Steward-ownership

Ownership and finance solutions for mission-driven businesses

Expo West 2019

presented by

The Purpose Foundation, RSF Social Finance,
Organic Valley & Organically Grown Company

Opening note

Our gathering as leaders, CEOs, and founders of independent organic companies at Expo West 2019 represents an exciting development in the sustainable business community. We have all seen the damage done to businesses by ownership transitions, exit strategies, and the burden of overinflated valuations. There is a growing movement to find a new relationship to ownership, one that enables businesses to remain mission-oriented and community-minded, which I am very excited about.

These new approaches to ownership can take on many forms, and can be adapted to work for different companies in a variety of situations. What these structures have in common is a desire to avoid steering a company off its intended course or mission merely to produce shareholder value. These structures can serve family businesses as well.

This is a new movement we are building together. And beyond serving the interests of new purpose-driven companies, this movement also provides opportunities for funders to support the transition of established companies into alternative ownership forms.

George Siemon, CEO Organic Valley

What do we all know

David Weinstein, Heath and Lejeune

What do we all know

We know that we are about changing the world. We have a new vision for agriculture. We envision a new kind of trade embedded in it. We know that humans have moved things all over the planet for thousands of years by trusting each other, and we want to rebuild structures in which that trust can thrive. Most fundamentally, we know that we are stewards of each other's well being and that our businesses exist to nurture the communities in which they exist.

We know that a world in which exchange is embedded in agriculture, in which trade is based in community, and in which wealth belongs to the stakeholders who created it is not the predominant business model today. It is not what exists now. But we know that it is not just possible, but necessary.

A new agricultural model is necessary because the old one doesn't work. It ruins the land. It poisons the water. It kills the animals. It turns the climate into a lottery. And the food it produces makes people sick. We started out as visionaries and dreamers - but without a model for our vision, we modeled our businesses on the businesses around us, and have continued replicating the predominant business structures since the mid-70s.

That was nearly fifty years ago. Since then, we have seen the ways that these business structures do not serve us. We have learned how a system in which businesses are each others' economic adversaries builds in extra costs and increases risk. We have acquiesced to a system that externalizes our responsibilities to our stakeholders. We have failed to create the means to pass on what we have created to another generation of dreamers who share our vision and values.

Against our better judgement, we have colluded with a system that enriches a very few and impoverishes the overwhelming majority. We have become inured to the callousness and rigid indifference it takes to live in a radically inequitable world. The very forms of our businesses perpetuate the lies that justify this inequity. As human beings, we know this is intolerable.

The power of aggregated wealth is unavoidable and inescapable. We have failed to appreciate this reality. In our businesses, we hoard the wealth as if it is ours alone. We have not learned to deploy this wealth to our mutual benefit.

Not only does this wealth belong to all of the stakeholders who participated in its creation - it must be used to enable us to thrive in a capital-centric world. We must find the forms that allow us to act on behalf of our mutual interest.

We are here to celebrate the reality of a new vision for our work. The structures we are being shown give us the means to walk away from the endemic inequity and irrational externalities that have plagued us for so long. They describe in a real way the opportunities that exist to empower all of the stakeholders who have given and will give value to our businesses. They provide a path for ensuring our businesses remain independent, so that they will continue to deliver on their missions long into the future.

We inherited the vision of a new kind of agriculture from those who came before us. We transformed that vision into a trade, and shared the harvest with the whole world. Now it is time to take another step, hand-in-hand with a new generation, to make what has been ours into something that will endure beyond the end of our lives.

Vision forward

Natalie Reitman-White, Organically Grown Company

I am honored to be a part of the "second generation" of our company and work alongside our founders. Like many entrepreneurs in the sustainable business sector, we are driven by a purpose. We see our businesses not as tools for short-term personal gain, but as constructive vehicles for creating change in the world. We measure success not in maximizing our profits, but in maximizing the positive impact we have on people and the planet. We do humble work - producing fibers, food, beverages, and goods - yet it has a profound meaning for our suppliers, employees, and consumers, as well as our soil, air, and water.

Over the past three years, I helped lead Organically Grown Company into a steward-ownership structure. We did this because our structure was creating burdensome repurchase obligations and putting us at risk of acquisition. The future we wanted for our company included a viable way for founders and shareholders to sell their shares while ensuring that the company remained firmly committed to its mission. It also offered a way to bring in aligned financing to grow our impact, and to share real-time rewards with our stakeholders. Our journey led us to a perpetual purpose trust, just one of a number of different steward-ownership models in use today.

As mission-driven entrepreneurs and investors, we must take up the challenge of re-thinking, re-imaging, and re-orienting the structures of ownership and finance around the principles of ecological regeneration, community prosperity, stewardship, and longevity. Conventional stock agreements, term sheets, liquidity horizons, and outsized return expectations are often misaligned with our operating models and value systems. These structures could easily pull our business into directions that are more suited to the needs of investors than our own goals. We believe we can raise capital and not sell out. We can structure evergreen, steward-owned businesses. And we can come together to build a movement to transform our economy. To do so, we need a strong community of business leaders, shared tools and resources, patient investment capital, and increased awareness of the role that ownership and financing play in the long-term success of businesses.

Community

Many of us are working individually to address the challenges of growth and succession in our businesses, but it is difficult to do this alone. We need a peer community of founders, CEOs, and next generation leaders to collaborate, exchange ideas and develop new solutions.

Infrastructure and practical resources

Seeking legal advice can be expensive. With open-sourced legal resources, we can lower the cost and difficulty of adopting these structures. Our movement needs to further develop legal solutions, provide how-to support for succession planning and raising capital on alternative terms, and conduct research on the role ownership plays in corporate social and environmental behavior.

Capital

Locating aligned capital takes time. Our movement needs investment opportunities to support companies in their transition to steward-ownership by providing liquidity to founders and former investors. We also need to create more options for viable, non-extractive, sustainable-return growth capital.

Awareness

We need to generate awareness of the powerful stories of pioneers who are choosing steward-ownership as an alternative to selling their companies. This can be amplified through a media campaign to build trade, public, and policy awareness about the steward ownership movement.

To accomplish all of this, Purpose, RSF Social Finance, and Organically Grown Company have partnered to start a nonprofit initiative that will be the hub of the steward-ownership movement in the U.S. Our initial focus is the sustainable products sector, but we know that these solutions are viable in other impact sectors of our economy.

Breaking Through the False Choice Between Mission and Liquidity

Jasper van Brakel, RSF Social Finance, originally published in Stanford Social Innovation Review

Many a social enterprise leader has asked themselves: If I take on equity investors, will I have to fight to preserve my company's mission? If I have to sell my company to a larger enterprise to provide an exit for investors, will I be selling out that mission? Do I have to stay small to stay loyal to my founding purpose? If I grow the company on my own, how can I ensure a mission-preserving succession?
For many growing, purpose-driven ventures, these questions are hardly theoretical: The choice between liquidity for the business or for owners on the one hand, and loyalty to a social or environmental mission on the other, is as real as it is problematic. And the stakes in addressing this conundrum go much deeper than the concerns of individual companies. The current corporate code, particularly in the United States, dictates that directors act in the best interests of the company and all of its shareholders. This notion of maximizing shareholder value as the ultimate goal of a corporation has laid the groundwork for the immense growth of wealth over the past 150 years, but it comes at a steep cost.

Today we find ourselves in an extractive global economy—one that is leading to ever-increasing inequality, rapid depletion of natural resources, potentially irreversible climate change, and enormous social challenges.

The bulk of the solutions needed to create social and economic justice, reverse climate change, and generally increase human consciousness must come from social enterprises and mission-based companies. As illustrated by Michael Porter's Shared Value Initiative, NGOs and governments do important work to drive positive change, but businesses have incredible leverage through the marketplace to scale the best ideas—if they have a mission that is greater than profits or shareholder value. We must get this right, and that imperative has created a global movement that is developing and testing alternatives that preserve mission, support growth, and ideally address the severe power imbalances created by dominant business structures.

Perpetual purpose trust: A new level of mission protection

An extremely promising model that has been implemented by a few companies in Europe and is just emerging in the US is the perpetual purpose trust. Chartered to protect the company's purpose (or mission), it owns a majority of common (voting) shares and appoints a board of directors.

With this structure, the company basically owns itself. A company can sell itself to a perpetual purpose trust by issuing preferred, non-governance stock and taking on debt to self-leverage a buyout. Outside investors can purchase that stock and receive a dividend—but because they will never see an exit, they are not investing with a speculative motive. The company is protected from hostile takeovers, and can focus all of its resources and attention on running the business and furthering the mission.

As an added benefit, the trust structure decouples ownership and control (which sits with the trust) from the financial outcomes of the equity investment (which sit with the operating company). As the sole owner, the trust prioritizes profitability in service to the operational well-being of the company and its mission, investors, employees, customers, and suppliers collectively. Time will tell how well this novel structure serves the mission and all stakeholders, but early indicators are positive and promising.

In July, Portland, Oregon-based produce distributor Organically Grown Company (OGC) became the first US business to adopt the structure. Previously employee- and grower-owned, OGC made the bold move to buy back all the shares from its stockholders and transfer them to the Sustainable Food and Agriculture Perpetual Purpose Trust, which will eventually hold 100 percent of the ownership rights.

Our organization, RSF Social Finance, provided a $10 million loan to help buy out OGC's previous shareholders and recapitalize the business, plus $1 million in working capital. In the spirit of integrated capital, a group of values-aligned equity investors has lined up to acquire non-governance stock and provide the company with additional capital. The trust will ensure that the company delivers positive economic, social, and environmental impact, and maintains its independence in perpetuity, never to be sold.

OGC had been providing liquidity to its retiring farmer- and employee-owners for decades. For the previous 10 years, its employee stock ownership plan (ESOP) allowed the company to fund share repurchases and redistribute the ownership to current employees. But with many founder-owners approaching retirement and mergers and acquisitions activity heating up in its sector, OGC grew concerned about its ability to fund the generational transition without compromising its ability to invest in the business or sacrificing its mission priorities.

"The perpetual purpose trust is an innovative model in the US, but OGC is part of an emerging global movement toward new corporate structures," says Natalie Reitman-White, vice president of Organizational Vitality and Trade Advocacy at OGC.

“This movement is challenging the status quo in capitalism, in which ownership, as a company scales and matures, becomes distanced and disconnected from the founding purpose and the stakeholders the company serves. In OGC’s new structure, the company “compass” stays aligned with the purpose, which creates more innovative, resilient, and valuable companies over the long term, as all stakeholders share the focus on purpose.”

Worker cooperatives: Fitting an old model to a new purpose

This is an old form that has always provided a clear alternative to typical, undemocratic, corporate power structures. Worker co-ops give all employees a voice and an ownership stake in the business, and can include customers and suppliers. Profits accrue to the owner stakeholders, so incentives are aligned for all parties. There is no guarantee of mission preservation, but co-op founders tend to assume that employee-owners are more likely to be committed to the mission, and hostile takeovers are less likely when there is no majority shareholder.

What’s new here is that a few pioneers have a found a way to raise growth capital within the co-op structure, which presents barriers to traditional equity investments. The fair-trade food purveyor Equal Exchange is a shining example. The company (also an RSF borrower) sells preferred shares to investors in periodic private offerings, but investors don’t receive voting rights or profits from share sales; instead, they get an annual dividend of 0 to 8 percent (5 percent is the target). The company has raised more than $16 million this way.

Equal Exchange has solved for mission risk too, with what co-executive director Rob Everts calls a “poison pill”: There’s no incentive to sell the company, because in the event of a sale, any proceeds remaining after paying off loans and returning investors’ money at face value would have to be donated to another fair-trade organization.

Benefit corporations: Bringing stakeholders to the shareholder table

For companies that want or need access to a broader range of investors, registration as a benefit corporation can provide mission protection within the framework of a conventional corporate structure. Benefit corporation status (not to be confused with B Corporation certification) is designed to preserve mission through capital raises and leadership changes, and add flexibility when evaluating potential sale and liquidity options.

(For background on how social enterprises are using this form, see "Benefit Corporation and L3C Adoption: A Survey.")

Benefit corporation status does not fully address the challenge of shareholder power, however. Most statutes require a supermajority shareholder vote of two-thirds or more to revoke benefit corporation status—a high bar, but one that could be cleared by, say, an acquirer buying out the founders. And collectively, shareholders still control significant aspects of a company's future. While benefit corporation statutes require that the board consider or balance the interests of a spectrum of stakeholders, they do not mandate any particular outcome. As with perpetual trusts, we need more time and testing to see how benefit corporations perform vis-à-vis their mission orientation over the long term.

Financial success is the means, not the end

A truly mission-first business that sees financial results as a necessity, rather than an objective, needs a financial and ownership structure that enables it to focus on its mission, rather than on chasing short-term profitability or shareholder favor. The model of maximizing shareholder value, whether or not the shareholders are employees, can't serve the purpose of a mission-based enterprise.

Mission-protective ownership structures like the ones mentioned above help build the scaffolding to support a community-based financial system that can unlock our human potential to fix the problems we've created under previous paradigms. This is going to take some experimentation, and we hope other funders will join us in testing and proving the viability of business structures fitted to purpose.

Introduction to Steward-ownership

Introduction

Steward-ownership is an alternative to conventional ownership that permanently secures a company's mission and independence in its legal DNA. Solutions for steward-ownership have been found by generations of entrepreneurs all over the world. These pioneers have found innovative ways of committing their businesses to two key principles: profits serve purpose and self-governance. These principles enable companies to remain independent, purpose-driven, and values-led over the long-term. Often structured as foundations or trust-owned companies, steward-owned companies historically have been broadly successful. Not only do they outperform traditional for-profit companies in long-term profit margins, but they are also more resilient to financial and political crises, and offer significantly less volatile returns. Compared to conventionally owned companies, steward-owned companies also pay employees higher wages with better benefits, attract and retain talent more effectively, and are less likely to reduce staff during financial downturns.

