to access debt and equity markets.

C The Importance of Raising Capital

Capital-raising is a necessary stage of business growth and development. The trust problem is most visible where social enterprises in the company form attempt to scale-up. Those enterprises that look most like traditional corporate structures are likely to have larger or more diverse sources of financing. In contrast, enterprises that appear the most dissimilar to traditional corporate structures, with stronger commitments to altruistic purposes, will likely rely on internal sources of capital (like that raised by founders and family members) and face limitations accessing debt and equity financing.[63] It is commonly accepted that small and medium enterprises experience a 'funding gap' while in the fledgling stage of their development.[64] This section will illustrate how the dual-missions of social enterprises in Aotearoa deepen this funding gap by undermining debt-raising potential. Attempting to subvert the gap creates a reliance on equity-raising, where social enterprises must grapple with a trust lacuna: by issuing shares and dispersing ownership, founders are vulnerable to diluting (or completely losing) control over their company's social mission.

[62] Seanor and Meaton, above n 52, at 29.

[63] Ellis Ferran and Look Chan Ho *Principles of Corporate Finance Law* (online ed, Oxford University Press, Oxford, 2014) at 57–59.

[64] See for example "How Big is New Zealand's Early-Stage Funding Gap? (12 September 2019) matū <www.matu.co.nz>; Small Business Council New Zealand *The New Zealand Small Business Strategy: Empowering small business to aspire, succeed and thrive* (July 2019); and Ferran and Ho, above n 63, at 57 for a United Kingdom perspective.

1 Debt-raising

The first source of external finance available to social enterprises is the debt market. Debt-raising describes the ability of companies to borrow money in exchange for a promise to repay the principal amount borrowed with interest.[65] Banks perform an important "project selection and monitoring function" where they assess the probability of the proposed social enterprise venture succeeding and, therefore, whether the borrower will have the ability to repay.[66]

Given that social enterprise exists in an ambiguous blend between non-profit and for-profit, their unique structures limit their ability to access the debt-funding arrangements required to scale-up.[67] The double-bottom line of social enterprises raises lending red-flags; their social purpose has the potential to compromise their profit-maximising prospects without a 'sound' business model. According to Eat My Lunch (with a revenue of 4.5 million in 2018), "'[t]he bank manager said to us there's no way you're going to make money by giving away free stuff, so they didn't give us a loan, so we actually started with business without any external funds'".[68] Furthermore, where a social enterprise is in the fledgling stage of its business growth, it will be risky and difficult for social enterprises to service their debt. Without sufficient personal security to guarantee loan repayments, social entrepreneurs are blocked from using debt-funding to secure the capital required to scale-up their businesses.[69]

2 Equity-raising

Given that debt-raising carries limitations and risky repayment obligations for burgeoning social enterprises, founders may seek out equity-raising as an alternative. Equity or share raising denotes investors contributing a portion of the company's capital in return for a company shareholding.[70]

[65] Ferran and Ho, above n 63, at 31.
[66] At 29 (emphasis removed).
[67] Horan and others, above n 31, at 5.
[68] At 21.
[69] At 21.
[70] Ferran and Ho, above n 63, at 43.

A share is "intangible personal property" that can be described as "a bundle of rights [or] liabilities that the holder of the share enjoys or bears in relation to the company".[71] Ordinary shares, as defined in the Companies Act, provide shareholders with an equal right to vote on resolutions and an equal portion of the company dividends.[72] Unlike debt-raising, issuing shares does not come with a corresponding *obligation* to distribute dividends. Rather, dividends are issued in a contingent fashion, where the company makes enough profit.[73] As such, shares are "risk capital"; they either expose an investor to financial gain or loss depending on whether the venture succeeds or fails.[74] Both publicly listed and privately held companies can issue shares,[75] but public listing, such as on the New Zealand Stock Exchange (NZX), offers companies a much greater capacity to raise capital.

Despite the potential equity-raising provides founders to raise large amounts of capital without corresponding payment obligations, engaging with the equity market exposes social enterprises to trust specific vulnerabilities. According to Robson, "socially conscious companies proceed at their own risk"[76] as issuing shares creates two vulnerabilities for social enterprises in New Zealand: 1) the risk of takeover for publicly listed companies; and 2) the risk that more diverse share ownership and corresponding divergent shareholder interests create mission-drift away from a social enterprise's altruistic purpose.

(a) Dispersed share ownership

The mere act of issuing shares creates control rights challenges for both private and public social enterprise companies. This paper has already illustrated that shareholders with ordinary shares possess meaningful controls over a company's management decisions,[77]

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[71] Watts, Campbell and Hare, above n 28, at 144.

[72] At 143. These rights can be modified by the constitution of the company: see Companies Act, s 36.

[73] Ferran and Ho, above n 63, at 31.

[74] Watts, Campbell and Hare, above n 28, at 130.

[75] Private shares issues are permitted so long as they comply with the sch 1 exemption requirements in the Financial Markets Conduct Act 2013.

[76] Robson, above n 15, at 519.

[77] Watson and Taylor, above n 27, at 56.

such as the ability of ordinary shareholders to vote on important business decisions through ordinary or special resolutions. Where ordinary shares have become dispersed, or where the founder no longer has a majority controlling shareholding, it may become difficult for the founder/director to secure majority approval for significant managerial decisions. In other words, reducing the founder's equity stake by issuing shares also reduces the representation and control they have over governance.[78] At this point the risk of dis-consonance is introduced. According to Dana Brakman Reiser:[79]

> Asking shareholders to police a balance between profit and mission may not be as much of an invitation to disaster as putting foxes in charge of henhouses, but neither is it sustainable. So long as shareholders differ in the degree of their commitment to preserving a social enterprise's mission, a loose thread will cause a for-profit's commitment to mission to unravel.

Although engaged investors are likely to be made aware of a social enterprise's social purpose in a shareholding agreement or company constitution, they may have "widely divergent" perspectives on how to achieve the company's respective missions, while ultimately expecting financial gains.[80]

(b) Takeovers for public companies

Alongside general control distribution, issuing listed shares to the public invites the more extreme risk of a social enterprise being exposed to takeover: an outside shareholder may attain a controlling shareholding in the social enterprise and the ability to reconstitute the board of directors.[81] Takeovers occur where a bidding company seeks to acquire a controlling interest in another publicly listed company, the 'target company', in order to

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[78] Horan and others, above n 31, at 6.

[79] Brackman Reiser "Social Enterprise Exits", above n 7, at 23.

[80] Stephen M Bainbridge "Director Versus Shareholder Primacy: New Zealand and the USA Compared" [2014] NZLR at 567.

[81] Companies Act, s 153(2).

ultimately control the target company's governance.[82] Where the cultures of the two companies clash, for example, where one company has a profit-maximisation bottom line and the other pursues a dual purpose of social good, a takeover can create 'negative synergy' and a realignment of the social enterprise's mission.[83]

In the social enterprise context, the Ben & Jerry's sale to Unilever is an oft-used example to scaremonger founders who wish to publicly list their companies in the United States. It can also provide an illustrative example of the risks of public listing for social enterprises in Aotearoa. In Delaware law, where a company is forced to sell, *Revlon* duties require the directors to prioritise shareholder wealth-maximisation.[84] Although originally a booming business, Ben & Jerry's began failing to deliver returns to shareholders.[85] According to the founders: "we did not want to sell the business … But we were a public company, and the board of directors' primary responsibility is the *interest of shareholders* … We didn't want to get bought by anybody."[86] The founders believed that the fragility of social enterprise and duties to shareholders imposed by *Revlon* relegated their social purpose to pursue profit maximisation.[87] Without making shareholders their priority, the founders felt "… vulnerable to stockholder lawsuits and hostile takeovers."[88]

Nevertheless, some literature has stressed that corporate law already afforded Ben & Jerry's adequate protection. Director primacy in the United States allowed the founders to wield takeover defences to elevate the power of the board and dissuade a takeover or merger where the defence used was "not draconian and 'within a range of

[82] Fletcher Boswell "Regulating the Regulators: A Comparative Analysis of Takeover Law" (LLB(Hons) Dissertation, Victoria University of Wellington, 2018) at 5.
[83] At 8.
[84] Antony Page and Robert A Katz "Freezing out Ben & Jerry: Corporate Law and the Sale of a Social Enterprise Icon" (2010) 35 VT L REV 211 at 236.
[85] At 225.
[86] At 229 (emphasis added).
[87] At 231.
[88] Ted Wachtel "Ben & Jerry's Ice Cream: To 'B' or not to 'B'" (16 September 2016) HuffPost <www.huffpost.com>.

reasonableness'".[89] It was a lack of trust in corporate law, not shareholder primacy, that induced the Ben & Jerry's sale. In fact, the company had a poison pill (that would devalue shares) and a staggered board (undermining effective governance control by limiting board appointments) that provided "significant protection" for their social mission.[90] More surprisingly, *Revlon* duties were not triggerable in the state of Vermont where Ben & Jerry's was incorporated. As such, the sale "starkly illustrates the gap between the perception and reality of the relationship between social enterprise and the law."[91]

Although advocates of hybrid social enterprise organisation structures siren the risk of takeover and loss of control over a company's mission, Unilever appears to have somewhat protected the Ben & Jerry's brand. In 2012, Unilever certified Ben & Jerry's through B-Lab, a non-profit organisation that certifies companies based on their social Impact Assessments.[92] They also maintained a unique partially independent board structure (composed of many of the previous board members) to maintain the integrity of Ben & Jerry's social mission.[93] It follows that even if the Ben & Jerry's sale is an exhibition of the risk of takeover, it can hardly be used as an example of total mission-shift.

However, in the New Zealand context, unlike the United States, the status of corporate law arguably makes social enterprises more vulnerable to takeover following a public listing; directors have less discretion to enact takeover defences than their counterparts in the United States.[94] Combining the complementary regimes of the Takeovers Code (the Code) in the Takeovers Act 1993 and the Companies Act s 133 proper purpose duty, a director may act in the "best interests of the company" to preserve their social enterprise's mission, but may breach both/either the Code and s 133 in the process.

[89] J Haskell Murray "Defending Patagonia: Mergers and Acquisitions with Benefit Corporations" (2013) 9 Hastings Business Law Journal 485 at 490, citing Unocal Corp v Mesa Petroleum Corp 493 A2d 946 (Del 1985); and Brackman Reiser, above n 7, at 14–15.

[90] Page and Katz, above n 84, at 234; and Haskell Murray, above n 89, at 503.

[91] Brackman Reiser, above n 7 at 153.

[92] Wachtel, above n 88.

[93] Page and Katz, above n 84, at 227; and see generally "About B Lab" B Lab <www.bcorporation.net>.

[94] Nico Just "A Comparative Study Between Australia, New Zealand and USA Concerning Directors' Duties When Issuing Shares as a Takeover Strategy" (2006) 3 NZPGLeJ 1 at 25.

