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Financing Social Enterprise: Is the Crowd the Answer?

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How does a business that wants "do good" while doing well finance its operations? In particular, how does a business of that kind find investors who understand and are committed to both its nonfinancial and financial objectives? This chapter addresses issues at the intersection of corporate governance and corporate finance with those questions in mind. Specifically, the pages that follow assess common foundational elements of social enterprise and crowdfunding and whether crowdfunding may be a promising (or even suitable) source of funding for social enterprise businesses.

The term "social enterprise" defies precise definition, but typically includes business ventures that focus their operations at least in part on societal or environmental betterment.[2] One might describe it as a movement. Its current popularity, however, including especially the U.S. movement to promote the legislative adoption of benefit corporations and other social enterprise business entities, stems from populist roots.

By focusing on a double or triple bottom line—serving social or environmental objectives as well as financial profit generation for the primary benefit of shareholders—social enterprise represents a distinct approach to organizing and conducting business operations. Reacting to a perceived unmet or underserved demand in the markets for business forms, charters, and tax benefits, legislatures recently have introduced for-profit social enterprise forms of entity in the United States and elsewhere. These new forms of entity (in particular, benefit corporations) are designed to offer venturers business formation and operation alternatives not otherwise available. In particular, in the United States, the express market niche that benefit corporation legislation fills is the space between for-profit and nonprofit corporations. The historic choice of entity environment was framed by these two corporate forms—one sometimes viewed to be oriented narrowly around the maximization of profits and shareholder wealth and the other around the absence of private inurement of financial value to business owners, principals, or employees.

Like social enterprise, crowdfunding reacts to unmet or underserved demand in a market—the market for capital. The definition of crowdfunding, like the definition of social

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[2] Although commentators have different ways of defining social enterprise, "the common thread of the social enterprise definition is a focus on the primary motivation of social betterment, coupled with the belief that surplus should principally be reinvested in the mission." Mystica M. Alexander, *A Comparative Look at International Approaches to Social Enterprise: Public Policy, Investment Structure, and Tax Incentives*, 7 WM. & MARY POL'Y REV. 1, 34 (2016).

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enterprise, is somewhat elusive. Acknowledging that no single definition is universally accepted, for the purpose of this chapter, crowdfunding is aptly and simply understood as a public appeal for financial backing: the solicitation of funding from, and the provision of funding by, an undifferentiated, unrestricted mass of individuals (the "crowd"), commonly over the Internet.[3] In its various forms,[4] crowdfunding may implicate many different areas of law and intersects in the business setting with choice of entity considerations as well as business finance (funding, restructuring, and investment exit considerations, including mergers and acquisitions). For purposes of this chapter, it is useful to identify four types of crowdfunding.

> [D]onative crowdfunding typically describes funding provided altruistically, out of generosity, with no expectation of receiving anything in return other than the satisfaction that the funder supported a cool business or project. . . .
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> Rewards-based crowdfunding involves investor contributions for which funders are acknowledged with a product or service. If a future product or service is offered to the funder at a discount in return for financial support, the financing often is labeled as pre-order crowdfunding or pre-sale crowdfunding.
>
> Securities crowdfunding (also sometimes referred to as investment crowdfunding) involves the offer and sale of equity (ownership interests with embedded financial and governance rights like stock or limited partnership or LLC interests), debt, or other securities— instruments that promise a financial return to funders (investors). [5]

Regardless of the form it takes, however, crowdfunding typically uses technology to transform traditional fundraising processes by, among other things, increasing the base of potential funders for a business or project. The crowdfunding movement—if we can label it as such—evolved into a populist adventure in which fundraisers and funders have sought

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[3] *See*, *e.g.*, Paul Belleflamme et al., *Crowdfunding: Tapping the Right Crowd*, 29 J. BUS. VENTURING 585, 588 (2014) ("Crowdfunding involves an open call, mostly through the Internet, for the provision of financial resources either in the form of donation or in exchange for the future product or some form of reward to support initiatives for specific purposes."); Joan MacLeod Heminway, *Business Lawyering in the Crowdfunding Era*, 3 AM. U. BUS. L. REV. 149, 151 (2014) ("In its purest form, crowdfunding involves a democratization of capital—raising incrementally small amounts of capital from a large, undifferentiated mass of funders, most commonly through transactions carried out solely or principally on the Internet.").

[4] Taxonomies of crowdfunding abound. *See*, *e.g.*, Melek Demiray et al., *The Crowdfunding Market, Models, Platforms, and Projects*, *in* CROWDFUNDING FOR SUSTAINABLE ENTREPRENEURSHIP AND INNOVATION 90, 91-99 (Walter Vassallo, ed. 2017); Joan MacLeod Heminway, *What is a Security in the Crowdfunding Era?*, 7 OHIO ST. ENTREP. BUS. L.J. 335, 358-59 (2012).

[5] *See* Joan MacLeod Heminway, *Small Business Finance: Is the Crowd the Answer?*, 10 WEALTH COUNSEL Q. 44, 45-46 (2016).

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and obtained legal changes designed to afford them participation rights in markets from which they had been largely excluded.