While most businesses serve to maximize profits to increase shareholder value, steward-owned companies serve a purpose. The definition of "purpose" varies across organizations. For some, it's defined by a larger external mission, such as supporting and promoting regenerative agriculture or working to ensure the internet remains free and open to all. Other companies derive their sense of purpose from what they offer, whether they are providing technology, products, or services to end customers. For others, purpose is more internal. It represents how they do business, whether that means ensuring their employees share in profits, are free to work remotely, or have the ability to self-manage. **What all steward-owned companies have in common is the belief that profits aren't the primary goal, but rather the means by which their purpose can be furthered.**

In order to safeguard its purpose, the "steering wheel" of a steward-owned company, i.e., control over its management, strategy, and key operational decisions, is held by people inside or closely connected to the organization. This is unusual for many businesses, where majority control is often held by external owners. Shareholders, private equity firms, or parent companies normally dictate strategy and decisions, with the primary goal of maximizing profit and increasing their bottom line. These "absentee owners" are rarely directly involved in the business' operation. They cannot feel responsible or accountable to the business, because they don't directly experience the needs of their customers or employees. They don't feel the impact of choices that maximize their financial gains at the expense of employees, suppliers or customers. This system removes responsibility and accountability from organizations, and relies on governments to regulate corporate norms and behavior. As Milton Friedman so famously put it, "There is one and only one social responsibility of business . . .to increase its profits."

The idea of a purpose-driven economy is fundamentally different. It proposes keeping responsibility for corporate behavior with the individuals in these organizations. Unlike conventional businesses, the individuals - or stewards - at the helm of steward-owned companies are deeply committed to the organization's missions, and are involved in their operations. "Ownership" in these organizations represents responsibility and the freedom to determine what's best for the long-term survival of a company's purpose. Such companies are not up for sale; instead, they are deliberately passed on to capable and value-aligned successors.

History of Steward-ownership

Steward-ownership is a novel idea, but not an entirely new one. We find one of the first modern examples of steward-ownership in the German optics manufacturing company Zeiss, founded in 1846 by Carl Zeiss. After Zeiss died in 1888, Ernst Abbe - a fellow researcher - created the Carl Zeiss Foundation, which has owned the company ever since. Abbe had been a professor of physics at the University of Jena, where he developed the mathematical foundation behind Zeiss' successes. It was most likely here, at a public university where he benefited from the support and research of other academics, that Abbe concluded that his successes did not belong to him alone. He carried this conviction with him to Zeiss.

The Carl Zeiss Foundation ensures the company cannot be sold, and that profits are either reinvested or donated to the common good. Abbe ensured the foundation protects workers' rights, guaranteeing them health care and retirement insurance, paid vacation, and an 8-hour work day long before it was the norm. He also mandated that the highest salary of any Zeiss employee not exceed more than 12 times the salary the lowest paid worker receives after being at the company for two years.Today Zeiss is a successful, innovative company with over €7 billion in annual revenue. Through its charitable donations, Zeiss supports local and global initiatives to promote health care and improve science education and research. The foundation has been a generous supporter of the University of Jena, where Zeiss' technology was originally developed.

Since then, hundreds of other steward-owned companies have emerged. Some of these companies have adopted foundation-based structures similar to that of Zeiss, while others have opted for different legal frameworks. The most well-known of these companies include the internet pioneer Mozilla (US), home healthcare provider Bayada (US), the electronics company Bosch (GER), the pharmaceutical company Novo Nordisk (DEN), and the department store chain John Lewis (UK).

Key principles

Profits serve purpose

For steward-owned companies, profits are a means to an end, not an end in and of themselves. All the profits generated by the company are either reinvested in the business, used to repay investors, shared with stakeholders, or donated to charity.

Self governance

For-profit businesses are often beholden to the interests of shareholders who aren't involved in the operation or management of the business. Steward-ownership structures keep control with the people who are actively engaged in or connected to the business. Voting shares can only be held by stewards, i.e., people in or close the business, and the business itself can never be sold.

These principles are a binding commitment to long-term mission preservation and independence. How they are legally enshrined into a company's legal DNA varies across organizations, but all steward-ownership models ensure that a company's steering wheel is passed on to able, talented, and values-aligned successors. Control cannot be bought or inherited. In this sense, steward-ownership represents a third way of allocating power in a company. This alternative power distribution ensures that management decisions reflect the interests of a broader range of stakeholders - not just economic shareholders. Profits in these organizations are clearly defined as a tool for supporting the company's mission, not an end in and of themselves. As a result, these structures help to resolve the inherent conflict between profit maximization and mission preservation. Because economic and voting rights are clearly separated, no individual owners, employees, or external stakeholders have a right to profit at the cost of the success of the business. What's more, no party is personally incentivized to maximize profit at the expense of purpose. This ensures the stewards of a company are able to make the best decisions for the whole organization, not only for themselves or for capital providers. It empowers them to take a long-term perspective on strategy without pressure from quarterly earnings reports or public stock valuations.

Proven benefits of steward-ownership

Steward-ownership keeps the underlying purpose and mission of a company deeply embedded in its operation, and enables generations of stewards to carry on the mission and values of an organization and protect its impact. Steward-owned companies are proven to be more successful over the long-term and act in the interests of a broad range of stakeholders, including employees, consumers, and society.

Mission and values preservation

Steward-ownership is a long-term commitment to a company's mission and values. Although these companies can still raise growth capital, control of the company can never be bought or sold in the traditional sense. Even if a steward-owned company is in a position where it can no longer survive and needs to sell, the proceeds from the sale are locked into the structure and would go to furthering the purpose of the company.

Long-term orientation

Without short-term pressure from financial markets and investors, steward-owned companies can focus on what is best for their organizations, employees, customers, investors, and society at large in the long-term. This leads to more innovation, as companies are able to reinvest more of their earnings into research and development (Thomsen, S. 2017). It also results in an improved longevity and resilience during economic downturns. Steward-owned companies are six times more likely to survive over 40 years than conventional companies (Børsting, C., Kuhn, J., Poulsen T., und Thomsen, S., 2017).

Good governance and management

Steward-ownership creates a foundation for exceptional governance and management, critical factors for the long-term success of any business. Transitioning to steward-ownership requires a deep exploration of the values, mission, purpose, and goals of an organization. The governance design process forces current owners and stakeholders to identify what the best solutions are for a company in the long-term. The results are governance and management systems that are better and more productive for employees and management, and more successful in fulfilling the purpose of the company.

Employee productivity and retention

Steward-ownership is a legally binding commitment to employees, guaranteeing that their work benefits the purpose of the company and not just its financial owners. This creates a psychological basis for deeper motivation. Additionally, workers experience increased job security, better representation in corporate governance, and fairer pay (Thomsen, S. 2017). This results in increased productivity (Kuhn, J and Thomsen, S., 2015) and social cohesion, which enables firms to attract and retain top talent.

Customer loyalty

Partners and consumers benefit from the improved service of a company in which employees and managers feel connected to and directly responsible for a company's mission. This leads to long-term customer loyalty.

Case Studies

Ziel

Mission-aligned ownership structure and financing

Ziel makes on-demand, quality activewear apparel in the United States. With a strong focus on sustainability, Ziel's model reduces waste and enables a flexible supply of clothing items which are made to order to the highest standard.

Marleen Vogelaar started Ziel in 2015 with a mission: to reduce waste in fashion manufacturing by leveraging on-demand technologies. Unlike traditional clothing manufacturers, which require design and inventory commitment a year before production, Ziel's platform enables companies to commission custom athletic apparel with no minimum order and delivery in under 10 days. Although still in its early stages, Ziel's designs have already been featured in Vogue magazine. The company has the potential to revolutionize how and where clothing is manufactured, and to dramatically decrease the amount of overproduction and waste in the apparel industry.

Making fashion sustainable

The fast fashion trend has become one of the world's worst environmental offenders. Our reliance on toxic textile treatments and dyes has contaminated river systems and water quality in major garment manufacturing areas like China, India, and Bangladesh. Meanwhile, popular synthetics fibers like polyester, nylon, and acrylic are essentially plastics made from petroleum. These materials take hundreds of years - if not more - to biodegrade.

Despite the adverse environmental impact of fashion manufacturing, we dispose of more clothing than ever. The apparel industry as a whole has a serious problem with overproduction: 40 percent of what it produces cannot be sold, and is destroyed or heavily discounted. These unwanted garments, which are often burned, shredded, or landfilled, have a huge impact on the planet. They release millions of tons of CO_2 into the atmosphere and result in hundreds of millions of tons of unrecycled toxic textiles in landfills annually. With Ziel, Vogelaar wants to make the industry more sustainable by using ecologically friendly textiles and fundamentally rethinking how clothing is ordered and manufactured. As a co-founder of Shapeways, the world's largest 3D printing service and marketplace, Vogelaar drove the transformation of 3D printing into the digital era of mass custom manufacturing. She's now bringing this same on-demand, network-based approach to athletic wear to reduces waste. Ziel exclusively sources textiles from the US that are dyed with a water-free process to avoid waste and water pollution.

Steward-shares

Represent **99%** of voting rights of the company, but no dividend rights.

Founder-shares

Founder shares have dividend rights but no voting rights. They are bought back by the company at a pre-determined valuation and represent delayed compensation for the founding years.

Veto-share

Veto-share
The Purpose Foundation holds a **1%** Veto-share without dividend rights.
This share can block a sale of the company and any change to the charter that would undermine steward-ownership.

Investor-shares

Investor-shares hold dividend rights, but no voting rights.

ziel

All of its products are made in the US, helping to create local jobs for low-middle class workers and eliminating the financial and environmental costs of overseas shipping.

Steward-ownership: mission protection

With her experience founding Shapeways and raising over $75 million in venture capital, Vogelaar is well-versed in the trade-off between growth and control. With Ziel she wanted to do things differently: She wanted to secure growth capital, while ensuring her mission of reducing fashion waste was never compromised by the needs of external stakeholders. Rather than exit the company through an IPO or private sale, Vogelaar wanted to keep control of the company inside the company with mission-aligned stewards.

To protect the company's independence and mission for the long-term, Vogelaar transitioned the company to steward-ownership. Ziel's Golden Share structure enables the company to take on the necessary capital to grow, while ensuring its independence and mission are protected over the long-term.

Clear division of voting and economic rights

Ziel's Golden Share structure includes four share classes, separating economic from voting rights while enabling the company to take on growth capital.

Steward-shares (A-shares)

Steward-shares, in this case Class A Common Stock in a US corporation, are retained by the company. They represent voting rights but not dividend rights. Only individuals active in the company may hold A-Shares. In the event that a team member leaves the company, their A-Shares must be returned to the company or passed on to new team members.

Founder-shares (B-shares)

There are two types of B-shares: Founder and Employee B-shares. B-shares don't have voting rights, but they can be redeemed by the company and receive dividends. The proportion of profits the company can use to buy back B-Shares is limited to protect the upside of investor-shares (D-shares).

Veto-share (C-shares)

One C-share was issued to The Purpose Foundation. The veto-share holder is responsible for vetoing any changes to the structure of Ziel's charter that would undermine the legal separation of voting and dividend rights, as well as any attempted sale of the company.
The veto-share holder does not have any further rights, and cannot weigh in on the company's operations

Investor shares (D-shares)

D-shares represent dividend rights but not voting rights. Structured as non-voting preferred equity, D-shares represent redeemable shares. The shareholder agreement requires the company to use a proportion of its free cash flow to redeem these shares for a predefined amount per share until they have been fully redeemed; the goal is to buy back all the shares in the next 10 years.

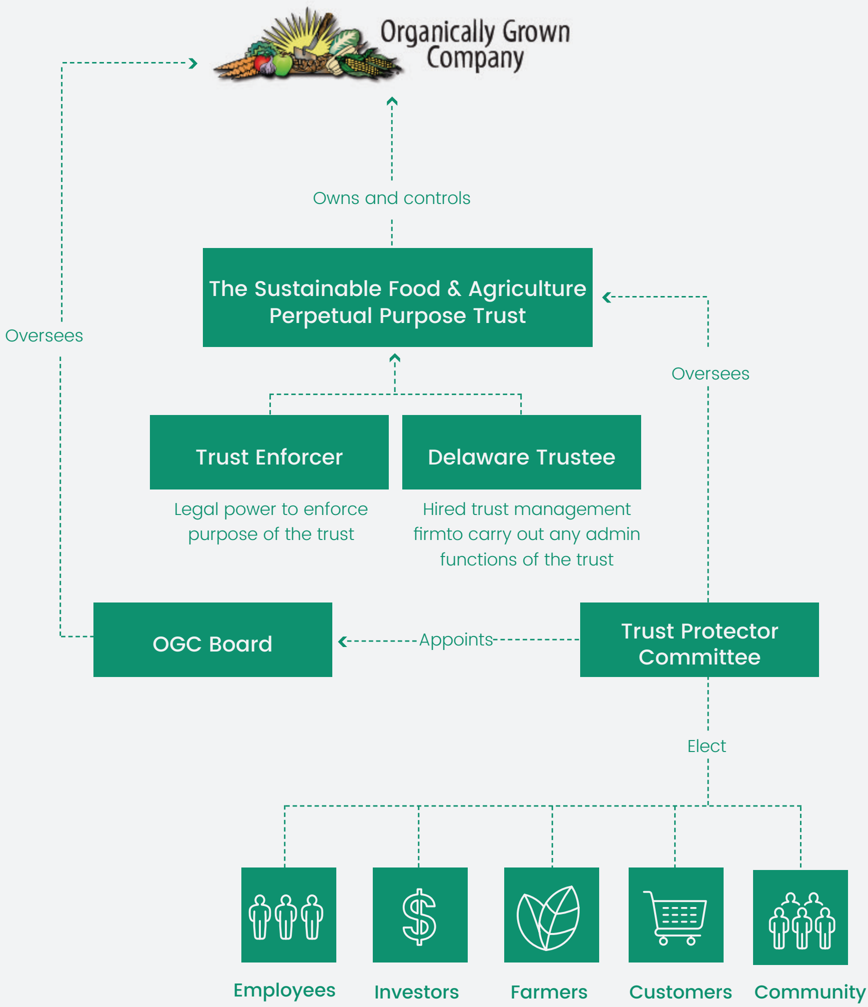
Ziel's steward-ownership model ensures the steering wheel of the company remains with the people most connected to its mission, customers, and operation over the long-term. By separating voting and dividend rights, the model protects the company from ever being forced by investors to maximize profit at the expense of purpose. What's more, the veto-share, held by a third party foundation, prevents any changes from being made to the company's governance structure, and prohibits any sale.

Organically Grown Company

Multi-stakeholder perpetual purpose trust

Organically Grown Company has been a leader in sustainable and organic agriculture for over 40 years. Its transition to steward-ownership reflects the company's deep commitment to supporting organic agriculture and helping it thrive by doing business in a way that is good, clean, and fair.