The Code favours shareholder primacy by ensuring that when takeovers ensue, shareholders are given the opportunity to consider and offer.[95] As such, the code prohibits the use of takeover defences, like poison pills and staggered boards, once a takeover bid has been made if their use would result in "an offer being frustrated; or the holders of equity securities of the code company being denied an opportunity to decide on the merits of the offer."[96] According to the Code and accompanying guidance note, a social enterprise director faced with a takeover is limited to dissuading shareholders from accepting the takeover offer (by issuing a publicised response to the offer), or providing them alternative offers in conjunction.[97]

While the position of the Takeover Regulations seems clear, it sits alongside and preserves the duties in the Companies Act. As a result, interpretation of the directors' s 133 "proper purpose" duty by the English, Australian and New Zealand courts has muddied the position on using takeover defences. In the United Kingdom Privy Council case *Howard Smith Ltd v Ampol Petroleum Ltd*, the Board's action to devalue the shares held by a majority bidding company was held to be an exercise of power for an improper purpose. Although directors are authorised to distribute shares:[98]

> … the directors' power under this Article is a fiduciary power: and it remains the case that an exercise of such a power though formally valid, may be attacked on the ground that it was not exercised for the purpose for which it was granted.

Assessing the legal scope of the power and its limits (issuing shares) against the "substantial purpose" for which it was used in fact,[99] their Lordships concluded that "… an issue of shares purely for the purpose of creating voting power has repeatedly been

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[95] At 13.

[96] At 25; and Takeovers Regulations 2000, r 38.

[97] Takeovers Regulations, r 39; and Takeovers Panel "Defensive Tactics" (9 September 2019) Guidance Notes <www.takeovers.govt.nz> at [2.4]–[2.6].

[98] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] UKPC 3 at 6.

[99] Just, above n 94, at 7, citing *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 835.

condemned …".[100] The High Court of Australia in *Harlowe's Nominees Pty Ltd v Woodside (Lake Entrance) Oil Co NL* adopted a similar view.[101] According to the Court in that case, issuing shares to dilute a majority shareholding is an improper exercise of power: directors are appointed by the majority and diluting a shareholding to maintain the director's control is an abuse of power.[102] This complements the Takeovers Panel guidance that "undertaking material issues of new shares …" would constitute a prohibited defensive tactic.[103]

Nevertheless, Prichard J in the New Zealand High Court case, *Baigent v D McL Wallace Ltd*, took a broader interpretation of the proper purpose duty which seems to allow other defensive measures. His honour was reluctant to extend the restrictive ratio of *Howard Smith Ltd v Ampol Petroleum Ltd* "outside the sphere of share issues, particularly in the takeover context."[104] In *Baigent*, where the defendants sold a company asset to frustrate a takeover, the Court found that "absent a personal conflict, it would be very rare for the sale of a company asset to be an abuse of power."[105] As such, the s 133 proper purpose duty could be interpreted to allow the sale of a major asset (crown jewel) to devalue a target company, in conflict with the Takeover Code.[106]

The limited number of cases applying the proper purpose duty to the takeover context makes the New Zealand position complicated and unclear.[107] However, it appears that even where a social enterprise director aims to act in the best interests of the company (protecting social mission) by thwarting a takeover offer, they will likely breach the Takeovers Code

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[100] Just, above n 94, at 8.

[101] *Harlowe's Nominees Pty Ltd v Woodside (Lake Entrance) Oil Co NL* [1968] HCA 37.

[102] Just, above n 94, at 10, citing *Harlowe's Nominees Pty Ltd v Woodside (Lake Entrance) Oil Co NL* (1968) 121 CLR 483 at 493.

[103] Takeovers Panel, above n 97, at [2.2].

[104] Just, above n 94, at 25.

[105] James Donovan "Deal Protection in Takeovers: A New Zealand Perspective" (2008) 5 AuckULRev 115 at 135.

[106] Takeovers Panel, above n 97, at [2.2].

[107] Donovan, above n 105, at 17.

and potentially the s 133 proper purpose duty. This makes corporate takeovers a vulnerability for social enterprises that may choose to publicly list in Aotearoa.

Canvassing these general and specific vulnerabilities associated with raising equity highlights the importance of maintaining control over governance as it has the profound ability to influence the entire company operation.[108] A conscientious social enterprise founder will be wary of diminishing their own equity stake to a point that relinquishes majority control if they intend to strongly pursue their social mission. The discussion of takeovers illustrates that reactive measures enacted to control governance may be at risk of legal challenge. As such, maintaining control is one essential mechanism for preserving the mission of social enterprises that work within the ambiguous third sector.

With these problems in mind, the following parts of this paper will examine whether existing corporate law provides adequate proactive strategies to help ensure mission stickiness for social enterprises when raising capital, or whether the answer lies in an alternative organisational structure.

IV Upholding the Double Bottom-Line: Limiting Ownership

Although social enterprise founders are likely to be controlling shareholders at the point of company incorporation, founders encounter the problem of maintaining control over governance and, therefore, social mission when attempting to raise share capital. This is especially so where the founder lacks sufficient personal equity to maintain a controlling shareholding. This paper suggests that social enterprise founders can maintain their social missions by following the example set by United States corporations, by concentrating ownership with company insiders.[109] Concentrating ownership allows social enterprise founders to engage with the equity market while avoiding the share distribution and takeover vulnerabilities described in Part III above.

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[108] Boswell, above n 82, at 5.

[109] Zohar Goshen and Assaf Hamdani "Majority Control and Minority Protection" in Jeffrey N Gordon and Wolf-Georg Ringe (eds) *The Oxford Handbook of Corporate Law and Governance* (online ed, Oxford University Press, Oxford, 2015) at 449.

A Concentrating Control and Signalling Trust

Enacting a strategy of concentrating control through limiting ownership involves altering the default share classification. The Companies Act s 36 "one share one vote" default gives shareholders voting rights on shareholder resolutions.[110] Nevertheless, s 37 permits companies to tailor the bundle of rights attached to shares through a company constitution, including the ability to create different share *classes.*[111]

Similar to some state statutes in the United States, the permissive nature of the ss 36 and 37 default rules in the Companies Act and NZX listing requirements[112] enable social enterprise founders to concentrate governance control without needing to hold a significant equity stake in the company.[113] In essence, they can further separate control from shareholder equity ownership.[114] Founders can engage in a strategy of limiting outsider ownership through dual-class shares: lower-value non-voting shares are offered to public investors and high-value voting shares remain with insiders.[115] Only the company insiders with voting rights participate in resolutions that exercise control over management decisions, which lessens the risk that "shareholders differ in the degree of their commitment to preserving a social enterprise's mission".[116]

Alongside ameliorating the general vulnerabilities of dispersed share ownership, issuing non-voting shares can protect a publicly listed social enterprise from unwanted takeovers. For the purposes of the Takeover Code, ordinary voting shares are those that count where "the number of shareholders a company has … is the number of shareholders that hold *voting* shares."[117] As such, non-voting shares can act as a preventative rather than

[110] Alessio Pacces *Rethinking Corporate Governance: The Law and Economics of Control Powers* (Routledge, New York, 2012) at 36.

[111] Shaun Martin and Frank Partnoy "Encumbered Shares" (2005) 3 U Ill L Rev 775 at 787, n 61.

[112] Compare the United Kingdom position: see Dorothy S Lund "Nonvoting Shares and Efficient Corporate Governance" (2019) 71 Stan L Rev 687 at 693.

[113] Minter Ellison Rudd Watts *IBA Guide on Shareholders' Agreements New Zealand* <www.ibanet.org>.

[114] Pacces, above n 110, at 88.

[115] Martin and Partnoy, above n 111, at 691.

[116] Brackman Reiser "Social Enterprise Exits", above n 7, at 23.

[117] Companies Act, s 199(1) (emphasis added); and Loyd Kavanagh "New Zealand: The Equity Crowdfunding Revolution" (11 October 2017) Minter Ellison Rudd Watts <www.minterellison.co.nz>.

'defensive tactic' that prevents a potential bidding company acquiring a controlling interest.

Applying this strategy in practice gives *founders* confidence that a social enterprise's social mission will be protected but may create an *investor* perception of complexity – financial risk and dis-consonance.[118] In this sense, non-voting shares may act as a social enterprise's double-edged sword; better maintaining social mission in practice but creating a perception of untrustworthiness.

Investors are well-versed with the propensity of "tech giants", like Facebook and Google, to use dual class share structures in their public offerings to disenfranchise outside shareholders.[119] The series of "missteps" made by Mark Zuckerberg as CEO and Chairman of Facebook makes the argument more convincing that a morphed capital structure of a company, with outside investors holding the greatest equity stake, should be mirrored in governance control. In 2019, 68 per cent of outside shareholders in Facebook voted to separate the roles of CEO and Chairman, both of which Mark Zuckerberg held, following a significant security breach.[120] As Zuckerberg controlled 58 per cent of the vote at the time through Facebook's dual class share structure, the founder was able to "strong arm investors" and prevent the attack against his position of control.[121]

The United States Securities and Exchange Commission and the United Kingdom investment sector emphasise the dislike and distrust of dual class structures. Both have disparaged dual class shares, believing that they increase "agency costs" or create the potential for "suboptimal decision[-]making" to the detriment of shareholder rights.[122] According to agency theory, the "checks and balances in hierarchical organisations in

[118] Emilie Aguirre "Beyond Profit" (2020–2021) 54 UC Davis L Rev 2077 at 2131.

[119] Brad Stone "Facebook Will Form 2 Classes of Stock" *The New York Times* (online ed, 25 November 2009) <www.nytimes.com>.

[120] Betsy Atkins "Facebook Strong Arms Investors Who Want Zuckerberg Out (7 June 2019) Forbes <www.forbes.com>.

[121] Atkins, above n 120.

[122] Lund, above n 112, at 693.

which empowerment flows through the board of directors to management and eventually to staff" are designed to reduce agency costs and problems, "notably those that arise between self-interested management and passive investors."[123] By giving the board control of the company's daily operations and strategic direction, directors are better able to respond to the market and grow the business.[124] Nevertheless, outside investors have very limited ability to correct management decisions.[125] Allowing company insiders, like Zuckerberg, concentrated governance control without their having an accompanying stake in equity increases the risk that directors will pursue their own interests or otherwise "misbehave".[126]

The success of large public companies, such as Facebook, indicates that directors can feel confident that the non-voting shares they issue will still be desired. Nevertheless, the discussion above illustrates that a social enterprise's use of dual class share structures may discourage benevolent members of the public from investing. With a lower chance of return and looser grip over management, investors may mistrust social enterprises issuing dual class shares, even though this action is taken to protect social mission.[127]

Nevertheless, the author suggests that the mistrust in social enterprises' use of non-voting shares is perceived rather than actual. In Aotearoa, four self-titled social enterprises have successfully raised equity on the crowdfunding platform, Pledge Me, while predominantly offering non-voting shares to the public. The average pledge amount from each social enterprise investor (between $715–$2,324) sat well below the level required to secure voting shares (between $25,0000–$35,000).[128] This sample suggests that the agency and

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[123] Fenwick and others, above n 41, at 68.

[124] Kosmas Papadopoulos "Dual-Class Shares: Governance Risks and Company Performance" (28 June 2019) Harvard Law School Forum on Corporate Governance <https://corpgov.law.harvard.edu>.

[125] Lund, above n 112, at 693; Aguirre, above n 118, at 2131.

[126] Lund, above n 112, at 693.

[127] Tim Human "The debate over dual-class shares in the UK" *IR Magazine* (online ed, 15 June 2021) <www.irmagazine.com>.

[128] These figures were taken from the crowdfunding Pledge Me pages and Information Memorandums of the following social enterprises: Again & Again, Downlights Ltd, Eat my Lunch and Little Yellow Bird. Each of these companies surpassed their minimum crowdfunding amounts. Pledge Me does not reveal how much each investor pledges in a campaign, so the average investment amount was calculated by dividing the

dis-consonance concerns associated with non-voting shares is unlikely to significantly compromise the ability of an equity-raising social enterprise to signal trustworthiness.

B Effective Capital Raising through Public Offers?

To be sure, non-voting shares can allow a social enterprise founder to access the equity market while maintaining a firm grip on control over governance. While the dis-consonance concerns associated with non-voting shares may be perceived rather than actual, this class of shares may nevertheless be considered less valuable to traditional investors. Steadman argues that traditional investors, such as venture capital firms, are unlikely to find non-voting shares valuable enough to acquire,[129] as "corporate control has a value which can later be onsold."[130] Various international studies have found that voting shares are valued 10 to 20 per cent higher than non-voting shares.[131] The primary reason for this differential is that voting rights enable shareholders to influence management decisions that "increase the value of cash flows" or that "'improve the performance of the corporation'".[132] This value of control thesis was upheld by the Privy Council in *Holt v Holt* where the Court found that "control must have a very substantial value."[133] Additionally, Colin Meyer suggests that the "market for corporate control" has grown over the last 60 years – through takeovers and hedge fund activism (where hedge funds buy blocks of shares to exert control over company direction).[134]

capital raised for each company by the number of pledges made to their campaign. See "Browse Campaigns" Pledge Me <www.pledgeme.co.nz>.

[129] The United States and United Kingdom are considering regulations that allow for dual class share offerings while balancing controller and outside shareholder rights: see generally Charles W Steadman "Maintaining Control of Close Corporations" (1959) 14 Bus Law 1077.

[130] Pacces, above n 110, at 94.

[131] Luigi Zingales "The Value of the Voting Right: A Study of the Milan Stock Exchange Experience" (1994) 7 The Review of Financial Studies 125 at 125; and Shmuel Hauser "The Value of Voting Rights to Majority Shareholders: Evidence from Dual-Class Stock Unifications" (2004) 17 The Review of Financial Studies 1167 at 1167.

[132] Roger M Kunz and James J Angel "Factors Affecting the Value of the Stock Voting Right: Evidence from the Swiss Equity Market" (1996) 25 Financial Management 7 at 8–9.

[133] *Holt v Holt* [1987] 1 NZLR 85 (PC) at 89.

[134] Meyer, above n 17, at 893.

If the value of voting rights derives from their ability to exercise control and influence, the non-voting and voting share value differential is mediated by the dominant market of passive investors rarely exercising their voting rights.[135] This international trend also seems to hold true in New Zealand. Although some commentators suggest that shareholder activism may be on the rise, the existing market of passive superannuation institutional investors persists where funds are "more likely to abstain than be seen to support an activist in any proxy campaign."[136] Even platforms for retail investors, such as Sharesies, place caveats on control: retail investors are beneficial owners, but a nominee company holds the shares and voting rights in their name.[137]

Although social enterprise investors may seek to exercise voting rights more than traditional investors, the success of crowdfunding social enterprises discussed in the above section suggests that benevolent investors still consider that non-voting shares are valuable. The desire to support an altruistic business and the promise that their non-voting shares maintain an equal portion of dividends may hearten benevolent retail investors that their contributions are still worth it.[138]

Notwithstanding the fact that issuing non-voting shares can source capital contributions for social enterprises seeking to control their mission, the relatively small scale of these enterprises limits their access to equity in practice. Large companies (generally those with more than 100 employees) can secure wider capital-raising opportunities through public listing. However, the NZD 10 million market capitalisation requirement restricts small to medium (0–50 employees) social enterprises from public listing.[139] Furthermore, public listing comes with significant regulatory compliance costs from the Financial Markets Conduct Act and the NZX Listing Rules. As an illustrative example, when Xero released

[135] Martin and Partnoy, above n 111, at 784.

[136] See David Raudkivi "Shareholder Activism & Engagement in New Zealand" (5 June 2019) Lexology <www.lexology.com>.

[137] Catherine Harris "Shareholder activism tipped to rise, even though some small-timers can't vote" (15 February 2021) Stuff <www.stuff.co.nz>.

[138] Hauser, above n 131, at 1169.

[139] NZX "Listing Requirements: What companies qualify to list on NZX?" <www.nzx.com>.

its Initial Public Offering (IPO) in 2007 to raise NZD15,000,000 for expansion, the company suffered NZD1,100,000 "in listing costs; including brokerage fees, share registry expenses, legal fees, investment advisory fees, accounting fees, advertisement costs and printing and distribution costs."[140] For start-up social enterprises, the listing and financial reporting compliance costs dwarf the capital-raising potential of public listing and have likely contributed to the absence of NZX listed social enterprises.[141] As such, social enterprises seeking to scale-up fall into a funding gap; where founders can no longer contribute personal equity or seek it from family members are largely blocked from debt-raising and similarly discouraged or unable to access public listing. Although an impasse may appear to exist, social enterprise founders can still successfully pursue a strategy of limiting ownership through alternate private equity-raising avenues, such as equity crowdfunding.

C Equity Crowdfunding: Filling the Funding Gap

The equity crowdfunding space is a relatively new avenue for unlisted companies to offer shares to the public. The available literature praises the self-regulatory system adopted in Aotearoa that better enables small to medium enterprises to fill their funding gaps.[142]

Equity crowdfunding raises capital by issuing "unlisted equity shares" to public retail investors.[143] The Financial Markets Conduct Regulations 2014 (FMC Regulations), which is overseen by the Financial Markets Authority (FMA), authorised the use of equity crowdfunding in Aotearoa with the view that New Zealand "needed more high-growth, innovative businesses to increase economic growth" and a key means of doing so was to

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[140] Jonathan William Stuart "Equity Crowdfunding in New Zealand: Reviewing the Investment Cap" (LLB (Hons) Dissertation, Victoria University of Wellington, 2018) at 25.

[141] At 26. To peruse the NZX listings, visit "NZX Main Board (NZSX)" NZX <www.NZX.com>.

[142] See generally Henry William Hillind "Exploiting the Crowd: The New Zealand Response to Equity Crowdfunding" (LLB(Hons) Dissertation, Victoria University of Wellington, 2014); Steve Kourabas and Ian Ramsay "Equity Crowdfunding in Australia and New Zealand" (2018) 29 International Company and Commercial Law Review 571; and Andrew A Schwartz "Social Enterprise Crowdfunding in New Zealand" in Benjamin Means and Joseph W Yockey *The Cambridge Handbook of Social Enterprise Law* (Cambridge University Press, Cambridge, 2018) 209.

[143] Hillind, above n 142, at 2; and Jeremy Muir "Equity Crowdfunding" Lexis Guidance.

give them access to "sufficient risk capital."[144] Usually, public offerings must comply with the FMC Regulations, like fulsome disclosure statements, in order to protect retail investors without institutional investment knowledge. However, these disclosure requirements can be costly and onerous for small enterprises. Balancing the capital-raising needs of businesses with the desire to protect retail investors from losing their life savings has meant that exceptions to these onerous disclosure requirements are typically restricted to sch 1 of the Act: where the investor has enough institutional knowledge to "protect themselves" (for example, venture capital firms), where there are "inherent restraints on an issuer of a social or business kind", or readily accessible information about the securities is available.[145] As equity crowdfunding employs crowdfunding platforms to act as 'gate keepers' of crowdfunding companies, "those individuals who participate in equity crowdfunding have … created their own class of investor … [that] warrants exemption" from the FMC Regulations.[146] As such, equity crowdfunding falls within the sch 1, cl 6 disclosure exception: "exclusion for offers through licensed intermediaries".[147]

The self-regulation associated with crowdfunding creates a handful of significant benefits for crowdfunding companies. Most importantly, any type of company can engage and there are less disclosure requirements than traditional public offerings (the regulations only require a warning statement and compliance with regulations preventing misleading or deceptive conduct).[148] Although there are no caps on how much an investor can invest in a crowdfunding company (unlike the United States JOBS Act),[149] retail investors are protected by the following two restrictions: the capital-raising company must use a platform licenced by the Financial Markets Conduct Act (which performs its gate-keeping

[144] Kourabas and Ramsay, above n 142, at 576; See Ministry of Business, Innovation and Employment *Business Growth Agenda: Future Direction 2014* (June 2014) at 33; and Elizabeth Prudence Christmas "Playing to the Crowd? A Critical Analysis of Equity Crowdfunding in the Financial Markets Conduct Act 2013" (LLB (Hons) Dissertation, Otago University, 9 October 2015) at 32.

[145] Christmas, above n 144, at 33.

[146] At 36.

[147] Financial Markets Conduct Act 2013, sch 1, cl 6.

[148] Muir, above n 143.

[149] Schwartz, above n 142, at 213.

function),[150] and unlisted share offers are limited to a maximum of $2 million in one year for each capital-raising company.[151] Attempting to embolden the blossoming start-up sector, this approach recognises the fact that unlike larger offers, small offers made to the public "are not posing a great risk to the economy"[152] and reducing the compliance costs companies must face to raise capital "reflects a more modern, forward thinking understanding of securities law".[153] Essentially, loosening unnecessary compliance standards incentivises entrepreneurship and catalyses the growth of the start-up sector.[154]

The efficacy of equity crowdfunding to successfully implement a strategy of limiting ownership is analysed below. This paper finds that despite the ability of crowdfunding to partially plug a financing gap for social enterprises, crowdfunding's capital-raising potential is somewhat limited by the current annual investment cap: it restricts the scale-up potential of social enterprises using crowdfunding alone; and it limits the ability of crowdfunding to act as a stepping-stone to public listing.

1 Signalling trust and maintaining mission through crowdfunding

Like public listings, social enterprises and other start-ups have used equity crowdfunding platforms to issue non-voting shares and enact a strategy of raising capital by limiting ownership to protect their missions.[155] In the New Zealand context, the social enterprise Eat My Lunch recognised the advantage of involving the general public in their venture and enacted a campaign that raised $807,093 on Pledgeme (their minimum target was $675,000).[156] The campaign's Information Memorandum clearly detailed the Eat My Lunch business model, particulars of the scale-up, and share offer breakdown. Specifically, each minimum investment of $500 would issue non-voting shares in return.[157]

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[150] Muir, above n 143.

[151] Muir, above n 143; and Schwartz, above n 142, at 212.

[152] Jonathan A Ande and Zehra G Kavame Eroglu "Could New Zealand's Equity Crowdfunding Regulations be the Model for the Developing World" (2021) 29 NZULR 557 at 566.