Founded in 1978, Organically Grown Company (OGC) has been a pioneer in sustainable, organic agriculture for over 40 years. From its roots as a farmer-run nonprofit, OGC has grown into one of the largest independent organic produce distributors in the United States. In 2017 the company moved more than 100 million pounds of fresh fruit and vegetables across the Pacific Northwest, employing more than 200 people. OGC has been instrumental in building and supporting organic regulation and trade at both the regional and national levels. OGC understands the impact ownership can have on an organization's mission, and has utilized multiple ownership structures over the course of its existence. It began as a nonprofit set up to help farmers implement organic growing methods; a few years later, however, the founders realized that selling the goods farmers produced would be a more effective way to support both them and the larger movement. The company became a farmers' cooperative, and later an S-Corp that worked to include employees in its ownership structure. Eventually, OGC created an employee stock ownership plan (ESOP).


Organically Grown Company
Owns and controls
The Sustainable Food & Agriculture Perpetual Purpose Trust
Oversees
Oversees
Trust Enforcer
Legal power to enforce purpose of the trust
Delaware Trustee
Hired trust management firmto carry out any admin functions of the trust
OGC Board
Appoints
Trust Protector Committee
Elect
Employees
Investors
Farmers
Customers
Community

Case Study

Scaling without selling

A few years ago the company was faced with a common business challenge: How does a mission-based company scale and transition its founders and early employees without selling or going public? OGC needed a long-term ownership solution that would allow it to remain purpose-driven and independent. Presented with this challenge, OGC sought an alternative ownership structure in the form of a Perpetual Purpose Trust (PPT), along with financing solutions that would enable the company to responsibly exit owners and employees while preserving its mission.

In 2018 OGC established the Sustainable Food and Agriculture PPT. Unlike conventional trusts, a PPT is established for the benefit of a purpose, rather than a person. It's also unique in that it runs in perpetuity instead of having a limit of 21 years or ending with the death of the grantor. OGC used a combination of debt and equity to buy back all of the shares from its stockholders in order to transition from an ESOP to a PPT; the Trust will eventually hold 100 percent of the company's ownership rights. This structure ensures OGC's long-term independence and mission-commitment.

Like all forms of steward-ownership, the Sustainable Food and Agriculture PPT ensures the separation of economic and voting rights. The PPT's Trust Agreement lays out the powers of the trustees and the company's governance processes. Power is shared among three governance bodies: the Corporate Trustee, the Trust Protector Committee, and the Trust Enforcer.

› Delaware Corporate Trustee

The Corporate Trustee is responsible for the prudent management of the Trust in accordance with the Trust Agreement terms. The Trustee is responsible for the Trust's administration, including tax reporting, trust distributions, etc. The original Trustee is appointed in the Trust Agreement. In the future, the Trust Protector Committee may remove or replace the Trustee, or the Trustee may appoint a successor.

› Trust Protector Committee

The Trust Protector Committee serves as the steward of OGC's mission. It is comprised of a broad range of stakeholders, including employees, growers, key customers, investors, and community representatives. Current committee members include Joe Rogoff, former president of Whole Foods Market, and George Siemon, CEO of Organic Valley. The authorities of the Trust Protector Committee are defined in the Trust Agreement. The Committee may modify the Trust Agreement, but cannot unilaterally redefine its purpose. The Committee is responsible for approving distributions from the Trust, as well as electing OGC's operational Board of Directors.

› Trust Enforcer

The Trust Enforcer is a stand-in for a traditional trust beneficiary, and is responsible for enforcing the purposes of the trust. The Enforcer may request and review information about OGC's financing, receive grievances from stakeholders concerning the operation of the Trust, and pursue legal action to enforce the purposes of the Trust.

Purpose maximization

The PPT structure enables OGC to remain permanently independent and to continue to deliver on its positive environmental, social, and economic goals without pressure to demonstrate short-term quarterly profits or produce exit-value for shareholders. Furthermore, it enables the stewards of the organization, who represent a broad range of stakeholders – including farmers, employees, customers, investors, and the wider community – to realize the company's purpose while sharing in its profits.

Structuring alternative financing solutions

In order to buy out previous shareholders and recapitalize its business, OGC leveraged a combination of debt and equity. The transaction presented a unique challenge: How could OGC provide investors with a reasonable risk-adjusted return on their investments while honoring its commitment to prioritizing purpose over profits? How could it balance the demands of a shared-representation structure with its need to maintain its own independence? To solve this problem, OGC and its investors collaborated on a deal structure that would balance both profits and governance responsibilities between the company and its stakeholder groups.

Shared governance

Investors are included as one of the five key stakeholder groups represented in the Trust Protector Committee. The committee is responsible for ensuring that the company is fulfilling its mission of supporting a healthy food ecosystem, and that the Board is operating the company for the benefit of all its stakeholders. If one of the stakeholder groups feels that OGC's Board or management is not acting in its best interests, it can petition the Trust Protector Committee to intervene on its behalf.

Shared upside

Preferred equity investors are entitled to a base preferred dividend. This dividend is cumulative – that is, if the dividend is not paid one year, it is still due the following year. Investor dividends are to be paid before any other stakeholder groups participate in profit distributions. The logic behind this structure is that workers and growers have already received their base pay as part of the ordinary course of business, so investors should get their preferred/base returns before others receive their benefits. OGC will distribute any excess profits to its stakeholder groups based on a predefined split:

Investors share in the company's profits when it does well, as is customary for an equity investment. For instance, if OGC does well, dividends to investors could increase by a factor of two or more.

Investors do not extract an outsized share of profits, however. Should the company produce surplus profits, other stakeholder groups receive 60 percent of additional distributions until investors receive a predefined percent of dividends, and 80 percent of profits thereafter.

Mētis Construction

Employee ownership trust: perpetual worker-ownership

Mētis Construction's unique Employee Ownership Trust combines the direct democracy of a worker-owned and controlled cooperative with the mission protection of steward-ownership. The structure ensures that both current worker-members and future generations of craftsmen will benefit from the business' success.

Matthias Scheiblehner founded Mētis Construction in 2008 in Seattle as a sole proprietorship. At the time Matthias was an independent contractor working with a group of other contractors and craftspeople on projects; over time the group found themselves working together nearly full-time on Mētis projects, and decided to form a worker-owned construction company.

Although the founding members knew they wanted Mētis to be worker-owned and controlled, they didn't want the company to only benefit its current members. Instead, they wanted Mētis to serve craftspeople for generations to come. This reflects a deep belief that carpentry is not just a tradeable skill, but a craft that's been cultivated and passed down for thousands of years. Rather than extract wealth from the labor of other carpenters, the founders of Mētis believed that as practitioners of the trade of carpentry they should band together and act as stewards of the trade for the benefit of the current and

Employee Ownership Trust

WA Perpetual Trust

Trust owns WA C-Corp on behalf of the membership

MĒTIS

WA C-Corp

Board of Directors / Trustees oversees governance, overall company performance, and hires the President

Board of directors

Elects

Employee-owner membership

Employee-owned stewardship

The co-founders of Mētis wanted to find a legal structure that reflected this conviction. They wanted a model that would help secure craftwork as a viable, stable profession by giving employees the opportunity to benefit from the company's successes, while also empowering them to act as stewards of the craft for future generations. In 2016, with the support of ICA and others, Mētis Construction transitioned to an employee-owned trust (EOT), which ensures that the business will remain worker-owned and controlled into the future. Unlike conventional trusts, an EOT is established for the benefit of a purpose - employee ownership - rather than an individual person. It's also unique in that it runs in perpetuity, instead of being limited to 21 years or the life of the grantor.

The EOT structure ensures that Mētis will remain independent and democratically controlled by its members into future generations. The trust agreement lays out the power of both the company's membership and its board of trustees, and the responsibilities of the outside trustee. It also outlines core values of the trust: Membership can never be sold, wages must be market-rate, the company must promote equity work as part of its mission, and, in the event that the company were to be liquidated, the profits would be donated to nonprofit organizations supporting worker ownership. In its governance, Mētis works similarly to a conventional worker coop; like a conventional worker coop, Mētis operates on the one worker/one vote principle.

Membership

The membership is responsible for electing the board of trustees and voting on bylaws and operating rules. Members have the right to share in the company's profits when the membership votes to distribute them. Although the goal is to distribute 70 percent of profits to members, the trust agreement explicitly obligates the membership to pass a strong company onto the next generation - meaning that in some years the membership may forego distributing profits to its members.

Worker-owner membership has no nominal value and cannot be sold. Once an employee leaves Mētis, their membership goes back to the company. As a result, the decision to become a member is a values-driven decision and reflects a desire to be a steward of the business rather than merely profit from its success. Employees are automatically given an opportunity to become members of Mētis' worker-ownership after a five-year waiting person or through a two-year expedited membership process. There are currently 16 members and 20 non-members. The goal is to have a little more than half of the employees as member-owners.

Board of Trustees

The board of trustees is elected by the members. It currently comprises five members and two non-members, all of whom are employees. Any Mētis member can run for the board of trustees, and a non-member can run if they are nominated by 3 members. The board of trustees is responsible for overseeing the company's operations and hiring the president of the company, who in turn hires the staff.

Outside Trustee

The outside trustee is a non-member responsible for auditing the company. An audit include a review of allocations made during the years covered by the audit, membership numbers and composition, and work done to achieve equity goals.

Creating a future of inclusion and sustainability

Since adopting the EOT in 2016, Mētis Construction has experienced continued financial success and thriving democratic governance. Members and non-members gather monthly to review the employee handbook and procedures. A cultural ethos of care for the people and planet is strongly embedded into this culture, leading members to challenge themselves to improve the company's environmental impact, a significant challenge in construction. They also push to include non-member profit-sharing, as well as further the company's equity work and community participation.

“It is our goal to create and maintain a structure that will remain in place for future generations of craftspeople; a structure that promotes the practice and teaching of the trades and the fostering of craftsmanship; a structure that facilitates worker ownership and hence promotes the financial viability of the trades as a career choice. We hope to provide an alternative model to that which dominates the marketplace and leads to the alienation of individuals from the products of their labor, the people with whom they work, the people for whom they produce, and the natural world.”

Mētis Construction

Structuring steward-ownership

Steward-ownership can be realized through several structures that instill a company's mission and independence into its legal DNA. These vary across legal jurisdictions, as well as in their structural complexity and governance philosophies.

Some structures, such as the Perpetual Purpose Trust, are uniquely designed to include a broad range of stakeholders in their governance and profit-sharing structures, e.g., employees, vendors, and investors. Other models, such as the Golden Share, can be adapted to accommodate the cultural and governance needs of both small and large organizations. All of the following ownership models share the same steward-ownership principles of self-governance and profits serving purpose. They ensure that control of a business is passed down from one generation of trusted stewards to the next, and that the company's mission is protected over the long-term.

In this way these models differ from other ownership structures like family-owned businesses, coops, and B corporations. Unlike family-owned business, in which both voting and economic rights are passed on to blood relatives, successors in steward-owned companies are selected based on ability and values-alignment. Cooperatives arrangements, in which each stakeholder is granted one vote, can still view the company as a commodity that can be sold for the benefit of its members. Although cooperatives can be set up as steward-owned companies, steward-ownership structures include protective provisions that de-incentivize, practically prohibiting, owner-members from selling. And unlike B Corps, which commit a company to its purpose, steward-ownership changes the fundamental power structure of a company. Again, steward-owned companies de-commodify corporate control to ensure long-term independence. As such, steward-ownership goes further than these models to secure a company's independence, preserve its mission, and separate economic and voting rights.

Golden Share

Jurisdictions: Delaware
Examples: Ziel, Creative Action Network

The US-Golden Share charter was developed by Rick Alexander, General Counsel of BLab, together with the Purpose Foundation. Based on the Delaware Public Benefit Corporate charter, the Golden Share form ensures that a company's assets are committed to a purpose and cannot be privatized, and that its governance is in the hands of people who are interested in the company's mission, rather than merely in profits. It fundamentally separates governance and economic rights by creating two to four types of shareholders. The mechanics of these shares vary depending on the business, but the essential logic remains the same:

Company

Governance Rights

Steward Shares

Steward shares (A-shares) hold 99% of voting rights of the company, but no dividend rights. These shares can only be held by people active in the business or closely related to its mission.

Golden Shares

Golden Share represents 1% of voting rights and the right to veto an attempted sale of the company or any changes to the structure that would undermine the separation of voting rights and dividend rights.

Economic Rights

Non-voting preferred shares

If needed, B-Shares can be issued for investors, founders, or employees. These shares hold dividend rights but no economic rights.

Employees and founders can only hold these shares if they are capped in order to avoid a conflict of interest between mission-preservation and profit-maximization. In any case, these shares are ideally issued with capped repurchase rights so that the company can repurchase them in the future.

Steward shares

These shares typically represent 99 to 100 percent of a company's voting rights, without any accompanying dividend rights. These shares cannot be sold on the free market, nor can they automatically be passed on to blood relatives. Instead, steward-shares are passed on to able and aligned successors. Some companies explicitly limit the group of people eligible to receive shares – for example, many companies using a Golden Share model specify that steward-shares can only be held by active employees. Some less common restrictions include other clearly defined groups of stakeholders, or limit share ownership to company management. How successors are chosen varies across companies. In some companies, stewards select their successors, who are then confirmed or vetoed by a workers council; others are guided by a succession board of independent advisors; in some cases, stewards are appointed by the company or an outside actor, typically years before succession.

Non-voting preferred shares

If necessary, share classes may be created with economic rights but no voting rights. These shares may be held by a charitable entity, investors, employees, or founders. Employees and founders can only hold these shares if there is a cap to potential dividend payouts to avoid a conflict of interest between mission-preservation and profit-maximization. In any case, these shares are ideally issued with capped repurchase rights so that the company can repurchase them in the future.

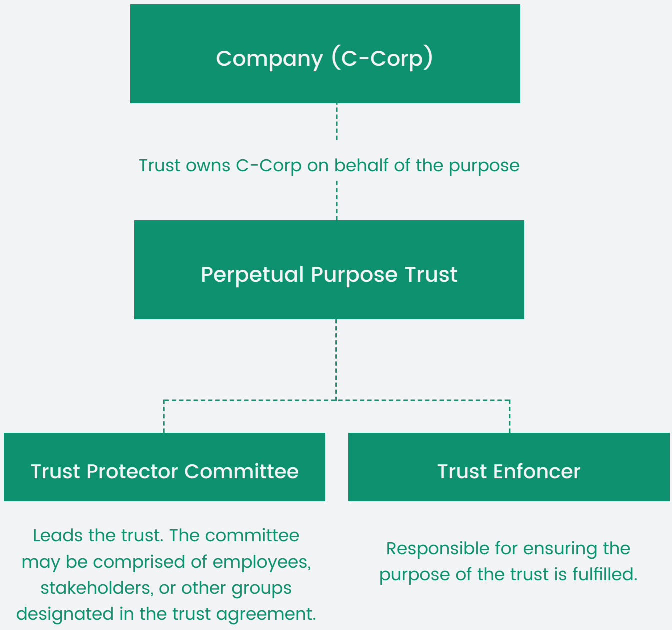
Golden share

This share class may comprise 1 percent or less of the company's normal voting power. The Golden Share holds veto rights on all decisions that would effectively undermine the company's commitment to steward-ownership. This veto share is held by a "veto-service" foundation such as the Purpose Foundation. To be a veto-share provider, a foundation must be self-owned and have clear provisions in its own charter that enable it to use this veto right to protect the provisions of steward-ownership. The veto-service foundation does not have a vote in any corporate decisions other than those that would change the company's constitution regarding its steward-ownership.

Perpetual Trusts

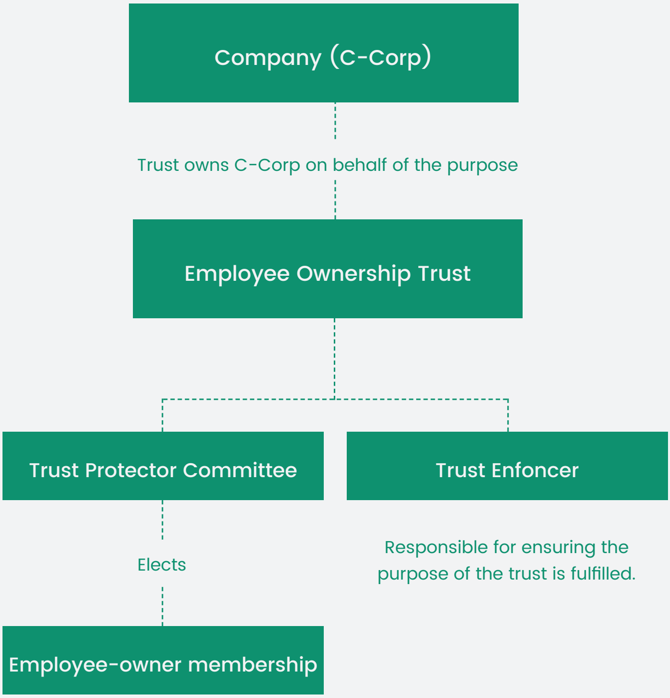
Jurisdictions: Four states currently have trust laws that meet all the criteria for a Perpetual Purpose Trust or Employee Ownership Trust as they apply to steward-ownership: Delaware, New Hampshire, Wyoming, and Maine. Nevada and South Dakota also permit the concept, but with constraints.
Examples: Organically Grown Company, Equity Atlas, Mëtis Construction

The Perpetual Purpose Trust (PPT) is a non-charitable trust that is established for the benefit of a purpose rather than a person. Unlike most trusts, which generally last 21 years or end with the death of the grantor, a PPT may operate indefinitely. The PPT structure grants a great deal of flexibility in how Trust Agreements are structured, the purpose of the trust, and how the operating bodies relate to each other. As a result, the PPT makes it possible to include multiple stakeholder groups – like vendors and employees – in a Trust Agreement.



Employee Ownership Trust

The Employee Ownership Trust (EOT) is a type of PPT in which employees or members are defined as the "purpose" of the business. The trust structure ensures that the ownership of a company remains in the hands of its employees or members. Employee-ownership in the trust is contingent on employment, and all privileges and rights are terminated when an individual leaves the company. Membership rights and privileges cannot be sold or transferred.



The requirements of these trust structures vary across states. Common required elements include:

Trust Enforcer

With a PPT or EOT, a trust enforcer (which can be one or more persons) is appointed to make sure the purpose of the trust is fulfilled. They play the role of trust beneficiary and enforce the purposes of the trust, and have the authority to pursue legal action if necessary. The enforcer does not have the power to change the trust situs, to change or modify the status of the trust, or to change its beneficiaries/purpose. Their appointment/removal powers are stated in the Trust Agreement, and are either held by the Trust Protector Committee or the Operating Company Board of Directors.

Trust Protector Committee

The Trust Protector Committee is the party appointed in a trust agreement to advise the trustee and ensure that the trust pursues its purpose. The Trust Protector Committee approves profit distributions from the Trust, and has the authority to modify the Trust Agreement – though with limitations when it comes to changing the Trust's purpose. It also has the authority to remove or replace a trustee, and to terminate the trust (though only in conjunction with other parties).

Corporate Trustee

A corporate trustee may also need to be appointed in the state where the Perpetual Purpose Trust is located, i.e., a Delaware Corporate Trustee. The trustee's role is often focused on administrative matters, e.g., tax reporting, trust distributions, etc.

Both the PPT and EOT structures grant a great deal of flexibility in how Trust Agreements are structured, the purpose of the trust, and how the operating bodies relate to each other. In particular, the PPT makes it easy to include multiple stakeholder groups – like vendors and employees – into the Trust Agreement.

Cooperatives

Jurisdictions: Cooperative law varies state-to-state
Examples: Evergreen Cooperatives, Equal Exchange

There are several ways cooperatives can be structured as steward-owned companies. When cooperatives become successful, so do the member-owners in the business. In these circumstances, it's not uncommon for members to sell the company to another firm, or transform the co-op into a non-cooperative structure in order to personally benefit from the company's successes. This is commonly known as "demutualization." This is especially common among cooperatives that are organized as "producer cooperatives", where member-owners are other businesses rather than worker-owners. There are solutions that can can be introduced to the structure to prevent de-mutualisation and ensure the long-term independence of the cooperative.

Golden Share

Similar to the Golden Share structure described before, a Golden Share (comprising 1% or more of the cooperative's ownership) is held by a third-party non-profit or veto-shareholder. The Golden Share does not give the third-party control over any business management or operations decisions, but it does have the explicit right to veto any attempted sale of the company, except in certain extreme circumstances. This preserves worker-governance while preventing demutualization.

Example: Evergreen Cooperatives

Evergreen Cooperatives, based in Cleveland, implements Golden Shares into all the cooperatives it helps set up and fund. The Golden Share helped Evergreen solve an interesting challenge - namely, how do you ensure that the capital invested in these cooperatives by foundations, government agencies, and non-profit organizations, which is meant to support economic development and combat poverty, doesn't get privatized by worker-owners through the demutualization and sale of a cooperative?

Under Evergreen Cooperatives' approach, each cooperative is 80 percent owned by its workers and 20 percent owned by the non-profit corporation at the center of its network. Workers are included in the governance of the non-profit, along with other community stakeholders. The Golden Share, i.e., the 20 percent owned by the non-profit, has limited rights to veto the sale of any of the cooperatives.

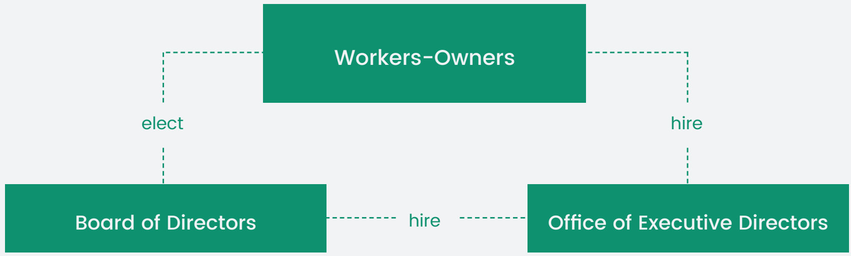
Poison Pill

In addition to the Golden Share, many cooperatives elect to enact a "poison-pill" - a charter clause that ensures that any profits from a sale would not be distributed directly to member-owners of the business, but rather donated to pre-selected non-profit organizations. Poison pills eliminate any incentive for the membership to demutualize for personal gain. In order to secure a cooperative's long-term independence, poison pills should be difficult to unwind. A "strong" poison pill would enshrine a high voting threshold in the cooperative's charter to ensure the clause is not overturned as an intermediate step in a profit-privatising demutualizsation.

As an additional layer of security, a cooperative can also elect to give a third-party Golden Share the right to veto any changes to the charter regarding the poison pill.

Example: Equal Exchange

Equal Exchange, based in Boston, was started over thirty years ago with the goals of bringing more equity to the coffee trade and fostering more consumer engagement, all within the context of a democratic cooperative model. As a worker-owned cooperative, only workers hold voting stock and they operate on the "one-vote per member" principle. All members are eligible for patronage rebate, i.e., profit-sharing, which is distributed equally among the members. The board, which is comprised of six employees and three people from outside the organization, decides how much of the annual profits will be distributed. In order to protect the cooperative's independence and it ensure it is never demutualized, Equal Exchange's bylaws include a "strong" poison pill. The poison pill bylaw clauses mandates that if the cooperative were to go out of business or were sold, all remaining assets, after obligations are repaid, would be donated to a fair trade organization.



Governance spectrum

The structures described in this section can be adapted to accommodate a variety of governance objectives. Steward-ownership as a philosophy is not prescriptive about governance design or stakeholder inclusion. From founder-lead stewardship to employee-ownership and multi-stakeholder governance, a spectrum of governance philosophies can be realized through these legal forms. It's important to note that the legal forms themselves, apart from cooperatives, do not prescribe any specific form of stakeholder inclusion. For example, the Perpetual Purpose Trust may be designed to include a range of stakeholders, as in the case of Organically Grown Company, but it is not mandatory, and the same legal structure could be used to create a simpler governance structure with a smaller group of stewards. How a company designs its governance structure depends greatly on the stage of the company, its history, culture, and values. Luckily, most of the steward-owned legal forms allow for flexible governance design.

Financing

Innovating finance for social enterprises

Aner Ben-Ami, Founding Partner Candide Group

The social enterprise community is revered as an innovative ecosystem of investors and entrepreneurs, with business models as diverse as the challenges they address, from poverty in the global south to recidivism and urban farming in the United States.

How are these businesses funded?

Oddly enough, the vast majority of social enterprises raise capital using the standard equity or convertible note term sheets designed to support fast-growing tech start-ups. But if a company is building a water distribution system in Kenya or a local food hub in North Carolina, why would it be funded using the same investment terms used to fund Snapchat, Instagram, or Uber? When was the last time an artisan sourcing project went public, or got acquired by Google?

At Candide Group, we seek to invest in companies and funds that offer systemic solutions to social justice and sustainability issues. We believe that the economic model and the investment tools utilized are inseparable parts of any approach to systemic change. Simply applying the same old models to companies that are distributing organic products, assembling fairly-sourced consumer electronics, or building consumer brands committed to ethical supply chains isn't sufficient. We believe that how business operates is every bit as important as what product or service it's selling. And investment structures—who owns the business, how liquidity is provided, who makes decisions, etc.—are an incredibly powerful lever in defining that how.

We need to redefine terms to better fit the unique attributes of social enterprises. Whether it be longer timelines, unconventional exits, or broader community participation, how we finance businesses today has an enormous effect on their potential impact over the long-term.

Standard term sheets: What's broken?

Models for early-stage equity investments assume a highfailure rate: As a rule of thumb, angel investors and venture capitalists expect roughly 15 percent of the companies to generate 85 percent of their returns. According to this model, at least half of a portfolio will return less than the capital originally invested. That's why early-stage investors look for returns — as those "home runs" have to make up for all the failed investments. This means that early stage venture/angel investors should only invest in companies that have the potential to become big winners.This is how the venture capital works — go big or go home.

But is that model the best one for (most) founders? How about for society as a whole?

By looking at the world through a venture capital lens, we do three things that are often bad for founders, workers, communities, and the planet:

- We overlook companies that could become good, sustainable businesses, but aren't likely to generate the outsized returns the venture funds are seeking.
- We make companies more likely to fail by pushing them to take on excessive risk in pursuit of moonshots.
- We push companies to "exit", whether or not that's in keeping with their founding vision and mission.

As the research in this book shows, we need alternative ownership and financing structures that:

(1) are flexible enough to meet the needs of very different kinds of businesses (more/less "venture style")

(2) enable companies to remain committed to their founding missions, rather than forcing them to sacrifice or dilute their missions to satisfy the needs of investors (growth, exit etc.).

Alternative approaches: What do we do instead?

To counter this "one size fits all" approach, a growing group of investors and entrepreneurs is working to develop and apply deal structures that support the growth trajectory of sustainable businesses, provide realistic returns for investors, and enable businesses to keep their missions front and center.

We say that these alternatives have "structured exits." In these deals, the path to liquidity is explicitly structured into the deal terms, as opposed to being reliant on an as-yet-unidentified acquisition or an IPO.

The overarching premise and intent of these structures can be summed up as follows: If an investment can realistically support a business to a point where it is profitable enough to pay investors back, and it is agreed that a traditional exit is unlikely or undesirable, we should be able to come up with a structure that offers liquidity to investors and sustainability for the business itself.

The examples of how this gets implemented are varied and evolving.

- In some cases, investments are still structured as equity investments, but redemption plans are more explicitly defined. The company could pledge to buy shares back every year using some percentage of its profits orrevenues, or — if this is not feasible — the company might buy shares back through a refinancing at the end of the life of the investment (e.g. a "put" option investors can utilize after 7 years).

• In other cases, investments are structured as revenue- or profit-based loans. For instance, investors could receive 3 percent of revenues until they've been paid a total of 3x their initial investment. The faster the company grows, the faster the investors earn their full returns (and vice versa).

We're seeing a groundswell of interest from founders who are increasingly aware that the venture capital "treadmill" might not be the right fit for them. We have some catching up to do on the investor side to develop the rights tools and solutions for these founders, but we are excited to continue working on these alternative solutions with pioneers like Purpose!

Aner Ben-Ami is an impact investor and founder of the Candide Group in Oakland, CA that advises and supports family offices on impact investment.

Alternative financing instruments

Like all companies, steward-owned companies reach stages in their development where they require investment capital to grow and develop their business. When a steward-owned company, or a company interested in transitioning to steward-ownership, reaches this point, its founders often find that the finance world is ill-equipped to cater to its needs.

First, let us consider the start-up context: the venture capital ecosystem and its financing tools are not designed to sustainably finance mission-driven companies. The whole start-up funding system is based on injecting large amounts of capital to grow a business so that it can be sold in a profitable exit or IPO.

Due to the high failure rate of startups, these instruments are designed to produce returns of at least 10x and more from successful investments. In addition, the term-sheets used for those investments often give investors far-reaching minority rights. One example is the "drag-along" right. Drag-along rights give investors who are interested in selling an investment the right to force the other owners, including the founders, to join the deal.