[153] Christmas, above n 144, at 34.

[154] At 34.

[155] Muir, above n 143.

[156] See "Eat My Lunch" Pledgeme <www.pledgeme.co.nz>.

[157] Eat My Lunch *Be Part of the Solution: An Investment with Purpose* (Information Memorandum, 2019) at 23.

The previous section described the risk of investors perceiving a company's dual class structures as risk-laden: raising fears of agency costs. Unlike public listing, crowdfunding's history and 'brand' may act as a 'focal point' that legitimises the strategy of limiting ownership and encourages public investors to 'pursue the stag' alongside social enterprise founders. Originating as a movement to support the projects of artists and musicians, crowdfunding was co-opted by entrepreneurs seeking to make their idiosyncratic visions a reality by connecting with the public.[158] In this sense, equity crowdfunding 'democratises investing'[159] – crowdfunding platforms provide a space for involving the community in an enterprise that determines to deliver impact to the community and society generally. Directly linking the success of a company's social purposes with community input distinguishes organisations that use crowdfunding from those that pursue traditional forms of financing. Crowdfunding businesses are commended for their social and environmental purposes, despite their immediate goal to raise capital. Aware of crowdfunding's potential to connect community and crowdfunder, the Eat My Lunch Pledgeme information memorandum states:[160]

> *With your help*, we've been able to have an impact on thousands of kids … there is still a long way to go. To reach even more kiwi kids in need, we need to scale.

As highlighted in the Eat my Lunch Memorandum, crowdfunding platforms, such as Pledgeme and The Snowball Effect, enhance public trust in crowdfunding companies by creating a positive synergy where "the interests of the platform, issuer and investor align."[161] Specifically, the gate-keeping platforms directly supervise and manage crowdfunding companies and issue simple disclosure statements about the risk of

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[158] Kelly Yamashita "The Evolution of Crowdfunding" *Jumpstart Magazine* (online ed, 21 April 2019) <www.jumpstartmag.com>.

[159] Othmar N Lehner and Alex Nicholls "Social finance and crowdfunding for social enterprises: a public-private case study providing legitimacy and leverage" (2014) 16 Venture Capital 271 at 275.

[160] Eat My Lunch, above n 157, at 2 (emphasis added).

[161] Christmas, above n 144, at 47.

investing.[162] The public is satisfied that only companies with the most "integrity" and "high-growth potential" are hosted.[163] Through self-regulation, investors can concentrate on a company's social goals and values "and thus its legitimacy"[164] or ability to stick to its social mission.[165] By engaging the crowd, as opposed to entering the traditional domain of profit-maximising companies (ie, public listing), this existing corporate law mechanism indicates to public investors that crowdfunding social enterprises plan to hold fast to their social missions. Issuing non-voting shares allows founders to do so in practice.

2 Does crowdfunding adequately plug the funding gap?

Equity crowdfunding not only democratises access to investment but also democratises access to capital. In other words, crowdfunding expands capital-raising potential by theoretically allowing any passionate entrepreneur to break into the equity market.[166] This effect is reflected in purposes of the Financial Markets Conduct Act. According to ss 3 and 4, the Act not only aims to promote the interests of consumers but to "promote the confident and informed participation of businesses, investors and consumers in the financial markets"[167] and "to promote innovation and flexibility in the financial markets".[168]

Despite this apparent duality of purposes, the Act's protection mechanisms used to promote the interests of retail investors somewhat limit the capital-raising potential of companies; namely, the high standards of crowdfunding customers and platforms and the $2 million annual investment cap. Not all companies seeking to make use of crowdfunding will do so

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[162] Ande and Eroglu, above n 152, at 561 and 565.

[163] At 561, fn 15.

[164] Stefano Cosma and others "Is Equity Crowdfunding a Good Tool for Social Enterprise?" in Mario La Torre and Helen Chiappini (eds) *Socially Responsible Investments: The Crossroads Between Institutional and Retail Investors* (online ed, Palgrave Pivot, 2019) 149 at 156.

[165] Lars Hornuf, Tobias Schilling and Armin Schwienbacker *Are Equity Crowdfunding Investors Active Investors?* (Max Planck Institute for Innovation and Competition Research Paper No 19–15, Working Paper No 7884, 2019) at 24.

[166] Karen Kerrigan "Understanding the Crowd" in Stephen Dresner (ed) *Crowdfunding: A Guide to Raising Capital on the Internet* (John Wiley & Sons, New York, 2014) 15 at 17.

[167] Financial Markets Conduct Act, s 3(a).

[168] Section 4(d). See also Trish Keeper (ed) "A critical examination of crowdfunding within the 'Long White Cloud' (New Zealand)" in *Global Capital Markets* (online ed, Edward Elgar Publishing, 2017) <www.elgaronline.com> 199 at 204.

successfully. In Aotearoa, the vigorous gatekeeping of crowdfunding platforms presents a significant obstacle which, like public listing, may undermine social enterprises accessing private share equity. To illustrate, Snowball Effect requires social enterprises to provide documents detailing:[169]

- why a company is seeking to raise capital;
- the "experience and qualifications of directors";
- "the company's growth strategy";
- "information on how the capital raised would be spent";
- "the price of its shares and the type of shares on offer";
- "the amount of targeted capital";
- "the company's shareholder structure prior to the offer"; and
- "its key risks and mitigations and future transactions that could affect the company".

Moreover, even if a social enterprise can surmount the platform gatekeepers, Kerrigan opines that the "'wisdom of the crowd' will effectively select, vet, and invest in quality entrepreneur's ideas", so a social enterprise founder must exceed the high expectations of retail investors with a prepared and viable business case.[170] Essentially, the rigorous vetting and selecting conducted by crowdfunding platforms and investors necessarily counterbalances the "liberal" FMA Regulations. But preventing a "race to the bottom"[171] may limit the number of social enterprises that can use the platforms to fill their funding gaps.

Further protecting public investors if a crowdfunding business fails is the $2 million cap on capital-raising over a 12-month period.[172] Depending on the plans of the crowdfunding company, this small offering may not raise enough capital to successfully implement

[169] Ande and Eroglu, above n 152, at 578–579.
[170] Kerrigan, above n 166, at 18.
[171] Ande and Eroglu, above n 152, at 560.
[172] Christmas, above n 144, at 16; and Stuart, above n 140, at 15.

company scale-up. Snowball Effect noted that most organisations that approached its crowdfunding platform sought to raise between $2 million to $10 million.[173] A premises expansion is an illustrative example. The average square meter capital value of commercial office space in Aotearoa ranges between $8,725 (lowest) and $13,000 (highest).[174] If Eat my Lunch sought to buy its current commercial premises in both Wellington and Auckland in the present property market, it would require at least $6.41 million to cover the rateable value of its properties,[175] clearly outside the small offer $2 million limit per year.

Nevertheless, some small to medium-sized businesses have sought to navigate the $2 million capital-raising cap by completing multiple crowd raises or by seeking a combination of equity crowdfunding and parallel small offers. For example, Zeffer Cider combined a crowdfunding campaign and an offer from a wholesale investor to raise $3,424,400 in 2018.[176] Like crowdfunding through licensed intermediaries, privately offering shares to wholesale investors (an investment business, a person meeting the investment activity criteria, or a government agency)[177] garners exemption from the disclosure obligations under pt 3 of the Financial Markets Conduct Act.[178] Working around and with the cap to scale-up is possible: it may increase capital for public listing or give the enterprise more ability to secure debt. However, a reliance on filling the social enterprise funding gap with wholesale investors may be ill-advised. In a study of the New Zealand Venture Capital market, Kalidas and Kelly described the size of the sector as "immature" with a distinct lack of organisations able to invest in venture capital firms.[179] A lack of investment in venture capital results in limited funds for small enterprise in turn. Further increasing the difficulty of securing venture capital is the practice of fund managers

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[173] Josh Daniell "New Zealand's equity crowdfunding regulations – should we re-visit the $2m cap?" (4 May 2016) Snowball Effect <www.snowballeffect.co.nz>.

[174] See Colliers International New Zealand *New Zealand Office: 2019 Review & 2020 Forecast* (2019) at 2.

[175] Figures were estimated by searching the addresses of Eat my Lunch commercial premises on OneRoof "How much is your home worth?" <www.oneroof.co.nz>.

[176] Stuart, above n 140, at 21.

[177] Financial Markets Conduct Act shc 1, pt 1, cl 3(3).

[178] Schedule 1, pt 1, cl 3(1).

[179] Sujit Kalidas and Andrew Kelly "New Zealand venture capital funds and access to new financing: an exploratory study" (2014) 26 Pacific Accounting Review 196 at 205, 211 and 217.

to "screen hundreds of thousands of deals to find 15-20 'good' opportunities, and eventually invest in 8-10."[180] Given that the small enterprise market was projected to require $2 billion for growth between 2014–2024, the small scale and overly selective practices of the venture capital sector make reliance on wholesale investing nonviable for some small social enterprises.[181]

Social entrepreneurs, either blocked from accessing public listing (due to capital requirements) or avoiding the compliance costs of FMA Regulations, can access the equity market by making small public offers of non-voting shares. Some companies have very successfully used crowdfunding platforms for their respective scale-up goals given the perception that crowdfunding is a mechanism for altruistic businesses to seek capital. Nevertheless, the rigorous vetting conducted by crowdfunding platforms and the low cap on equity-raising imposed by Financial Conduct Markets Act sch 1 means that any scale-up will be relatively small. In its current regulated form, equity crowdfunding may only be a short-term solution for social enterprises seeking to walk the balance between maintaining mission and capital-raising by enacting a strategy of limiting ownership.

More fundamentally, one must also recognise the strategy's overall limitation: maintaining social mission by concentrating control depends on the benevolence of the social enterprise founders and insiders. As articulated by Brakman Reiser and Dean:[182]

> … [social enterprises] can insert protective language in organic documents. They can keep their entities small and allow only the like minded to invest. Indeed, a control position likely offers the best protection against suit or takeover by investors motivated purely by profit. For profit social enterprise founders cannot, however, protect their enterprises from the potential predation of their future selves.

[180] At 213.

[181] At 213.

[182] Brakman Reiser and Dean "Hunting the Stag with Fly Paper: A Hybrid Financial Instrument for Social Enterprise", above n 24, at 1506.

With this limitation in mind, Part V will examine whether organisational structure is a better, more durable focal point and mechanism for signalling and entrenching mission while social enterprises raise capital.

V Hybrid Structures Upholding the Double Bottom-Line?