Obviously, this can undermine the social or environmental mission of the underlying company, but that's a secondary concern to the investor – and the financial objectives of investors are given more weight than the purpose of the company itself.

For companies seeking to prioritize long-term sustainability and multi-stakeholder engagement, these capital structures are often outright incompatible.

Mature companies face a similar challenge. Without access to long-term, patient capital, these businesses are often forced to sell to private equity firms or go public in order to provide investors, founders, and employees with liquidity. Private equity firms make money by cutting costs, maximizing profits,and ultimately reselling companies to other firms, where the cycle continues. It is very difficult for any business to stay committed to its values and mission in this model. And companies face similar challenges on the public market, where quarterly earnings reports, speculative investors, and activist shareholders demand businesses prioritize short-term earnings over long-term mission and strategy. Going public and selling all but guarantees a company is forced to prioritize shareholder value over its mission and the interests of its other

To sum up, conventional financing tools rarely work for social enterprises or steward-owned companies, because:

- Excessive return expectations lead to unrealistic growth trajectories, and leave viable businesses (that cannot become "unicorns") without funding;

- Equity financing with preferred shares is often designed so that investors gain as much control over a business as possible; and

- Selling shares to private equity investors or on the public market strips businesses of their independence and forces them to prioritize shareholder value over mission.

These financing tools contradict the principles of steward-ownership, compromising business' independence and any mission-oriented perspective on profits.

The problem is further compounded by the fact that even impact investors are likely to seek similar terms when funding social enterprises. While impact investors often share a social outcomes goal with founders, they frequently fail to realize the implications of those goals for a company's financing structure. That is why we often see impact investors seeking similar returns on similar terms and timelines as venture capital and private equity investors.

Fortunately, there are viable alternatives to conventional financing, and a growing community of investors and entrepreneurs who are leveraging them to support steady growth and balance the impact of their business with returns to investors. We will take a detailed look at the different options available for financing existing and prospective steward-owned companies.

Non-voting Redeemable Preferred Equity

Like traditional equity, non-voting equity represents financial ownership of the company. Redeemable shares can – and sometimes must – be repurchased by the company at a predetermined valuation, either gradually or at a fixed maturity date. The redemption value and date are clearly defined in the shareholder agreement. Redemptions can be paid from different liquidity sources, including cash, successive equity rounds, or debt.

For steward-owned companies, these shares are created without voting rights. In lieu of voting rights, investors normally require protective provisions to ensure they have some recourse in emergency situations, e.g., a CEO defrauding a company.

Unlike revenue-based financing models, non-voting redeemable preferred equity keeps money inside of companies during their crucial early years of growth. Redeemable preferred equity also has the advantage of capping redemption valuation at a certain multiple of the original purchase price, preventing shares from becoming too expensive to buy back once a company has achieved profitability. For an investor, a redeemable share has the advantage that repayment is relatively secure and predictable assuming the company remains solvent.

Company profile

Non-voting redeemable preferred equity works well for steward-companies that want to raise substantial amounts of capital ($1M+) over multiple rounds while maintaining control over decision-making. Ideally, the company has a pathway for revenue growth that allows it to meet the mounting repayment obligations. This tool is one of the most generally applicable and has been used in cases ranging from venture-backed startups to mature companies going through a recapitalization process. For later stage companies, non-voting redeemable preferred equity will often include a "base" dividend to provide a secure ongoing income source for investors.

Variables

- Conditions under which investors or the company can call for share redemptions
- Base or guaranteed dividend rate
- Protective provisions for investors

Benefits	Downsides
Similar to conventional equity, familiar to investors	Requires careful balance between capital raised and growth expectations
Clear path to liquidity for investors and founders	Requires careful business planning to make sure redemptions are feasible
Sets a clear anchor price, path, and structure for future capital raises	Difficult to raise multiple rounds if growth has been slower than projected

Equity-like debt

Subordinated loans

Subordinated loans are unsecured loans subordinate to other debt, and therefore can act like equity on a company's balance sheet. An investment is paid to the company as a loan, and repaid over a pre-defined term; the interest rate can be either fixed or variable, tied to inter-bank lending rates or the company's performance. There are many possibilities for structuring the terms – for example, they might specify that interest is only paid until a predetermined multiple of the principal has been returned. Subordinate loans work well for investors, who are often happy to assume equity-like risk but prefer the simplicity and flexibility of a debt agreement. Companies taking on subordinate loans have to be comfortable treating loan repayments as a cost, rather than distributing net profits as they would have had they issued equity. The advantage of treating interest payments as costs is that it lowers a company's taxable income.

Atypical silent participation

This type of security, which is common in Germany, is a mezzanine capital instrument that acts like equity but without the control. It is a non-trading partnership (in German a "GbR", short for "Gesellschaft bürgerlichen Rechts") between an investor and a company. The investor participates directly in the profits and losses of the company, with these profits or losses becoming effective for tax purposes as they occur. Atypical silent participation works well in Germany, in part because the losses investors incur before a company achieves profitability immediately reduce their tax liabilities. It is also much easier to implement than an actual equity investment; it does not require notarization, yet it works just like equity from a financial perspective. Atypical silent participation does not need to entail voting rights, but it can include certain red lines (or "zustimmungspflichtigen Punkte").

Demand dividend

Demand dividend

A demand dividend is a preferred equity share that requires a company to make periodic payments to investors based on a percentage of its available cash flow, usually until the investors have achieved some predetermined return – i.e., the “total obligation”. For example, Company A raises $250,000, and in return pays out 5 percent of its “free cash flow” until investors have received a total of $500,000 in distributions, or a 2x return on their initial investments. The repayment typically starts after a “holiday” or “honeymoon” period.

Company profile

Demand dividend returns work well for companies interested in keeping their voting rights and that do not want to exit or go public, and therefore need to provide investors with liquidity from their own cash flows or other growth capital. They are best suited for companies beyond the proof-of-concept stage with relatively healthy growth projections and a reasonable line of sight to stable revenues. They are less well suited for early-stage companies that are far from achieving positive cash flow and those that still rely on continuously reinvesting their profits.

Variables

- “Total obligation”

-Definition of demand dividend (e.g. % of EBITDA, other freecash flow formula)

- Holiday period

Benefits	Downsides
True equity on books	Free cash flow formulas can be complex to architect and negotiate.
Capped return - the company knows its true obligation to investors	Can be seen as an additional risk for follow-on equity investors
Holiday period enables a company to grow without the burden of payment obligations	

Revenue/royalty share

Under a revenue/royalty share loan, operating revenue is shared with investors to repay investments. In a revenue share, investors and entrepreneurs are both interested in the company's ability to create sustainable revenue. Investors are repaid incrementally as the company generates more sales, typically receiving a predetermined return on their investments. Revenue shares are easy to implement and monitor because revenue is an easily measured, uncontroversial metric of performance. Entrepreneurs benefit from a flexible payment structure, as payments to investors are directly proportional to company performance. If the company's revenue grows quickly, investors are repaid over a shorter period of time; if growth is slow, investors achieve their returns over a longer timeframe. Investors also benefit from the security of having direct access to revenue regardless of the company's other financial metrics. The model is less well suited for companies in sectors with high scaling costs, as they may end up having to repay investors even as they are still making significant losses.

Company profile

Revenue/royalty instruments work well for companies that are already profitable or have a clear path to profitability.

Variables

- Total obligation
- Proportion of sales or revenue accessible to investors

Benefits	Downsides
Easy to implement and measure	Can be seen as an additional risk for follow-on investors and debt providers
Flexible payment structures for entrepreneurs	Can put a company in a difficult position if costs remain high when royalty payments activate
Secure for investors	
Well-known structure	

Securing liquidity for investors and founders

All investors need a straightforward way to get liquidity from their investments. For early-stage investors, liquidity typically is provided through external acquisition of the company or an IPO. Because steward-owned companies do not aim for an exit, however – at least not in the traditional sense – they need alternative ways of providing investors with liquidity. Fortunately, there are several well-proven alternatives.

Cash share buybacks

The simplest and most direct way to provide liquidity for investors is from the cash generated by the company. If a company has sufficient cash reserves after a period of growth and/or saving, buybacks can be arranged with investors based on a valuation of the company or a pre-agreed buyback price or formula. To ensure buybacks do not occur solely at the discretion of the company, investors in steward-ownershipstart-ups usually get a put-option, or a "redemption right", which forces the company to use a certain percentage of free cash flow for buybacks that are valued at a predetermined price.

Leveraged buy-out

A common way to recapitalize a more mature company is to buy out earlier investors with debt, in combination with subordinated debt or preferred non-voting equity that the company issues. This works well if the company has positive cash flows or hard assets and can secure a loan with a reasonable interest rate. Debt providers often require covenants and/or liens on assets to secure their investments. Preferred equity providers might want a minimum dividend that is paid annually with a defined upside, since they don't control the company or its decisions regarding dividend payouts.

Equity raise

A startup company may want to provide investors with some liquidity through partial share buybacks as it grows and raises larger and larger rounds of equity. This relieves the return pressure for early investors, while ideally securing the company cheaper capital for continued growth.

Dividends

Some investors are willing to accept a long-term share of dividend distributions in lieu of liquidating shares. The conditions under which dividends are distributed must be agreed upon beforehand, as investors typically do not hold board seats or have controlling votes in steward-owned companies. This can take the form of a "base" or "guaranteed" dividend triggered by a milestone or a performance metric built into the dividend agreement.

Non-voting or low-voting IPO

Steward-owned companies do not allow the sale of their majority voting interests. This does not, however, preclude a company from offering shares on the public market. Indeed, roughly 70 percent of the value of the Danish stock market value is derived from steward-owned companies. These and other mainstream companies have opted to offer either strictly limited and minority controlling interests or non-voting economic shares on the public market. The latter is the preferred method for steward-owned companies, as it enables investors to capture gains from valuation increases without compromising the control of the company.

Sale to another steward-owned company

In some cases, a steward-owned company may take over another if they share a common purpose and operating philosophy. In these cases, the new parent company may take on additional capital, or use cash reserves to provide liquidity to investors and founders of the company that is being acquired. Unlike a traditional exit, this transaction does not undermine the mission of the company. In some cases a larger steward-owned company may simply be the best next steward for a steward-owned start-up.

Disclaimer
This is not financial or legal advice. Rather, the above is based on practical analysis gathered from our research into investments in steward-owned companies.

Conclusion

All of these instruments enable steward-owned companies and companies transitioning to steward-ownership to provide investors with liquidity. These instruments do not threaten the independence of a steward-owned company, nor do they compromise a company's commitment to mission-preservation. Unlike the financing instruments conventionally leveraged to provide liquidity, many of these tools require longer investment periods. Luckily, a growing number of investors understand the importance of patient capital to ensuring a company's mission and impact over the long-term.

Views on ownership

On Ownership - a conversation with Prof. Colin Meyer

Colin Mayer is the Peter Moores Professor of Management Studies at Oxford University's Saïd Business School, and served as the Peter Moores Dean of the School between 2006 and 2011. He is an expert on all aspects of corporate finance, governance and taxation, and the regulation of financial institutions. He has consulted for numerous large firms and for governments, regulators, and international agencies around the world.

What are corporations for? Why do they exist?

Colin Mayer: Corporations exist to perform functions that benefit the customers or communities of the corporations. And that reflects the origins of corporations. The first named corporation was established in Rome to undertake public functions during the first few centuries AD. The Roman concept of the corporation was designed to undertake public work, and it was subsequently adopted by the Roman Catholic Church. And in each case, they had a specifically designed function. The public works of corporations included the building of public buildings, roads, the provision of public services. One of the earliest known forms of cooperation is the university.

Public goods, as we would call them today.

CM: Yes, exactly. And in the case of the Catholic church, it was literally to run and provide the administration. In the case of the universities, it was to provide education. And in the Middle Ages it was part of the formation of the guilds overtaking trading functions, providing training for people working in those guilds.

So you take an opposing perspective to well-known statements such as "The purpose of a company is to maximize its own profits." You wouldn't agree with this.

CM: No, not at all. The purpose of a company is to perform functions that will benefit communities, societies, and customers, and in the process of doing that the owners of a company generate profits – but profits are not as such the objective of a corporation.

What are profits for then?

CM: Profits are there to provide the incentives for those who put up the capital for the business to do so, it is the reward for doing so. But while those who work for the company should be rewarded for doing so, that does not make the maximization of profits the objective of the company. The objective of the company is to deliver things that will benefit others, and in the process to make profits.

Today not many people have the impression that this is the reason corporations exist. How was this back in the old days in Rome? Did this work there already? Did the companies really work for the public benefit? What was different?

CM: What is different about the companies of Rome and those established in the Middle Ages was that they were established under license. So they had a fundamental purpose to fulfill those public functions. In the case of the medieval guilds, it was to perform the roles in terms of the delivery of particular services. In the case of the medieval companies, they got a license from the king, the monarchy, and then subsequently from parliament. So, for example, corporations in the 18th and 19th centuries, the 18th century in particular, which built railways and canals did so under licenses from parliament. So the corporation up until the 19th century was essentially licensed by government or the monarchies to perform its functions with a clearly defined public purpose behind them.

What changed that was really the establishment of the colonies in the United States. The colonies were established as corporations. So, for example, Massachusetts, Pennsylvania etc. were established as corporations. And then, in turn, they committed others to establish corporations within those states. And so emerged the freedom to incorporate, which became a feature of the corporation during the 19th century. And thereafter the distinct public function of a corporation was no longer the case.

So, all that began with colonization?

CM: Yes. So, it really emerged as part of the colonization function. And then it was adopted more widely in European companies as well.

And before that, every company had to have a license?

CM: They all had licenses to operate. There was only really in the 19th century a notion of freedom to incorporate.

That's interesting. And during this period of licensing, what was the ownership structure of these companies?

CM: So, there were public subscriptions much along the lines of what we have today. So, to take another example, the East Indian Company, which was one of the largest companies of its time in the world, had external public subscribers, so the notion of there being shareholders was well-established. But the difference was that those companies, although they had shareholders, had to perform this public function. So, in history, the fundamental purpose of the company was to fulfill its licensing condition. And as part of that, it would then generate profits.

So that's why I'm saying: The underlying notion of corporations was not to maximize their profits.

Was the East Indian Company the first company that actually had shareholders, in the sense that people who did not work for the company owned it?

CM: Well, it was not the first. I mean, for example, there was the Russian Company or the Hudson Bay Company, which were established to undertake trading activities. They all had that same notion of there being a purpose and objective of the establishment of a corporation, and then shareholders who invested in them. Now, if you look at other ones, the universities, eg., you take the Cambridge colleges, you'll find that today every single Cambridge college has its own royal charter, its own legal form of purpose. They don't have outside shareholders, but the people who run them are the fellows of the colleges.

Are they the owners?

CM: No. They are, if you like, the trustees. They are responsible for ensuring that the purpose is fulfilled and that the original charter is met. There are no owners as such. They are, if you like, ownerless corporations.

No. They are, if you like, the trustees. They are responsible for ensuring that the purpose is fulfilled and that the original charter is met. There are no owners as such. They are, if you like, ownerless corporations.

CM: Yes, as long as they work there. When they retire they are no longer members of the governing body of the college.

If we split the terms “ownership” or “property” into a bundle of rights including the ability to govern, to receive profits, to sell a company, inherit it, or even destroy it, then as I understand it the college fellows inclusively hold the right to govern.

CM: Yes, they have “management rights”, but not “ownership rights”. This in particular was an important element to the corporation, because what the companies like the Russian Company did was take the notion of the guild – they had this “ministerial” role, they were just purely administering the activities like merging or trading – but then fused that into the notion of having capital and being able to raise more capital. So the real invention behind things like The East Indian Company is to take the notion of a guild as administration and to fuse into that the notion of being able to raise capital. And that‘s what really gives rise to the distinctive feature of a corporation; it is that combination of capital and administration.

In your book, you make a strong claim about what problems corporations face. Why are corporations widely seen as a problem for society, an actor that only maximizes its own profits?

CM: Well, you really described the problem in your question. The problem is that the original intention of corporations is being lost. And the fact that you open your remarks by saying, well, actually, everyone thinks that the corporation has the objective to maximize its profit – that’s basically the source of the problem that you‘re talking about. And it might therefore just help to understand how this has come about, and how we‘ve gone from the notion of a corporation in the Middle Ages to where it is today. Freedom of incorporation, as I described it, is not itself a problem. Indeed, initially, corporations performed a very strong purpose and function. Not necessarily a public function, but they clearly had a notion of servicing their customers.

It was really during the 20th century with the change in the nature of the ownership of corporations that the emphasis shifted to the importance of the shareholders, to maximizing in the service of shareholders. The legal form of a corporation specifies, very clearly, the objective of those running the corporation is to promote the interest of the corporation, not to promote the interests of its shareholders. So, in principle, the fiduciary responsibility of directors is to the company as such; but in practice that is of little significance, and in fact all of the controlling rights reside with the shareholders.

And the reason that that has happened is that shareholding has moved from individual shareholding – what it used to be and in many countries still is, predominantly in the hands of families – to large numbers of outside shareholders, and then to institutional shareholders. And those institutional shareholders, since they are responsible to their ultimate investors, they regard their sole responsibility – perhaps quite rightly – as being just to extract as much as they can in terms of returns from the companies in which they invest. So the system has moved over time into one that has essentially conferred all of the rights and controls to shareholders, and shifted it away from those who run the corporation, who had an interest in ensuring what the interests of the corporation itself were.

The motivators for that were the technological changes occurring around the time of the Industrial Revolution in particular. There were a lot of new opportunities, in particular manufacturing opportunities that emerged that previously had not existed. That meant that the functions that needed to be performed in the economy were not based simply on public works and infrastructure. They all indeed were run in agriculture. So, around the time that Adam Smith was writing, there was a change in progress in terms of the meat of what a corporation should have to fulfill towards essentially much more innovative activities. And it was those innovative activities that then gave rise to pressure to have a freedom of incorporation.

So after the collapse of the South Sea Company in 1720, the Bubble Act prevented people from establishing private companies. But people were getting round that through essentially using partnerships, in other words unincorporated businesses. People were using unincorporated partnerships as a way of creating companies. In fact, the law was allowing people to establish surrogate corporations, and in the case of Britain in 1856 it was decided that really one had to establish private corporations as legal entities and not to encourage this way of getting around the law to establish companies.

Was this also when the limited liability act was implemented?

CM: Yes, limited liability came into being in 1856. It was designed to facilitate the raising of capital for companies that were being incorporated. And the notion of limited liability was much opposed at that time. It was a very important component of the law that allowed corporations to flourish. Some people say that limited liability is really the problem behind the corporation, and if one had freedom of incorporation without limited liability than we wouldn‘t have the current problem. But that is a complete misunderstanding. I mean, it is true that in the absence of limited liability those who own banks have a greater interest in ensuring they don‘t engage in reckless activities, but to be able to have a market and shares in companies, you have to have limited liability. Because otherwise, in terms of purchasing shares, you would only be willing to buy shares if you knew how much wealth everyone else in the company had in order to know what your liability actually is. So it is infeasible to run a system without limited liability.

We just touched the topic already briefly, but perhaps a bit more precisely what is actually the problem of these shareholder-driven companies?

CM: The problem with starting from the notion of saying that a company‘s objective is to maximize its shareholders’ interests is that it potentially undermines what is the real objective of the corporation, and that is to fulfill its purpose. The great thing about freedom of incorporation, and the reason why this was a massive step forwards, is that for freedom of incorporation you can have a myriad of purposes of companies. Companies that are designed to produce the cheapest products, companies that are designed to produce the most reliable products, those that are most innovative in whatever... Whereas previously it was only the monarch or parliament who could actually identify what should be the purpose of a company.

So the freedom of incorporation has allowed for a huge diversity of purpose, and through permitting people to identify the purpose you then allow them to identify with what is the mechanism by which they can best deliver that purpose. And incredibly, they show that they will actually deliver the best washing machines, the most reliable cars or whatever. And the answer to that is that in some cases it hinges critically on employing the most skilled people, people who are really dedicated to producing the services that are required. In some cases it requires raising large amounts of capital. But what this means is there are lots of different interests in the companies. In some cases it is the suppliers who are critically important – for example, a company that I do a lot of work with is one of the natural chocolate manufacturers, and for them access to the cocoa producers in the world and having a reliable source of cocoa supply is important. How they treat the cocoa suppliers and the commitment they make is critical to their success. They don‘t have outside shareholders. To them, raising capital is not the key element.

To a large manufacturing firm very dependent on capital intensive investments, raising outside equity is critically important. What the shareholder-view of the corporation does is it imposes the notion that the only part that really matters is the equity providers. Increasingly, that is simply not the case. One of the things I‘m going to talk about this morning is how we have moved away from the capital intensive world to a world of actually human capital and intellectual capital. And that means that the corporation today is really dependant on something that is very different from that of the shareholder-interests of the past. This focus on the notion of the shareholder-oriented corporation is actually undermining the commercial success of corporations, let alone their role in ensuring that the environment is protected and that societies are protected.

Let‘s put it like this: It would be in the shareholders’ interest that companies don‘t focus on shareholder interests.

CM: Exactly. And indeed, that‘s true for the most successful companies in the world. They have as their purpose objectives that are not maximizing shareholder value, and in the process of delivering their purpose they succeed in delivering in substantial terms for their shareholders.

What sort of companies do you have in mind?

CM: Companies like Bertelsmann, Bosch these are all owned by foundations. Their objectives are clearly defined purposes. They have a long-term stable ownership structure that allows them to focus on the purpose of the corporation. In general, there is an increasing realization that the changing ownership structure of companies is becoming very detrimental to the achievement of long-term purposes.

What would you say is the corporation of the future? Where are we heading to?

CM: There are three themes that are really emerging in the current discussions about corporations. Those are: One, purpose, ensuring purpose; two, ownership and the kind of ownership that‘s contributive to the delivery of that purpose; and three, governance and the way in which the management of companies is aligned with the delivery of that purpose. Those are the three key elements that are emerging.

What‘s going to be the key feature of the corporation of the 21st century?

CM: There are two possibilities: One is that we continue along the current trajectory, and actually we have continuing failures and collapses of economies and financial systems and continuing environmental degradation. The second is that we actually recognize the fact that there is a fundamental problem, and a new form comes about.

And if a new form comes about, what we will end up with is corporations that reflect in many respects what I was describing with this original feature of corporations that deliver substantial benefits to communities, nations, and customers. I'm optimistic. I may be naive, but I believe that there is now a sufficient realization that this needs to happen, that change is going to take place.

I'll give you an example of the way I think change is manifesting: The curricula of business schools around the world are changing dramatically from being focused on how management should deliver shareholder returns to recognizing that, actually, that's not the right focus of business school curricula, and it has to be on what is the purpose of a corporation and how should it deliver on that.

What does this mean on a company level? If we shift towards purpose-driven companies, do we stick to the current ownership structure with the shareholders?

CM: What it means for companies is that they are shifting their ownership. There are two changes taking place, one of which is that those that are running institutions like pension funds and life-insurance companies are increasingly realizing that the approach they have taken in the past century towards portfolio management, holding diversified portfolios, is not beneficial for them, and that actual success comes from being engaged, long-term shareholders. Not hedge-fund activism, but activism in the form of being supportive of management and ensuring that management will deliver on its purpose. That is one change that is taking place in terms of the nature of the institutional investment.

The other change that is taking place is that companies are increasingly realizing that the influence of the stock market on their activities is becoming incredibly detrimental. And so one of the features that is taking place over the past few years is a collapse of stock markets in the west. So, for example, over the last twenty years, the number of companies listed in the London Stock Exchange has halved from 2,000 to 1,000, and the same is taking place in the US. Companies are voting with their feet, private equity is rising and companies are going private. But private equity is not the solution, because companies need many cases to raise capital; so what will emerge is a very different nature of ownership. Companies will still be listed on stock markets, but they will have long-term, committed shareholders.

Does this mean the change consists only in the fact that shareholders, e.g. pension funds, will invest with a more long-term perspective? Who will hold the control rights?

CM: The ultimate control rights reside with those who have an interest in the delivery of the long-term purpose of the corporation. That may not necessarily be pension funds or insurance companies. The interesting feature of companies like Bertelsmann and Bosch is that they are not controlled by pension funds but by foundations, and that, I think, is a very interesting alternative model that has some advantages over the pension fund/life insurance approach.

This morning you also described the structure of the corporations within colleges like Cambridge and Oxford. You called the trustees the responsible cooperating partners. Don‘t you think, this could be a model for companies, too?

CM: So, that‘s basically like the foundations. If you like, the foundations are not quite ownerless companies, but are almost ownerless companies. Because the foundations themselves are not answerable to any outside investor. So, the Oxford Colleges model is in many respects a bit like an industrial foundation.

If you could design the perfect legal form for future companies, what would it be like?

CM: I would design it in a way to encourage as much diversity in corporate forms as possible. So, legislation should enable a company to choose that form which is best suited to its situation. It shouldn't be prescriptive in laying down any particular right form. For example, in some cases employee-owned companies are appropriate; in other cases, industrial foundations may be appropriate. An unfortunate feature of what the European Commission is trying to do is based on trying to harmonize, rather than recognizing the immense benefits that come in the European system from diversity.

You started off by depicting historical elements concerning features of corporations, especially the fact that every company needed a "license." Who could be the "purpose licence-provider" of the future?

CM: In many of the most successful companies, the essential purpose comes from those who founded the organization. And that‘s where the advantage over public licensing comes from, because you can then have a lot of individual ideas to what the purpose should be. In my book, I talk about this a bit like having lots of islands:

The world is populated by islands with different purposes, and people can choose which island they want to live in, buy from, work for, invest in.

This also goes in line with studies from Harvard and Zurich University saying that 90% of founders of companies are actually intrinsically motivated and they don’t strive for profit maximization. But then the question is, how can we make sure that this purpose drive remains when the company all of a sudden needs more money?

CM: That was the problem behind corporations. For example, in Britain, we had a lot of highly motivated and altruistic family companies, but then in the process of setting up stock markets, the businesses became invalid.

That is the advantage of the foundation. The foundation has two advantages: One, it avoids the dilution problem, because the foundation can retain control. But it also overcomes the heredity problem, which forces a company to depend on whether or not the descendants have the entrepreneurial genes of their parents. It essentially allows one to select from a much richer gene pool than in the case of just pure family companies.

Let’s go 50 years into the future. We have a lot of purpose-driven companies. How is this going to influence the functions of the economy?

CM: Well, I can illustrate that with perhaps what is the most troublesome area of the economy at the moment, and that is the banking system, where basically what we‘re trying to do is to ensure that the objectives of banks are aligned with the public purpose simply through regulation. The problem with that is that the objectives of regulators in upholding the public purpose is diametrically opposed to the objectives of owners in terms of maximizing profit. So, the owners do whatever they can to get around the regulations.

Now, what I‘ve just been describing in terms of changing the purpose – and in the case of banks ensuring the license condition is part of the purpose – that means that the fiduciary responsibilities of the directors are no longer simply to maximize profits, but to deliver on that purpose of the company. So, instead of that being a conflict between the bank and the regulator, the interest of the two becomes aligned. Through this process, whatever is perceived to be the public interest is actually delivered by corporations, not circumvented by them.

… we could deregulate and still uphold the public interest.

CM: Yes. The role of the regulator would become much less intrusive than it is at present. Thank you very much for this interview!

Evolving Mission-Based Choices to Replace the Legal “Default Setting”

Ronald D. McFall, Stoel Rives LLP

Many entrepreneurs and business owners pursue their business activities with a desire for both profitable operation and pursuit of a particular mission or goal. Those goals may range from positive environmental impacts to creation of educational opportunity to community betterment objectives. In each case, such endeavors involve balancing and accommodating the need and objectives of operating a profitable, sustainable business with support for the identified mission or goal.

That need for balance is also evident in the continued evolution of legal structures and ownership models in which mission-driven businesses may operate. Ranging from rapidly evolving ownership structures to traditional models developed in the 1930’s and 1940’s, the alternatives available to businesses have increased in number and flexibility. It is possible for those developing a new enterprise to consider both the mission of the enterprise and the stakeholders who will benefit from operation of the for-profit business when selecting a legal structure.

Most business in the United States operate in well-established legal structures that can be viewed as constituting the “Default Setting”. In most corporations or limited liability companies, ownership is the key characteristic.

Income from operation of the business is typically allocated as dividends distributed to stockholders/LLC members on basis of proportionate ownership. When the business is sold (or liquidated), any value remaining after payment of the debts of the business and any fixed claims (the “residual value”) is paid to stockholders/LLC members in proportion to ownership. Finally, in some situations involving the possible sale of a business, the Board of Directors making decisions regarding that possible sale may have a fiduciary duty to maximize the sale price for benefit of the stockholders. Arising in a variety of court cases, including those involving the Revlon cosmetics company, this application of a Board’s fiduciary duties directly impacts the possibility that the desire to maintain a company’s mission will come into conflict with the fiduciary need to maximize financial gain to the stockholders.