To foster the development of this emerging third sector with "blended missions",[183] legislatures in the United States and the United Kingdom have developed hybrid organisational structures that aim to allow social entrepreneurs to pursue both social and profit-making purposes. Advocates of these hybrid forms argue that existing company law principles, such as shareholder primacy, prevent social enterprise founders from pursuing their dual missions while scaling up. In particular, where social enterprises do scale-up, concentrating control does not ensure "durable enforcement" of their social missions.[184] In other words, even if a social enterprise incorporates a social mission in their company constitution and issues non-voting shares to protect it, company law still maintains an "inability to reliably scale-up [, barring] companies with objectives beyond profit from substantial potential impact".[185]

Proponents of hybrids suggest that their novel organisational structures are not merely "'receptacles' of assets" but "legally constructed 'signals' that drive the strategic behavior of market participants".[186] As such, social entrepreneurs can encourage investors to pursue the 'stag', investing in socially minded business, as organisational structure is a much stronger focal point than dual class share structures. Accordingly, social enterprise hybrids bake the double bottom-line into organisational structure, entrenching the organisation's purposes through internal and/or external regulation.

Like the strategy of limiting ownership, the desirability of adopting hybrid organisational forms can be determined by examining their ability to expand financing options and

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[183] Dana Brakman Reiser "The Next Big Thing: Flexible Purpose Corporations" (2012) 2(1) Am U Bus L R 55 at 56.

[184] Aguirre, above n 118, at 2147.

[185] At 2148.

[186] Robson, above n 15, at 502.

maintain "credible commitments" to enforcement of social enterprise missions.[187] To do so, this paper will examine benefit corporations developed in the United States, and the United Kingdom's Community Interest Companies (CIC). Ultimately, while an organisation's legal structure can address the vulnerabilities of social enterprise when they attempt to scale-up, these forms have the unfavourable effect of trading social enterprise goals "off against each other."[188]

A Features of Benefit Corporations and CICs

Benefit corporations and CICs "promise to strike a permanent, comprehensive balance between profit and mission" that flexible company structures fail to lock in.[189] Social entrepreneurs may successfully insulate their companies from profit-seeking outside investors by steadfastly maintaining control, but they cannot "protect their enterprises from the potential predations of their future selves."[190]

Benefit corporations like Patagonia and Allbirds, not to be confused with traditional company structures certified by B-Lab,[191] have been adopted in 13 states of the United States.[192] Most benefit corporation legislation addresses four distinct areas: "(1) general provisions, (2) corporate purpose, (3) accountability, and (4) transparency."[193] Benefit corporations state the social enterprise social purpose in their incorporation documents: generation of "general public benefit" and other specific public benefits.[194] For example, Allbirds aims to deliver specific benefit to environmental conservation,[195] while Patagonia has selected six specific benefits to measure its impact against: to contribute one percent of annual net revenue to conservation charities; to design high quality products with minimal environmental impact; to conduct operations with minimal environmental impact;

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[187] Brakman Reiser "Governing and Financing Blended Enterprise", above n 61, at 619.
[188] At 620.
[189] Brakman Reiser and Dean, above n 24, at 1498 and 1505.
[190] At 1506; and Brakman Resier "Governing and Financing Blended Enterprise", above n 61, at 645.
[191] B Lab "About B Lab" <https://bcorporation.net>.
[192] Esposito, above n 14, at 695.
[193] At 697.
[194] At 698.
[195] Allbirds *2020 Sustainability Report* (2020) at 5.

to share best practice knowledge with other businesses; and to strive for company transparency.[196] This benefit segregation ensures that benefit corporations impact both the wider community and environment alongside a specific sector.[197] Consumers and investors can check the progress of these organisations against their stated benefits through third-party audited reports.[198]

Additionally, by requiring directors to assess both general and specific benefit, benefit corporation legislation appears to reject shareholder primacy and address the dis-consonance concerns associated with traditional company structures.[199] The directors of Allbirds or Patagonia retain their fiduciary duty to act in the best interests of the corporation, which must include an assessment of stakeholders' interests. Therefore, shareholder interests will not always rank ahead of social mission.[200] The organisational structure of benefit corporations comforts social entrepreneurs that they are shielded from shareholder derivative action where they decline to *prioritise* shareholder wealth maximisation.[201] Essentially, the form adds greater strength to the 'business judgement' rule. That being said, removing the shareholder wealth maximisation norm while increasing the range of mandatory company interests to consider may also undermine the ability to *enforce* the benefit corporation's social and environmental mission (part B will discuss this negative in more detail).[202]

The United Kingdom Parliament created the CIC through an amendment to the Companies Act 2004 (UK). Although CICs are relatively new, thousands of organisations have recognised their benefits and adopted their form.[203] However, unlike the well-known benefit corporations of the United States, such as Allbirds and Patagonia, most

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[196] See Patagonia Works *Annual Benefit Corporation Report: Fiscal Year 2019* (2019).

[197] Esposito, above n 14, at 697.

[198] Brakman Reiser and Dean, above n 24, at 1509.

[199] At 1510; and Plerhoples, above n 5, at 258.

[200] Jeremy Chen "What is a California Benefit Corporation" The Law Office of Jeremy Chen <www.jeremychenlaw.com>.

[201] DIA, above n 18, at 12.

[202] Plerhoples, above n 5, at 228.

[203] Esposito, above n 14, at 630.

organisations adopting the CIC form are community focused, true to the structure's name.[204] By maintaining the general structure of the limited liability company,[205] the "off-the-shelf" hybrid generates multiple benefits for social enterprises; most importantly, by ingraining a social purpose within the organisation.[206] The structure proposes to "improve access to finance, create a strong new brand, be legally protected from demutualisation, and preserve assets and profits solely for social purposes."[207] Incorporating as a CIC requires a social enterprise to register, like a traditional company, and satisfy the community interest test to gain their "community interest status" from the government Regulator.[208] A "reasonable person might consider [the social enterprise] activity [is] being carried on for the benefit of the community"[209] where the social enterprise places a cap on dividends or guarantees to reinvest profits.[210] It also requires the company directors to make annual community interest reports to the CIC Regulator who ensures that the CIC benefits are being spread wide enough throughout the community.[211]

B Do Hybrids Better Signal Trust and Maintain Social Mission?

Benefit corporations signal to investors and consumers that they will hold fast to their social missions by employing the benefit corporation brand, which creates a favourable public image for their businesses. By imposing legal structures on companies that mandate the pursuit of social purposes, benefit corporations "stand out" from the crowd by "showing a higher level of commitment to environmental or social responsibility."[212] Both proponents and critics alike have noticed an emerging dichotomy between "good companies", those that register as a benefit corporation, and "bad companies", those that choose to maintain

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[204] Michelle Cho "Benefit Corporations in the United States and Community Interest Companies in the United Kingdom: Does Social Enterprise Actually Work?" (2017) 37 Northwestern Journal of International Law and Business 149 at 165.

[205] Esposito, above n 14, at 675.

[206] At 674.

[207] Brakman Reiser "Governing and Financing Blended Enterprise", above n 61, at 631.

[208] At 631

[209] DIA, above n 18, at 12; Esposito, above n 14, at 676.

[210] Esposito, above n 14, at 675.

[211] At 676.

[212] Kelly Spors "Should you become a B Corp?" (13 August 2012) Small Business Trends <https://smallbiztrends.com>.

the traditional company form.[213] Whether this brand *effectively* signals and attracts customers and investors is a separate matter.

While benefit corporations may strongly signal their "good" nature, the commitments made in their enacting legislation appear to be mere moral claims.[214] Benefit corporation structures maintain many attributes of traditional company structures[215] and leave the social purposes of the organisation vulnerable to mission-drift through a lack of available director accountability mechanisms. First, while a social enterprise must state specific and general public benefits in their incorporating documents, benefit corporation legislation fails to rank social and financial purposes, giving directors wide decision-making discretion.[216] So long as a director meaningfully considers all mandated interests, the benefit corporation legislation lessens the ability to challenge that director on their chosen course of action.[217]

Secondly, the fact that all enforcement action against director decision-making must be taken by shareholders undermines the claim that benefit corporations subvert the shareholder primacy norm to consider stakeholders. This means that where stakeholders disagree with a director's decision or feel they have breached one of their fiduciary duties, their claims must be advanced by shareholder enforceable actions.[218] If shareholder and stakeholder interests conflict, stakeholders are left with little recourse.

Thirdly, in the event that shareholders advance a proxy enforcement action for stakeholders, exercising control over the benefit corporation's legacy is somewhat hamstrung by opaque reporting requirements. The "major innovation of the benefit corporation form" is measuring their benefit through third-party reporting standards.[219]

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[213] See for example Mark Underberg and Paul Weiss "Benefit Corporation vs. 'Regular' Corporations: A Harmful Dichotomy" (13 May 2012) Harvard Law School Forum on Corporate Governance <https://corpgov.law.harvard.edu>.

[214] Brakman Reiser "Governing and Financing Blended Enterprise", above n 61, at 642.

[215] At 643.

[216] Esposito, above n 14, at 700; and Plerhoples, above n 5, at 228.

[217] Esposito, above n 14, at 700.

[218] At 700 and 709.

[219] Brakman Reiser and Dean, above n 24, at 1509.

However, the accountability and transparency seemingly ensured by this reporting is undermined by a lack of objective criteria. In other words, third-party auditors develop and measure their own individual standards which makes comparing and evaluating the social impact of benefit corporations difficult. Although third-party reviewers offering certification systems, like B-Lab, could revoke their certification where a benefit corporation drifts from its social purposes, nothing strongly prevents auditors facilitating a "race to the bottom" or similar greenwashing problems faced by CSR.[220] As such, it appears that benefit corporation structures signal they will behave as "good" companies but cannot entrench these commitments. As third-party auditors play a "supporting role" and do not necessarily enforce missions, shareholders are charged with preventing mission-drift, which leaves "a social enterprise's legacy vulnerable to unilateral abandonment".[221]

In contrast to benefit corporations, CICs have "let [branding] fall to the wayside",[222] but possess much stronger commitments to entrench and signal social mission. CICs actively utilise the shareholder primacy norm: CIC directors must satisfy the community interest test which elevates the social enterprise's social purposes above its other "primary goals";[223] and participants (shareholders) in a CIC cannot abdicate responsibility, but must "satisfy themselves that the company continues to meet the community interest test and fully involves the community in its activities and development."[224] Alongside internal regulation, the Companies Act (UK) imposes external regulatory measures on CICs to ensure that they continue to uphold their social legacy. These measures include: a cap on dividends issuable to shareholders; an asset lock preventing below-market sales of assets, unless sold to another community organisation (including upon company wind-up);[225] and the power of the Regulator to audit the company, dismiss directors, appoint a manager to

[220] Esposito, above n 14, at 710 and 712.
[221] Brakman Reiser and Dean, above n 24, at 1515–1516.
[222] Cho, above n 204, at 152.
[223] Brakman Reiser "Governing and Financing Blended Enterprise", above n 61, at 632–633.
[224] At 633.
[225] Esposito, above n 14, at 677.

oversee CIC operations, and initiate civil proceedings.[226] Therefore, the internal and external regulation of CIC's gives them better ability to commit to their social mission.

C Better Capital-Raising Potential?

Signalling and maintaining social mission is essential for securing consumer and investor trust, and as a corollary, their support and funding. Benefit corporations have largely traditional corporate structures, including un-capped dividends for shareholders. This means that they are unlikely to successfully secure donations and other charity-related funding.[227] Nevertheless, one identified advantage of the benefit corporation brand is its ability to foster trust and encourage other sources of external financing. The apparent capital-raising success of sustainable branding has been called into question by scholars, such as Koehn, who suggest that more is required to elevate companies in the eyes of consumers. Crucially, success depended upon stakeholder perceptions of the company's "intentions and its past history".[228] Given that a social enterprise exhibits social purposes from inception, any doubts about the effectiveness of the benefit corporation brand to attract customers and investment appear less convincing.

Benefit corporation status allows social enterprises to more readily secure debt and equity financing and also provides linkages to other likeminded social businesses.[229] The "value" of benefit corporation status is clearly demonstrated in benefit corporation success stories.[230] For example, after becoming a benefit corporation, Etsy was established as "a more sustainable organization in the eyes of customers and employees alike."[231] Consumer and investor support of the organisation helped it publicly list on 16 April 2015 to broaden its capital-raising opportunities.[232]

[226] At 676.
[227] Brakman Reiser "Governing and Financing Blended Enterprise", above n 61, at 650.
[228] Daryl Koehn "Why the New Benefit Corporation May Not Prove to Be Truly Socially Beneficial" (2016) 35 Business and Professional Ethics Journal 17 at 25–26.
[229] Cho, above n 204, at 154.
[230] At 154–155.
[231] At 155.
[232] At 155.

Dissimilar to benefit corporations, the strong mission-protecting mechanisms associated with CICs negatively restrain their capital-raising potential. For example, CICs are inhibited from accessing debt-raising agreements due to their asset lock and dividend cap: taking a large loan from a financial institution would place a charge over CIC assets, assets that can only be disposed of at fair market value or to another community organisation; and would subject the CIC to regular interest payments, in conflict with the cap on 'dividends'.[233] Despite this issue being raised with the government Regulator, they:[234]

> … were not persuaded that the cap should be removed to allow unrestricted interest payments … [recognising that] Companies sometimes accept high interest returns in order to secure loans and we need to guard against the risk that the assets of a very successful CIC may be depleted …

Clearly, the CIC form was not created to facilitate easier access to debt-financing, but even its ability to target equity-financing is limited by the cap on dividends. Like traditional companies, investors can purchase shares in a CIC and gain an equal share of dividends in return. However, aggregate dividends cannot surpass 35 per cent and the asset lock prevents shareholders from a residual claim on company assets at liquidation or wind-up.[235] These radically reformed shares may be even less attractive to investors than non-voting shares: they are effectively "prevented from sharing in any potential upside resulting from their investment … it is without reward."[236] The United Kingdom government's inability to build the CIC brand to recognise "global" rather than just "local community benefits" likely exasperates these capital-raising barriers by constraining CIC "recognition and impact" to the community level.[237]

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[233] Brakman Reiser "Governing and Financing Blended Enterprise", above n 61, at 634–635 and 648–649.

[234] Department for Business Innovation and Skills *Changes to the Dividend and Interest Caps for Community Interest Companies: Response to the CIC consultation on the dividend and interest caps* (10 December 2013) at 4.94.

[235] Brakman Reiser "Governing and Financing Blended Enterprise", above n 61, at 636; Department for Business, Energy and Industrial Strategy *Office of the Regulator of Community Interest Companies: Information and guidance notes – Chapter 6: The Asset Lock* (May 2016) at 9.

[236] Department for Business Innovation and Skills, above n 234, at 4.4.

[237] Cho, above n 204, at 165.

D Comparing Social Enterprise Hybrids and the Limiting Ownership Strategy

Both approaches, adopting a strategy of limiting ownership and adopting hybrid organisational structures, attempt to balance or emulate the dual missions of social enterprise: pursuing profit-making and social and environmental purposes. Proponents of hybrid forms rightly suggest that these organisational forms are better at signalling a commitment to social and environmental missions than existing company law. In Part IV, this paper suggested that a strategy of limiting ownership through non-voting shares carries a risk that investors will perceive there to be agency costs. This risk may be mediated by the equity crowdfunding brand and associated gatekeeping of platform providers, but consumer and investment confusion could persist. For example, Eat My Lunch engaged in multiple crowdfunding rounds but the community remained "confounded" that Eat My Lunch did not utilise a charity *structure* to house its social mission and levied accusations of social washing. As such, one could claim that the "resounding [disadvantage] of the existing [company structure is] the lack of ability to signal and protect the primary impact" of social enterprises.[238] Without "compelling evidence",[239] like organisational structure, to signal a commitment to dual missions, investors and consumers may cry foul.

Whether hybrid forms are better at *entrenching* mission than the strategy of limiting ownership is more contingent on the chosen hybrid. By using internal and external control mechanisms, customers and investors do not need to rely on the continued benevolence of social enterprise founders alone to pursue social and environmental mission. CICs possess the strongest commitments to social and environmental purposes by imposing an asset lock, dividend cap, and Regulator powers of control. In contrast, the above sections have demonstrated that the benefit corporation brand signals trustworthiness but undermines its commitments through an absence of meaningful director accountability and general reliance on shareholders to hold directors to account. Benefit corporations do face some challenges to completely "shedding their social mission" (a director must propose a transaction or amendment removing social mission which is approved by a "supermajority"

[238] Horan, above n 31, at 17 and 30.

[239] Dana Brakman Reiser and Steven A Dean (eds) "The Social Enterprise Trust Deficit" in *Social Enterprise Law: Trust, Public Benefit and Capital Markets* (Oxford University Press, Oxford, 2017) at 12.

of shareholders)[240] but maintain significant flexibility for the prioritisation of goals: A social enterprise adopting this form can generally redeploy the company's assets for the profit-making purpose and only face revocation of B-Lab certification status as a result.[241]

A strategy of limiting ownership in traditional company form allows social enterprises to fill their funding gap through equity crowdfunding. Although total capital-raising is restricted to $2 million per annum, social enterprises could theoretically engage in multiple funding rounds with success.[242] In comparison, the success of hybrid forms enabling access to capital is mixed depending on the form adopted. The benefit corporation brand, coupled with most features of traditional company structures, allows these organisations to access both debt and equity markets. For example, Patagonia has become the benefit corporation "poster child"[243] with an impact score of 151.4 in 2021[244] and estimated net value of USD800 million in 2018.[245] However, the CIC form "faces the most serious obstacles to enhancing financing"[246] as its dividend cap and asset lock limit the ability to acquire loans and attract equity investment, even with an elevated maximum aggregate cap at 35 per cent.[247]

To be sure, both proposed strategies have competing internal priorities: the strategy of limiting ownership through equity crowdfunding pits the goals of capital-raising social enterprises against the interest of protecting public investors;[248] while current hybrid forms prioritise one social enterprise goal at the detriment of the other depending on the nature of their respective organisational structures. Bearing this in mind, this paper suggests that the disharmonious balancing exercise conducted by hybrid forms is more problematic to

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[240] Brakman Reiser and Dean, above n 24, at 1511.

[241] Brakman Reiser "Governing and Financing Blended Enterprise", above n 61, at 655.

[242] See for example the discussion around Zefer Cider in part IVD.

[243] Cassie Werber "How Patagonia became the B Corps poster child" (17 February 2020) Quartz at Work <www.quartz.com>.

[244] "B Impact Report" (2021) Certified B Corporation <www.bcorporation.net>.

[245] Angel Au-Yeung "Outdoor Clothing Chain Patagonia Starts Selling Online Again After Unusual Decision To Pause Its E-Commerce Due to Pandemic" *Forbes* (23 April 2020) <www.forbes.com>.

[246] Brakman Reiser "Governing and Financing Blended Enterprise", above n 61, at 654.

[247] Department for Business Innovation and Skills, above n 234, at 34.

[248] See Keeper, above n 168, at 204.

resolve. Rather than harbingers of entrenched commitments to social mission and enhanced access to equity and debt markets, the lackadaisical balancing of social enterprise goals forces social entrepreneurs into an unsatisfactory compromise.[249] As such, Part VI of this paper sets out the preferred approach for social enterprises wishing to scale up; using 'number eight wire' to make do with what already exists in Aotearoa.

VI Proposed Path and Potential Reform

At present, no hybrid structure has embraced social enterprises' dual missions in perfect balance. With no guarantee of success, this paper suggests that embarking on this exercise in New Zealand would be a significant feat: the social enterprise sector would need to review the existing hybrid structures across jurisdictions, the "ideological foundations" and history of social enterprise in Aotearoa (including the lasting influence of colonisation), the widening divisions in wealth and income,[250] and the sector's ultimate goals. The gargantuan task of this endeavour is further complicated by the contradictory conclusions of studies conducted by organisations in the social enterprise sector and Department of Internal Affairs. According to Internal Affairs, "the dominant message was that development of a stronger social enterprise market does not hinge on legal structure, and that there are more immediate priorities."[251] In contrast, the Ākina Foundation recommended that the Companies Act be amended to incorporate "Impact Companies" that ingrain community impact and guide directors on how to balance social enterprises' dual purposes.[252] In their view, the operating challenges social enterprises face call for a new legal structure.

This paper agrees with the Department of Internal Affairs and advocates for the strategy of limiting ownership through dual class shares and equity crowdfunding. To adequately support small to medium social enterprises, minor regulatory reforms of the crowdfunding space are required. Such regulation should not be evaluated with solely traditional

[249] Brakman Reiser "Governing and Financing Blended Enterprise", above n 61, at 655.
[250] Matheson, above n 8, at 5 and 18.
[251] DIA, above n 18, at 17.
[252] Horan, above n 31, at 29–31.

corporate structures and business in mind;[253] the important task is reconceptualising how best to balance the goals of protecting investors and promoting small enterprise.

Through a strategy of limiting ownership, social entrepreneurs can signal trust and maintain their social missions. Although legal structure itself is a strong focal point for investors and customers, B-Lab certification can also signal the flag. Several New Zealand companies have already seen this advantage, including: ecostore, untouched world, fix and fogg, chia sisters and more.[254] The equity crowdfunding 'brand' can increase the success of signalling trustworthiness. The history of the platforms and the strong gatekeeping conducted by platform providers elevates the perceived integrity of crowdfunding social enterprises. Additionally, by issuing non-voting shares to concentrate control with company insiders and by incorporating social purposes in the company's constitution, a social enterprise founder will be able to better entrench the chosen social and environmental missions. It would take a special resolution of company insiders, holding the majority of voting shares, to alter the company resolution. Finally, crowdfunding platforms allow social enterprises to partially fill the existing funding gap for small businesses; they can engage in multiple rounds to reach NZX listing requirements or increase their capital to better engage in and commit to debt-raising obligations. Unlike public listing or debt-raising, which hybrid forms supposedly increase access to, equity crowdfunding "provides a cost-effective and accessible means of public fundraising for small companies"[255] by attracting "small parcels of funds … quickly and easily."[256]

After the crowdfunding reforms were implemented in 2014, analysing the development of the sector identifies aspects that "are restricting the potential of the market."[257] The current balance of promoting enterprise and protecting investors weighs too heavily in favour of the latter. As the regulation currently stands, the $2 million cap on equity raising within

[253] Although a different reform was proposed, see the general discussion in Anne Matthew "Crowd-sourced equity funding: the regulatory challenges of innovative fintech and fundraising" (2017) 36 UQLJ 41.