Fortunately, there is a long history of business organizations and structures that desire either a different mission than that presented by the default setting or wish to benefit a broader group of stakeholders than just the owners of the business.

One of the earliest business forms that allowed pursuit of alternative, mission-driven objectives was the Cooperative. Whether an agricultural marketing cooperative, a supply cooperative, a worker cooperative or a housing cooperative, the key concept is always that of "patronage": business done with or for the cooperative. Under that approach, both operating income and residual value are allocated based on the proportionate amount of business each member has done with the cooperative, regardless of how much capital each member has invested in the enterprise. In addition, governance is based on the concept of "One Member, One Vote", rather than aligning voting power with ownership. In recent years, the cooperative legal form has continued to evolve, to permit entities that are a blend of traditional cooperative principles and LLC/partnership taxation, with both patron members and investor members. That evolution has also included the development of "multi-stakeholder" cooperatives in which workers, customers, suppliers and other constituents may all hold separate classes of membership.

Another well-established alternative is to make the employees as a class of stakeholders into stockholders. While this is often completed in private companies by simple stock grants to employees, both the employees and the business may benefit, in some circumstances, from the use of an "Employee Stock Ownership Plan". Such plans provide a retirement program for the benefit of the employees, tied to the performance and success of the business. Sales of shares to the ESOP may also provide liquidity for existing stockholders and the operation of a business owned, partially or entirely, by an ESOP can provide tax-advantaged treatment. An ESOP can own S Corporation shares and dividends paid to the ESOP are typically not taxable. While such plans can provide significant benefits to the employees, ESOP's are highly regulated, with ESOP trustees subject to fiduciary duties to maximize financial benefit to employee beneficiaries.

In recent years, there has been a wave of legislation creating new types of legal entities focused on providing public benefits. Referred to broadly as "Benefit Corporations", such legal entities (either a corporation or a limited liability company) have a goal of creating a general public benefit in addition to generating profit for the owners. These entities typically identify a third-party standard as a measure of their efforts to create the identified public benefit. Such statutes, in effect, change the standard of conduct for the Board of Directors from acting in the "best interests of the corporation" to acting in both the best interests of the corporation and the public benefit pursued by the entity. However, not all of these statutes explicitly change the "default setting" described above. As a result, future interpretation of these statutes will be required to clarify the impact these statutes have on the balance between pursuit of mission and the drive for profit maximization.

Even more recently, mission-driven businesses in the United States are pursuing new legal forms and structures that seek to instill a "steward" perspective in the ownership and operation of a business, rather than the "extractive" approach that may result from the traditional focus on maximizing profit for the benefit of stockholders. One structure that is attracting interest is the "Golden Share" approach, a structure that is more familiar in Europe. That structure involves the creation of 3 types of stock: i) "steward" shares with voting rights, but no financial rights (often held by employees); ii) economic shares with no governance rights; and iii) a "Golden Share" that has the right to veto changes in mission, the sale of the business or similar fundamental modifications of the enterprise.The separation of governance rights and economic rights greatly reduces the impetus for the possible sale of the business, while the additional veto rights held by the Golden Share help assure that the mission of the business will not be easily abandoned.

Another developing structure focuses on ownership of a mission-driven operating company by a "Perpetual Purpose Trust". That type of trust does not have individual financial beneficiaries, but holds its assets—ownership in an operating company—for the benefit of the purpose for which the trust was formed. That purpose can be established in the trust agreement and, for example, could include working to spread organic or other specific agricultural practices or providing particular community benefits. If the purpose trust, as controlling owner, so directs, the operating business would be free to use its resources for the benefit of multiple classes of stakeholders, rather than solely for the trust as stockholder. In addition, so long as the operating company continues to pursue the purpose established in the trust agreement, the perpetual purpose trust, as owner, would have little incentive to sell the business.

Evolving from traditional alternatives such as cooperatives and employee ownership, the range of legal structures available to mission-driven businesses continues to grow. Increasing use of benefit corporation statutes and the development and spread of "steward ownership" models such as the Golden Share and the Perpetual Purpose Trust promise to provide even greater flexibility to entrepreneurs and business owners seeking to balance financial benefit and the other missions they are pursuing through operation of their enterprises.

Pitfalls of ESOPs - Christopher Michael

Christopher Michael is an attorney and advisor with a focus on employee ownership trusts, perpetual purpose trusts, and employee stock ownership plans. He has published on these alternatives in leading peer-reviewed law journals, including Tax Notes and Probate & Property.

For the last four decades, an employee stock ownership plan (ESOP) has been the optimal legal mechanism for transferring ownership of stock to employees in the company in which they work. A primary goal of ESOPs is often long-term employee ownership, as an ongoing employee reward program that leads to improvements in productivity and profitability, and helps to ensure the longevity of the company. Unfortunately, the laws applicable to ESOPs have not kept pace with evolving trust law. In particular, legislators have not adapted ESOP policy to states' widespread reform of the rule against perpetuities. Even in states that have eliminated the rule against perpetuities, the "exclusive benefit" rule imposed by federal law requires ESOPs to prioritize employees' retirement income at the expense of employees' continued ownership of their business, and thus prohibits a perpetual ESOP trust. As such, ESOPs are an uncertain vehicle when it comes to safeguarding the ownership of a firm by its employees. The ESOP structure is also exceedingly complex, which warrants additional concern.

This article discusses perpetuity and other related problems with ESOPs and introduces the employee ownership trust (EOT) or perpetual purpose trust (PPT) as a viable alternative.

Development of ESOPs

The ESOP was developed in the 1950s by a San Francisco lawyer named Louis Kelso. An ESOP is an employee benefit program, under which employer stock is transferred to individual employee accounts within a tax-exempt trust. The employer is required to repurchase an employee's shares upon his or her retirement. In 1974, Kelso worked with Senator Russell Long to pass legislation under the Employee Retirement Income Security Act (ERISA) that gives special status to ESOP trusts. Unlike other qualified retirement plans, ESOPs may borrow from an employer for the purchase of employer shares. 29 U.S.C. § 1108(b)(3). Over the ensuing years, additional benefits were conferred under the Internal Revenue Code, including capital gains deferral for owners who sell shares to an ESOP trust and reinvest sale proceeds in domestic securities. IRC § 1042. In recent years, many S corporations have opted for 100% employee ownership, as such companies are effectively tax-exempt due to the combination of pass-through tax treatment and the tax-exempt status of the ESOP trust. IRC §§ 501(a), 401(a), 1361(c)(6).

As a direct result of ESOP legislation, the United States has demonstrated that employee ownership can be a mainstream phenomenon. Today, eleven percent of the private-sector workforce (13.5 million employees) participates in an ESOP at 7,000 companies. ***ESOP (Employee Stock Ownership Plan) Facts***, Nat'l Center for Emp. Ownership, http://www.esop.org (last visited June 24, 2016). And approximately 1.5 million Americans work at 4,000 majority employee-owned businesses. ESOP plans exist in nearly every industry and at companies of all sizes. The largest majority ESOP company is Publix Supermarkets with over 180,000 employees. These figures are unparalleled in other major industrialized nations, and constitute a significant advance over previous historical periods. ***See generally*** Joseph R. Blasi, Richard B. Freeman & Douglas L. Kruse, The Citizen's Share, 159-66 (2013). And yet, these achievements are the consequence of a modest formula––a package of financial incentives for business owners and companies––that has enjoyed bipartisan support in Congress for the last forty years.

Naturally, four decades of ESOP practice have also yielded lessons and opportunities for improvement. Central concerns for many founders, employee-owners, employee ownership advocates, and ESOP professional service providers include the longevity of the ESOP structure itself, as well as its complexity. In the typical ESOP transaction, a retiring business owner aims to reward his or her employees and preserve the legacy of his or her business. The fiduciary duties of ESOP trustees, however, require the sale of an ESOP's stock upon receipt of a profitable offer–– which may be a boon to a single generation of employees, but eliminates ownership for future employees and diminishes the founder's legacy. Moreover, structuring the ESOP transaction is time-consuming and involves a significant learning curve, a feat that can be difficult for retiring owners. While some business owners and managers embrace the technical side of ESOPs, many more retiring owners and estate advisors prefer to avoid the tightly regulated domain of ERISA trustee standards, employee share repurchase schedules, and an obscure section of the federal tax code.

Evolving Trust Law

In the post-War period, federal legislation supported the expansive growth of employee trusts. Yet, federal policy preceded an adequate state law framework. Vesting issues (with respect to future employees) threatened the trusts' viability under the common law rule against perpetuities. Christian Marius Lauritzen, II, ***Perpetuities and Pension Trusts***, 4 Taxes 519, 520-21 (1946). By 1950, the pensions of seven million employees were jeopardized by this "serious legal problem." Article, ***Insulating Pension Benefits from Creditors***, 3 Stan. L. Rev. 270, 279 (1951).

At the same time, commentators were "unanimous in the view" that employee trusts should be exempted from the rule on policy grounds. Note, ***Legal Problems of Private Pension Plans***, 70 Harv. L. Rev. 490, 493 (1957); ***see generally***, Lauritzen, ***supra***, at 524-30. The states responded in due measure. By 1956, "[a]bout three-fourths of the states ha[d] adopted statutes exempting employee benefit trusts from...the Rule Against Perpetuities." Robert J. Lynn, James W. Foreman & William W. Wehr, ***The New Inheritance: Employee Benefit Plans as a Wealth Devolution Device***, 11 Stan. L. Rev. 242, 254 (1959).

Of course, beginning in 1983 with South Dakota, a majority of states altogether eliminated, or substantially modified, the rule against perpetuities. S.D. Codified Laws § 43-5-8; accord. Del. Code Ann. tit. 25, § 503; N.J. Stat. Ann. § 46:2F-9. In so doing, these states allowed the possibility of perpetual (or dynasty) trusts for any number of trust purposes. Perpetual trusts are now commonplace and simple.

The employee ownership policy enacted by Kelso and Long in 1974 did not fully leverage the availability of perpetual employee trusts across the United States. Neither did ESOP law incorporate advances in dynasty trust law more generally over the ensuing forty years. Under current law, a trust provision that instructs an ESOP trustee to hold employer shares in perpetuity, thereby establishing a lasting program of employee ownership at the company, would conflict with the "exclusive benefit" rule under Title I of ERISA.

The "Exclusive Benefit" Rule

Under ERISA, ESOP fiduciaries must act with "the exclusive purpose of: (i) providing benefits to participants [employees] and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan." 29 U.S.C. §1104(a)(1). For many years, discrepancies between the Department of Labor (DOL), the Internal Revenue Service (IRS), and federal courts permitted a range of opinion as to the types of benefits permissible under the law. According to a 1992 memorandum, the DOL and the IRS objected to a plan that incorporated non-financial benefits, such as "job security," "conditions of employment," "employment opportunities," and "the prospect of the Participants and ***prospective*** Participants for future benefits under the Plan." Gen. ***Counsel Memorandum***, GCM 39870, at 2-3 (I.R.S. Apr. 7, 1992) (emphasis added). In a 1994 bulletin, the DOL issued a slightly more flexible interpretation that allowed for the consideration of collateral benefits "that were not related to the plan's expected investment return, only if such investments were equal or superior to alternative available investments." ***Interpretive Bulletin Relating to the Employee Retirement Income Security Act of 1974***, 59 FR 32606-01, at 32607.

In contrast, a majority of federal circuit courts adopted a fiduciary standard that 1) acknowledged Congress's goal of encouraging employee ownership through ESOP formation; 2) questioned the extent to which ESOPs are purely investment vehicles; and 3) reflected an understanding of ESOP legislation as a carve-out within the broader framework of ERISA. ***Lanfear v. Home Depot, Inc.***, 679 F.3d 1267, 1278-79 (11th Cir. 2012); ***Moench v. Robertson***, 62 F.3d 553, 568-72 (3d Cir. 1995); ***Donovan v. Cunningham***, 716 F.2d 1455, 1466-67 (5th Cir. 1983).

Ultimately, a recent opinion by the United States Supreme Court clarified that ERISA benefits do not include "nonpecuniary benefits like those supposed to arise from employee ownership of employer stock." ***Fifth Third Bancorp v. Dudenhoeffer***, 134 S. Ct. 2459, 2468 (2014). Rather, the "exclusive benefit" rule "must be understood to refer to the sort of financial benefits (such as retirement income) that trustees who manage investments typically seek to secure for the trust's beneficiaries." Id. Thus, current law prohibits ERISA trustees from prioritizing non-financial benefits, such as working conditions, job security, or employee ownership as "a goal in and of itself." ***Moench***, 62 F.3d at 568. As such, existing fiduciary standards under ERISA would override a perpetuity provision in an ESOP trust document.

Additional Concerns

Even if ESOP policy in fact embraced non-financial benefits, thereby allowing perpetuity as a valid term of an ESOP trust, an additional problem would still threaten perpetual employee ownership. Under common law, beneficiaries may dissolve a trust by unanimous consent. Thus, employee-beneficiaries of an ESOP could attempt to "bust the trust."

An even more recent development in trust law eliminates the requirement of a trust beneficiary, and allows trustors to establish a trust with a non-charitable purpose. Of course, the law has long permitted trusts dedicated to charitable purposes, but non-charitable purpose trusts are new. Originally authorized in foreign territories such as Jersey and Bermuda, U.S. states witnessed a wave of purpose trust legislation in the last decade. Del. Code Ann. tit. 12, § 3556; Mass. Gen. Laws Ann. ch. 203E, § 409; S.D. Codified Laws § 55-1-20. Purpose trusts are now also included in the uniform trust code as model legislation recommended for adoption by all U.S. states. Unif. Trust Code § 409. In light of late twentieth century and twenty-first century developments in trust law, a moderate improvement to ESOP law would allow founders to leverage jurisdictions, such as South Dakota or Delaware, that permit both dynasty and purpose trusts. Founders would then be able to achieve the strongest guarantee for perpetual employee ownership as a purpose of an ESOP trust. Yet even then, another obstacle arises in the context of minority ESOP-owned businesses. A company may choose to refrain from contributing new shares to an established ESOP. This is not often a real-world problem, as employers typically "recycle" shares back into the plan. But absent fresh contributions of employer stock, a minority ESOP will terminate after the exit of all current employee-participants. A solution to this problem would require further legislative action. As illustrated, ESOP law, which continues to recognize only financial benefits, treats an ESOP trust purely as a retirement vehicle. This purpose contrasts with Congress's intended use of the ESOP trust as a vehicle for employee ownership. ***Martin v. Feilen***, 965 F.2d 660, 664 (8th Cir. 1992). The tension between these purposes argues for alternatives to an ESOP trust that do not involve such a conflict. To this end, American and British history reveals a tradition of employee ownership that pre-dates Kelso and ERISA, and, in turn, offers a workable solution.