[254] "B Corp Directory" B Lab <www.bcorporation.net>.

[255] Ande and Eroglu, above n 152, at 561.

[256] Christmas, above n 144, at 34–37.

[257] Daniell, above n 173.

any 12-month period may prevent social enterprises from reaching their true capital-raising potential in scale-up: most businesses seek to use equity crowdfunding to raise between $2 million to $10 million.[258] These funding gap concerns have not only been raised with crowdfunding platforms but included in submissions to the FMA and the Ministry of Business Innovation and Employment (MBIE).[259] As such, this paper proposes reforming the equity crowdfunding regulations to increase the $2 million cap to $5 million. This figure is a more suitable re-balancing middle ground that would better fill the existing funding gap for small to medium social enterprises.

A Assessing the Desirability of Reform

Assessing the desirability of this reform involves canvassing the existing tensions of equity crowdfunding, investor protection and promoting start-up innovation, and whether lifting the $2 million cap would expose retail investors to too much risk. Recognising that balancing these concerns is an important and complex task, this paper offers possible methods for striking the capital-raising and investor protection balance. More importantly, this section indicates that more thought and research should be dedicated to this area.

There are a handful of arguments suggesting that the $2 million cap should not be increased, but each is ameliorated when considering the current regulatory and investor practices in the crowdfunding market. First, it is widely accepted that small to medium enterprises and start-ups are 'riskier' investments, discussed in Parts II and III of this paper. According to Statistics New Zealand, small businesses have a relatively high failure rate. Between 2011–2020, only 40 per cent of small businesses born in 2010 survived nine years, as seen in Figure 1 below.[260] Given the relatively high failure rate, the FMA may be

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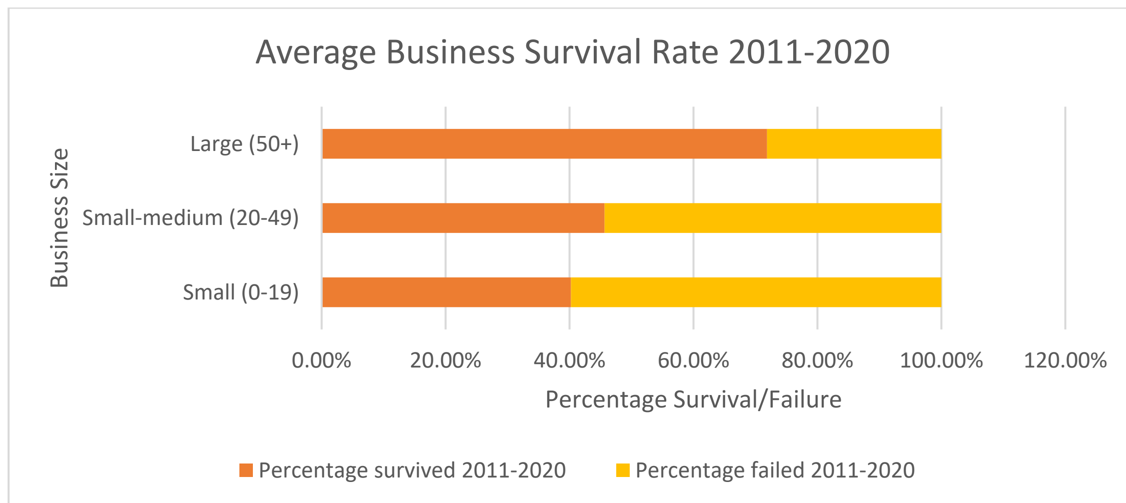
[258] Daniell, above n 173.

[259] See Ministry of Business, Innovation and Employment *Financial Markets Conduct Act 2013: Monitoring and Evaluation Report 2020 Phase Two* (2020) at 3; and Ernst & Young and Work and Steering Committee *Growing New Zealand's Capital Markets 2029: a vision and growth agenda to promote stronger capital markets for all New Zealanders* (2019). However, this report views the securities regulations as sufficiently improved.

[260] This percentage was calculated from the data downloaded from Statistics New Zealand "New Zealand business demography statistics: As at February 2020" <www.stats.govt.nz>.

justified in maintaining the cap at its current level to reduce the exposure of retail investors to loss when a start-up ultimately fails.

Figure 1:



This risk exposure is heightened by the "information asymmetries" between the crowdfunding companies and public retail investors. Although crowdfunding platforms are required to issue disclosure or warning statements, they do not advise retail investors lacking institutional investment knowledge exactly how to identify a good or a bad investment.[261]

However, mediating the risk exposure of retail investors is the fact that although there is no limit on the amount an investor can contribute to a campaign, they are very unlikely to invest anything close to the full cap amount of $2 million in one venture. If this was the case, then "they would automatically be classed as a wholesale investor and could invest as much as they like."[262] The FMA in 2020 recorded that most investments made by retail investors through licensed crowdfunding platforms were small. For example, 76 per cent of investments ranged between $0–4,999.[263] Generally, larger offers attract larger pools of

[261] Stuart, above n 140, at 11.
[262] Daniell, above n 173.
[263] Financial Markets Authority "Peer-to-peer lending and crowdfunding: sector snapshot" (30 June 2020) <www.fma.govt.nz>.

investors, not more investment from individual investors. As such, retail investors would be wiser to invest in larger offers as the more established nature of the crowdfunding business lowers the risk of individual exposure to loss.[264]

Furthermore, the important regulatory and gatekeeping role that crowdfunding platforms adopt to protect retail investors from loss suggests that the cap could be increased. As a result of rigorous vetting, only start-ups with integrity and growth potential will be hosted. For example, the FMA recorded that crowdfunding platforms declined a whopping 91 per cent (304 of 334) of potential issuers in 2020, an 87 per cent increase from 2019.[265] While gatekeeping is the current self-regulatory practice, relying solely on this mechanism may be placing too much trust in retail investor practices and crowdfunding platforms.

The second concern advanced is that although individual retail investors are unlikely to invest a significant proportion of the company's sought capital alone,[266] increasing the capital-raising cap exposes retail investors to the risk that they are purchasing illiquid shares, thus increasing their exposure to loss.[267] As such, the retail investor, when purchasing non-voting shares from crowdfunding companies, hedges that when the social enterprise expands they can recoup their investment *if* the social enterprise publicly lists. Moderating this concern is the recent emergence of secondary markets, like Unlisted, for trading shares of small to medium businesses.[268] These platforms not only allow investors to re-sell non-voting shares, but it also "inevitabl[y] grow[s] the primary market".[269] Expanding the crowdfunding market would not only benefit crowdfunders and the hosting platforms but would give retail investors a wider range of investment opportunity and potentially higher return on their investments.[270] While these platforms exist, there is no guarantee that crowdfunding social enterprises will also be participating on secondary

[264] Stuart, above n 140, at 31.
[265] Financial Markets Authority, above n 263.
[266] Stuart, above n 140, at 32.
[267] At 32; and Kourabas and Ramsay, above n 142, at 4.
[268] See generally Unlisted Securities Exchange at <www.usx.co.nz>.
[269] Christmas, above n 144, at 49.
[270] Stuart, above n 140, at 33.

markets, like Unlisted. Furthermore, small secondary platforms are unlicensed and largely unregulated. For example, the Financial Markets Conduct (Unlisted Market) Regulations 2015 only requires that the Unlisted issues warning statements about its unlicensed nature, alerts the FMA to cases of unfair dealing, and provides reports detailing trade volumes, issuers, share numbers and complaints.[271]

At the heart of the regulatory concern for retail investors is the potential that *individual members* of the public may be exposed to significant loss through crowdfunding business failure. With this central concern in mind, this paper suggests that the capital-raising cap can justifiably be lifted to a middle ground of $5 million per annum if the FMA couples current crowdfunding self-regulation with either individual investment caps or anchor investors.

B Alternative Mechanisms for Protecting Retail Investors

Liberalising the regulation around the crowdfunding cap raises concerns that retail investors will be left under-protected if crowdfunding businesses fail. To reconcile this concern, the FMA could make one of two corresponding conservative reforms: first, restricting the amount that each *individual* investor can contribute to a crowdfunding campaign; or secondly, requiring each campaign seeking to raise over $2 million to secure an anchor investor before garnering contributions from the public.

Restricting individual investor contributions to crowdfunding businesses can take multiple forms. MBIE's Regulatory Impact Statement recommended that the FMA could: restrict the amount an individual can invest in each *issuer* to $30,000 ('per-issuer cap'); or similar to the United States, could cap the amount each *investor* can contribute in any 12-month period, which is scaled according to each investor's wealth ('per-investor cap').[272]

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[271] See Financial Markets Conduct (Unlisted Market) Regulations 2015, cl 5.

[272] Cabinet Business Committee *Financial Markets Conduct Regulations Paper 4 – Licensing regimes* CAB 991 at [136]. The United States restricts individual investors with an annual income or net worth less than $100,000 from investing more than $2,000 (five per cent of their annual income), and for those with income or net worth more than $100,000, restricts investment up to $10,000 (10 per cent of their income): at [137].

Whatever form taken, a limit on investor contributions would reduce the risk of "large scale investor losses".[273]

Despite their potential, each approach would create regulatory difficulty. Ultimately, these complications led MBIE in its Regulatory Impact Statement to recommend against adopting an investor cap. A per-issuer cap could reduce the risk of retail investor loss by encouraging portfolio diversification.[274] However, setting the cap at a large figure ($30,000) would be unlikely to protect less wealthy retail investors. If the cap was lowered further, wealthy investors would find crowdfunding investing too restrictive.[275] Wherever the cap is set, a per-issuer cap faces practical enforcement challenges; an investor could simply create multiple accounts, for example.[276] While a set per-issuer cap may be simply applied once the cap is settled, a per-investor cap generates unnecessary regulatory complexity unless investors self-certify their wealth.[277] More fundamentally, investor caps would create dyssynergy with the cl 12 small offer exemption under sch 1 of the Financial Markets Conduct Act.[278] Limiting investor contributions to a certain range excessively undermines the crowdfunding capital-raising potential for small social enterprises and is likely to drive them to abandon crowdfunding in pursuit of other exemptions under the Act where they will lose the trust signalling benefits of crowdfunding.[279]

In light of the above, a better approach to enhancing retail investor protection while increasing the capital-raising cap to $5 million is to require anchor investor syndication for crowdfunding campaigns over $2 million. Anchor investors, also known as their sub-classes of strategic or cornerstone investors, are a common feature of Asian stock

[273] Cabinet Business Committee, above n 272, at [139].

[274] Ministry of Business, Innovation and Employment *Regulatory Impact Statement Financial Markets Conduct Regulations* (2013) at 62.

[275] Cabinet Business Committee, above n 272, at [141].

[276] Ministry of Business, Innovation and Employment, above n 274, at 62; and Cabinet Business Committee, above n 272, at [140].

[277] Ministry of Business, Innovation and Employment, above n 274, at 62; and Cabinet Business Committee, above n 272, at [141].

[278] Financial Markets Conduct Act, sch 1 cl 12.

[279] Cabinet Business Committee, above n 272, at [140].

exchanges[280] that "subscribe for shares in an IPO, and who benefit from the allocation of stock in advance."[281] By entering into a pre-IPO contract with the issuing company, anchor investors are guaranteed a share allocation that will not be diluted by the following IPO share allocation.[282] According to a study of the Hong Kong stock exchange conducted by Espenlaub and others, cornerstone investors (wealthy individuals or entities) seek to benefit from an issuing company in the short term and have a neutral relationship with the length a company maintains public share listing. In contrast, strategic investors (significant customers and suppliers of the issuing company) have a more positive impact on listing length.[283] Specifically, the lockout periods (preventing anchor investors from selling their shares for a specified period), expertise and monitoring conducted by strategic investors contribute to longer public listing periods for the issuing company.

Although observed in the public listing context, anchor investors could be an advantageous addition to securing the durability and strength of crowdfunding businesses while allowing them to access increased sources of capital. For example, if Eat My Lunch aimed to raise over $2 million through equity crowdfunding, it would be required to first secure a 20 per cent cornerstone stake of its funding goal before launching to other retail investors. As these anchor investors are not limited to venture capital firms or other institutional investors, this requirement is unlikely to be overly burdensome for capital-raising social enterprises. In fact, in 2017 Eat My Lunch secured its supplier, FoodStuffs, as a 26 per cent shareholder before it launched on Pledgeme in 2019.[284]

Not only would anchor investors support the strength of crowdfunding campaigns but they "would be incentivised to closely scrutinise the business and its prospects before

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[280] Susanne Espenlaub and others "Committed anchor investment and IPO survival: The roles of cornerstone and strategic investors" (2016) 41 Journal of Corporate Finance 39 at 141; and Philippe Espinasse *Cornerstone Investors: A Practice Guide for Asian IPOs* (Hong Kong University Press, Hong Kong, 2018) at 11.

[281] Espinasse, above n 280, at 7.

[282] At 7; and Espenlaub and others, above n 280, at 141.

[283] Espenlaub and others, above n 280, at 152.

[284] See Rachel Clayton "Eat My Lunch brings on Foodstuffs as a strategic partner" (10 September 2017) Stuff <www.stuff.co.nz>.

committing to invest in it".[285] Coupling the due diligence of anchor investors with that conducted by hosting platforms decreases the information asymmetry risks and the likelihood that retail investors choose a business that will not survive. Furthermore, at a moderately placed percentage of 20 per cent, it is unlikely that imposing this additional restriction on crowdfunding businesses would outweigh the capital-raising benefits gained from increasing the capital cap, only applying to those who seek to raise over $2 million.[286]

VII Conclusion

The market preference shift towards 'sustainable capitalism' has driven large corporations and small to medium enterprises alike to adopt social and environmental purposes alongside their profit-making incentives. The rapid uptake of corporate social responsibility practices has coincided with the emerging social enterprise phenomenon, where organisations adopting the company form dedicate their businesses to the pursuit of dual social and profit-making purposes from company inception.

This paper has positioned social enterprises within an ambiguous third sector; adopting the altruistic purposes traditionally associated with charity and non-profit sectors alongside the profit-making drive of traditional corporations. This altruistic yet self-serving blend of missions creates a trust lacuna: consumers and investors fear dis-consonance, or the risk that the social enterprise will drift to favour shareholder primacy and profit-making due to its company structure. Although this perception has not yet become a reality in Aotearoa, essential to the success of these enterprises attracting customers and investors is their ability to 'signal the flag'— creating a legal focal point where all parties feel confident that the social enterprise will commit to their double bottom-line.

As "high risk" companies, social enterprises are forced to seek out public sources of capital in scale-up. Relying on equity-raising to scale-up, social entrepreneurs are faced with one leering example of the trust problem: the risk that issuing shares, through takeover or dispersed share ownership, dilutes or overrides company insider control of social mission.

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[285] Stuart, above n 140, at 35.
[286] At 35.

The key question facing social enterprise founders is: how can social enterprises raise capital while signalling and maintaining their social or environmental purpose(s)? The natural second question is determining whether there are existing focal points and control mechanisms in company law to pursue social enterprise goals, or whether social enterprises require something structurally stronger, such as the hybrid organisational forms designed in the United States (benefit corporations) and United Kingdom (community interest corporations) to house their blended missions.

This paper has examined the existing company law mechanisms and hybrid forms to conclude that a strategy of limiting ownership by issuing non-voting shares through equity crowdfunding platforms is a suitable reply to both questions. Although this strategy carries with it existing limitations, most of these concerns can potentially be reformed in a much simpler manner than creating an entirely new legal structure in New Zealand. Although hybrid organisations may strongly signal the blended mission of social enterprise through their strict controls or branding, both benefit corporations and CICs create internal organisational disharmony that force a social enterprise founder to compromise one of their dual missions for the other.

Equity crowdfunding also seeks to balance a competing tension but is easier to reconcile. Rather than mediating a conflict between the dual missions of social enterprise, it attempts to reconcile the discord between retail investor protection and governmental attempts to grow the start-up sector. The equity crowdfunding brand, history and gatekeeping of platforms signal to investors that crowdfunding businesses are enterprises with integrity and growth potential. It not only democratises investing by involving the community but democratises capital-raising by plugging the funding gap for social enterprises. By issuing non-voting shares through equity crowdfunding platforms, social enterprise founders can raise up to $2 million without relinquishing control over their company's governance and social mission, albeit subject to the founder's continuing benevolence and commitment to social mission in the future.

This paper has also suggested small amendments could be made to the Financial Markets Conduct Act to better fill the funding gap of social enterprises. If the capital-raising cap for small offers was lifted to $5 million, social enterprises would be better able to cater to their costly scale-up needs. Coupling the gate-keeping responsibilities of crowdfunding platforms with the requirement that enterprises seeking over $2 million secure a 20 per cent anchor investment may better balance the goals of facilitating social enterprise capital-raising and protecting retail investors.

The rapid uptake of social enterprise in Aotearoa reinforces the international community's perception of New Zealand as a place of ingenuity and innovation. In a similar vein, equity crowdfunding is an innovative tool that is wholly suitable for supporting the development of social enterprise. When considering the development of the third sector, one must ask why it is necessary to re-invent the wheel when adequate support can be offered to social enterprises by making a few minor regulatory adjustments.

VIII Appendix

Figure 2:[287]

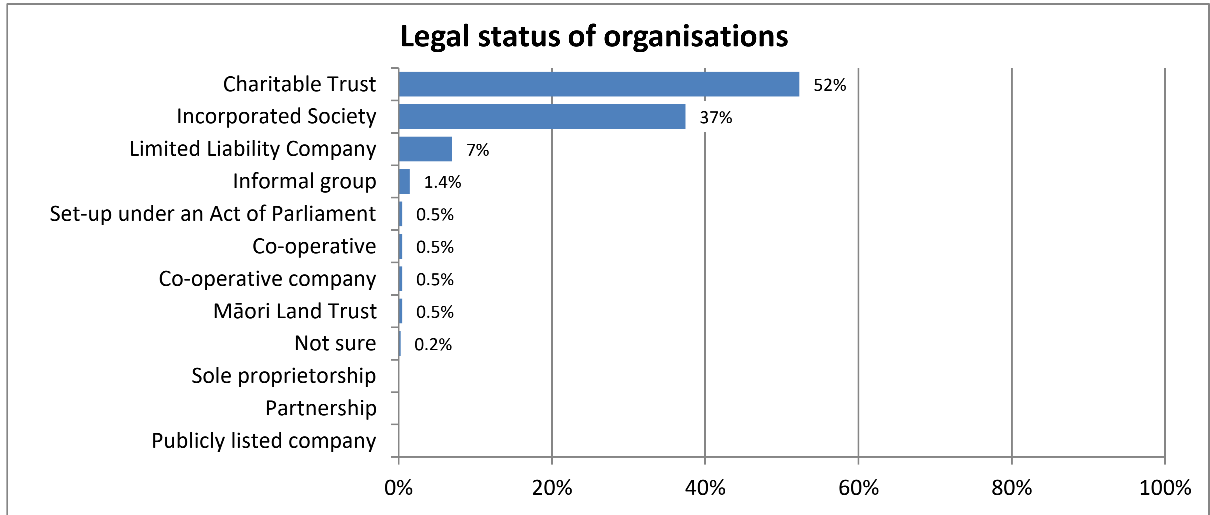
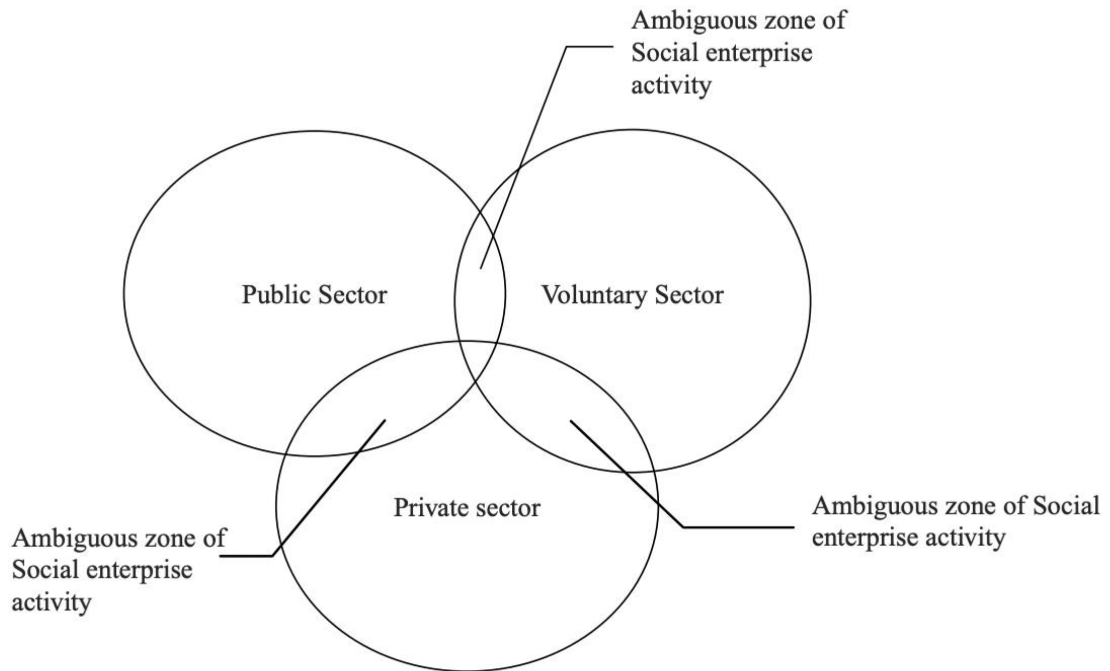


Figure 3:[288]



[287] DIA, above n 18.

[288] Seanor and Meaton, above n 52, at 28.

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