Traditional Employee Ownership

Over 150 years ago, a popular conception of employee ownership developed in the United States and United Kingdom as a widely shared response to the rise of the modern corporation, large-scale centralized manufacturing, and capital-intensive technologies. Government officials, academics, business elites, and working people on both sides of the Atlantic, of disparate professional and class backgrounds, believed that employee ownership was a moral imperative and an essential measure of human and industrial progress.

John Stuart Mill, the influential philosopher, political economist, and member of Parliament, was the most notable nineteenth-century advocate of employee ownership. Mill was frequently quoted by contemporaries for his belief that employer-owned firms would "be gradually superseded by partnership, in one of two forms: in some cases, association of the labourers with [employers]; in others, and perhaps finally in all, association of labourers among themselves." John Stuart Mill, ***Principles of Political Economy***, at IV.7.14 (William J. Ashley ed., Longmans, Green and Co., 7th ed. 1909) (1870). He thought that employee ownership was not only inevitable, but held the potential for: a change in society, which would combine the freedom and independence of the individual, with the moral, intellectual, and economical advantages of aggregate production; and...realize, at least in the industrial department, the best aspirations of the democratic spirit, by...effacing all social distinctions but those fairly earned by personal services and exertions. Id. at IV.7.62.

Echoing popular sentiment, Mill felt that an economic system in which employee ownership was the predominant structure "would be the nearest approach to social justice, and the most beneficial ordering of industrial affairs for the universal good, which it is possible at present to foresee." Id.

At heart, Mill's views, and the views of like-minded Americans and Brits, were sustained by a fundamental belief that: intelligent, educated labor possesses the capacity for the accomplishment of any undertaking or enterprise, and need not wait for an individual called an employer to associate its effort, and direct and control the industry out of which it earns wages and pays premium to capital...Intelligent labor need not wait until some [person] has hired it. It can...employ itself. Bureau of Labor Statistics, State of California, ***Third Biennial Report***, at 324 (1888).

The preceding passage was authored by U.S. Senator, railroad magnate, and founder of Stanford University, Leland Stanford. At the time, he was writing from his seat in the U.S. Senate in support of model employee ownership legislation for the District of Columbia. 49th Cong. (1886). Traditional principles of employee ownership, as advocated by Mill, Stanford, and many others, involve profits, voting, and culture. Reformers were particularly interested in the fair distribution of profits, and tended to praise financial structures that rewarded employees on the basis of labor input. Voting rights were pervasive in definitions of employee ownership, and employee-owned firms were understood to be enterprises in which employees elected the board of directors, and voted on shareholder issues, on a "one person, one vote" basis. Mill, supra, at IV.7.21. Finally, employee ownership was synonymous with a culture of personal responsibility, industrial harmony, workplace health and safety, individual dignity, just compensation, and temperance. Where employees made a financial investment in the firm, being issued a fair reimbursement upon exit was a matter of due course. The primary aim of employee ownership, however, was not to generate a profit for exiting employee-owners.

Employee Ownership Trusts

Perhaps more in line with these traditional principles of employee ownership is the employee ownership trust. One of the mainstream forms of employee ownership in the United Kingdom, an EOT does not involve assigning and repurchasing shares for individual employees. Rather, stock is transferred to a perpetual trust and administered on behalf of all present and future employees. The best example of an EOT is John Lewis Partnership. Originally founded in 1894, the popular British retail chain employs 91,500 associates, and has been held in trust for its employees since 1929.

John Lewis, unlike an ESOP company, has no obligation to repurchase the stock of individual employees. Instead, employees are “naked in, naked out.” They earn a percentage of profits while working at the firm, but exit without realizing any growth in the firm’s value, much as in a law partnership. John Lewis also has a constitution which accords voting rights to all of its employees, empowering them to elect the firm’s governing body. The Constitution of the John Lewis Partnership (June 2015), https://www.johnlewispartnership.co.uk/about/our-constitution.html (last visited Oct. 21, 2016). Finally, John Lewis trustees are required to preserve the business and its employee-owned structure for the benefit of the employees––a benefit that is understood to include both financial and non-financial elements and is best expressed in the culture of the firm, that is, the quality of working relationships among employee-owners.

In the United States, an EOT is able to give voting rights to employees by means of a power to direct the trustee. This power can be as narrowly or widely tailored as the trustor wishes. In this way, current employees can be granted effective control of high-level decisions, such as electing board directors and voting on shareholder issues, while maintaining trustee discretion over critical matters, such as the sale of the company and its substantial assets. Some states, like South Dakota and Delaware, have directed trustee statutes, which not only allow such a bifurcation, but also allow trust planners to substantially limit the liability of directed trustees. Del. Code Ann. Tit. 12 § 3313(b); S.D. Codified Laws §§ 55-1B-2,-5.

Planners should keep in mind that ERISA specifically excludes trusts that do not systematically defer income until retirement. 29 U.S.C. § 1002(2)(A); ***McKinsey v. Sentry Ins.***, 986 F.2d 401, 405-6 (10th Cir. 1993); ***Murphy v. Inexco Oil Co.***, 611 F.2d 570, 574-76 (5th Cir. 1980). As such, perpetual employee ownership can be achieved today, without any regulatory or legislative changes, by means of establishing an EOT in a perpetual and purpose trust jurisdiction. An EOT can be used for both minority and majority ownership of a company, and nothing precludes the combination of a majority EOT (for perpetuity) and a minority ESOP (for tax benefits).

Of course, no business lasts forever. EOTs should have an independent co-trustee or trust protector that can approve the liquidation or sale of the company when the close of the business is unavoidable. This function is strengthened when the co-trustee or trust protector is 1) appointed upon creation of the trust; 2) not subject to employee election or recall; and 3) self-appointing with respect to successor co-trustees or trust protectors. Under the terms of the trust, the principal might be reserved for distribution to an organization that supports employee ownership.

An additional benefit of the EOT is that certain “constitutional protections” can be locked into the structure. For example, the EOT might require the company to 1) safeguard earnings by fixing base compensation in line with market rates; 2) retain a percentage of annual net income as permanent reserves; 3) allocate funds for employee education and engagement; 4) join a lobbying association for employee-owned businesses, such as the ESOP Association; or 5) make annual contributions to a charity in support of employee ownership, such as the National Center for Employee Ownership. Naturally, planners should tailor such protections, and the overall package of employee benefits under the EOT, to the needs and interests of their clients.

Finally, and of central importance, the EOT is a simple structure. It takes a fraction of the time required to implement an ESOP, and due to the lack of any repurchase obligation or corresponding need for annual valuations, ongoing administration costs for an EOT are minimal. Whereas one of the greatest challenges for ESOP firms is communicating the ESOP's retirement benefits to plan participants, the real-time benefits of an EOT are easy to explain to employee-owners. In turn, the EOT is arguably more efficient as a reward-based feedback mechanism, which is critical when increased productivity is one of the goals of an employee ownership program. At John Lewis Partnership, the rewards are self-apparent, not only in the culture of the company, but at annual meetings where the company-wide bonus is declared on a raised placard as a single- or double-digit percentage of salary.

Perpetual Purpose Trusts

Some business owners have no special interest in employee ownership, but are interested in transferring ownership of their company to some social-benefit vehicle that will preserve the legacy of their business while doing good for society. The perpetual purpose trust need not, by any means, only be used to create employee ownership. Rather, the PPT is a legal entity type that can be flexibly molded to the diverse goals of business owners. Organically Grown Company (OGC), a distributor of agricultural produce in the Pacific Northwest, is a great example of a U.S. company that used a PPT to create benefits for the environment, the community, their farmer-suppliers, customers, and employees. Interestingly enough, OGC's employees were already the company owners through an ESOP, but PPT ownership was considered more desirable for all due to the upside benefits of including multiple stakeholders, as well as the ability to avoid the constraints of an ESOP. The employees continue to receive financial benefits while they work at OGC through a healthy profit-sharing program. At the same time, OGC can work to lower costs to their consumers while increasing returns to their farmer-suppliers. They can also increase the level of their contributions back to the community through donations or service work. And all of the above can be included in the governance of the company. As Organically Grown Company demonstrates, a PPT allows business owners to think beyond employee ownership and include other classes of stakeholders or types of social causes in the flow of benefits from their business, not to mention in the governance of their business. However, a PPT can also be used in a balanced fashion to achieve long-term rewards for the business owner's family (or estate), in addition to other important social purposes. For instance, the business owner and their family might be included as a beneficiary under the PPT, receiving some flow of income for a limited or indefinite period after the transfer. Alternatively, or in addition to this flow of income, the principal of the PPT might be distributed back to the business owner's estate at some point in the future, should the continued viability of the business be threatened by changing market conditions. It is fair to say that the possibilities are limited only by the business owner's imagination and the creativity of their counsel, as U.S. trust law now has access to a range of tools that are capable of more fully respecting the wishes of today's business owners.

Key takeaways

The case studies, perspectives, and practical advice presented in this book explore the variety of ways that companies use steward-ownership to protect their mission and lasting independence. These entrepreneurs, companies, and investors demonstrate how steward-ownership can be a viable alternative to our prevailing cultural, legal, and economic definitions of "ownershi". Whereas the dominant model understands corporate ownership as an investment and a tool for generating personal wealth, steward-ownership views it as a duty or a responsibility, one that is passed on from one generation of able, mission-aligned stewards to the next. What's more, steward-ownership fundamentally challenges what a company is, whom it serves, and why it exists. In doing so, it shifts the paradigm away from profit and shareholder value maximization towards a new economic model that prioritizes stewardship and "purpose maximization".

Steward-ownership structures commit companies to three key principles:

Economic and voting rights are separated

How this principle is achieved varies across structures, but the core understanding is that a company's direction should be decided based on what's best for the long-term success and survival of its mission rather than the economic interests of individuals within the organization. Although separating voting rights from dividend rights may seem counterintuitive in the context of mainstream economic theory, behavioral economic research suggests that intrinsic motivation is a stronger, more reliable motivator than monetary incentives over the long-term.

Stewardship is closely linked to the organization

Stewardship is always passed on to individuals who are deeply connected to the operations or mission of a company. Whether current or former managers, employees, or industry leaders, stewards must have a deep understanding of an organization, including its mission, its operations, and its industry. This ensures that control of a company, i.e., its voting rights, remain with able individuals who are deeply connected to the values of the company. It keeps "entrepreneurship" within the businesses, rather than outsourcing it to external shareholders.

Profits are not extracted

Profits are primarily reinvested in these companies and not extracted by external shareholders. This enables steward-owned businesses to reinvest a substantial proportion of their profits in research and development.

These principles keep the underlying purpose of a company central to its operations. They ensure that generations of stewards can carry on the mission and values of an organization and protect its impact. Ownership in these companies represents accountability and the freedom to determine what's best for the long-term survival of its mission. Such companies are not for sale, but are deliberately passed on to capable and value-aligned successors. As shown in this book, steward-owned companies are proven to be more successful over the long-term and to act in the interests of a broad range of stakeholders, including employees, consumers, investors and society.

Benefits of the long view

Without short-term pressure from financial markets and investors, steward-owned companies can take a long view on what is best for their business, their employees, and their stakeholders. This leads to more innovation, as companies are able to reinvest more of their earnings into research and development. For employees it results in increased job security, better representation in corporate governance, and fairer pay, as well as a deeper intrinsic motivation to support the company's mission. Employees also benefit from good governance and better management, which these structures facilitate. What's more, partners and consumers benefit from the improved service of a company in which employees and managers feel connected to and directly responsible for its mission.

Why we need to rethink ownership

New ownership solutions are needed across the business landscape. From a small startup wanting to grow without losing control of its mission to a mature, profitable privately-owned business facing the challenge of succession, companies and their leaders need alternative ownership and financing solutions. They need legal structures that enshrine the principles of steward-ownership into their legal DNA and enable them to stay mission-driven for the long-term. They need patient, non-extractive capital that does not force them to sell controlling shares to external investors. Aligned investors support companies and keep control in the hands of their stewards, who are closely connected to their companies' operations and values.

We need a new economic paradigm that places purpose rather than profit at the center of our economic activity. We need practical instruments for helping companies stay mission-driven and independent in order to fight the burgeoning trend of centralization of capital and market power. Steward-ownership can resolve the shortcomings of neoliberalism and its profit-maximization paradigm, while preserving the dynamic power of entrepreneurship and for-profit enterprise. It enables businesses to pursue purpose while acting in the interests of a broad range of stakeholders, from employees and consumers to the environment and society.

The companies, entrepreneurs, investors, and thought-leaders in this book represent the pioneers of a growing trend of self-governed companies and alternative financing. We hope this book serves as a source of inspiration and practical knowledge for all who want to support steward-ownership.

Acknowledgements

This event and accompanying book were made possible by our generous community of partners, advisors, companies, and donors. Thank you for your continued support in our work and the steward-ownership movement. We would like to offer our sincerest gratitude to everyone cited in this book. We appreciate your time and dedication to the research and promotion of steward-ownership and alternative financing.

Specifically, we would like to thank the generous contributors to this book:

Jason Wiener, Esq.

George Siemon, CEO, Organic Valley

David Weinstein, Heath & LeJeune/Organic Pioneer

Jasper van Brakel, CEO, RSF Social Finance

Prof. Colin Mayer, Peter Moores Professor of Management Studies, Oxford University

Ronald D. McFall, Stoel Rives LLP

Christopher Michael

About Purpose

Purpose is a network of organizations that serve a global community of entrepreneurs, investors, and citizens who believe companies should remain independent and purpose-driven over the long-term. Our mission is to make steward-ownership and alternative financing accessible to entrepreneurs, investors, and lawyers all over the world. Our projects include: developing new legal forms for steward-ownership, creating investment vehicles dedicated to supporting steward-owned companies, building supportive infrastructures for research and education, and working directly with companies on their paths to steward-ownership. Our work combines non-profit research and infrastructural development with for-profit advising and investment activities. Our for-profit entities are structured as steward-owned companies, so no individual in the Purpose organization financially profits from our successes. Both of our investment vehicles are designed to keep capital costs low to ensure capital and services remain accessible for mission-driven companies.

purpose-foundation.com