Both social enterprise and crowdfunding have become popular in the new millennium—perhaps most significantly in the years following the global financial crisis of 2008. Although current data on social enterprise (given definitional and factual issues) is difficult to come by, publicly available information documents overall growth in the formation of social enterprises from 1974 to 2004,[6] and one commentator observes (in a publication speaking as of 2012) that "60 percent of U.S. social enterprises were created in 2006 or later, with 29 percent created since 2011."[7] The introduction of B Corporation (also known as B Corp) certification, low-profit limited liability companies, benefit corporations, and social purpose corporations signaled and catalyzed interest in social enterprise and other mission-driven businesses. On the crowdfunding side, Kickstarter, Indiegogo, Gofundme, and other platforms have popularized donative, rewards-based, and pre-sale crowdfunding in the United States. A market analysis written for Statista estimates the total transaction value of crowdfunded offerings (including crowdfund investing, crowdfund lending, and crowdfunding of other kinds) in the United States to reach 82 billion dollars by 2021; globally, the market is expected to grow to 565.2 billion by 2021.[8]

Perhaps it is unsurprising then, that U.S. social enterprise has been relatively quick to engage crowdfunding as a means of financing new and ongoing ventures. In addition, early data in the United States for securities offerings conducted under Regulation Crowdfunding[9]—promulgated under the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act (the "CROWDFUND Act"), Title III of the Jumpstart Our Business Startups Act[10]—indicates a relatively high incidence of securities crowdfunding by social enterprise firms.[11] The common account of social enterprise and crowdfunding as

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[6] *See* Community Wealth Ventures, Inc., Social Enterprise: A Portrait of the Field, at 2, http://community-wealth.org/sites/clone.community-wealth.org/files/downloads/report-cwv-sea-case.pdf.

[7] Ben Thornley, *The Facts on Social Enterprise*, HUFFINGTON POST, Nov. 8, 2012, updated January 8, 2013, http://www.huffingtonpost.com/ben-thornley/ social enterprise_b_2090144.html.

[8] Tobias Bohnhoff, *Fintech: Business Finance* (Feb 2017), *available at* https://www.statista.com/download/outlook/whiterpaper/FinTech_Business_Finance_Outlook_0217.pdf.

[9] 17 C.F.R. §§ 227.100 – 503 (2017).

[10] Pub. L. No. 112-116, 126 Stat. 306 §§ 301-305 (2012) (codified as amended in scattered sections of 12 U.S.C. and 15 U.S.C.).

[11] *See* Marc A. Leaf et al., Crowdfunding Report—FINRA's First Enforcement Action and Updated Data Analysis (Jan. 30, 2017), http://www.drinkerbiddle.com/insights/publications/2017/01/crowdfunding-report [hereinafter 2017 Crowdfunding Report]("Approximately 16 percent of all issuers are either registered benefit corporations . . . , certified B Corps . . . , or operate within traditional corporate forms with strong social and/or environmental missions . . . .").

grassroots movements coalescing to striking out against legal and financial structures deemed to be elitist or exclusive, together with the parallel growth trajectories of social enterprise and crowdfunding, may underlie (or at least help explain) the use of crowdfunding by social enterprise firms in financing their operations.

In any event, social enterprise's early-adopter status and general significance in the crowdfunding realm is understudied and undertheorized to date. This chapter offers information that aims to address in part this perceived deficit in the literature by illuminating and commenting on the history, present experience, and future prospects of financing social enterprise through crowdfunding—especially securities crowdfunding. The chapter has a modest objective: to make salient observations about crowdfunding social enterprise ventures based on doctrine, policy, theory, and practice. The observations consist of both reasons to think that crowdfunding could be a promising means of financing social enterprise and cautionary tales regarding the crowdsourcing of funds to support social enterprise firms. In particular, there may be cause for concern in using securities crowdfunding to finance benefit corporations.

The chapter begins by briefly tracing the common movement and populist-oriented foundations of current manifestations of social enterprise and crowdfunding. Next, the chapter addresses the financing of social enterprise through crowdfunding, focusing on the relatively recent advent of securities crowdfunding (including specifically the May 2016 introduction of securities offerings under Regulation Crowdfunding in the United States). The remainder of the chapter reflects on these foundational matters by contextualizing crowdfunded social enterprise in the overall market for social enterprise finance and commenting on litigation risk and the possible impacts of social enterprise on securities crowdfunding (and vice versa). Although, the chapter focuses principally on U.S. social enterprise and crowdfunding, certain observations are—or may be—more broadly applicable.

Parallels in the Development of Social Enterprise and Crowdfunding

Perceived gaps in coverage and exclusivity may catalyze market innovations. For-profit social enterprise and crowdfunding may be viewed as innovations that respond to these types of deficiencies in the markets for business associations (most pointedly, the market for for-profit business corporations) and financial capital, respectively. These two market innovations have not been led by government initiatives, although legislation has played a role in the development of each. Rather, social enterprise and crowdfunding have largely bubbled up from the masses as an initial matter and have been further advanced and more solidly institutionalized by politically savvy leaders intending to galvanize support and serve an observed public need.

Social enterprises and forms of social enterprise entity address a public need to more expressly serve societal or environmental, as well as financial, objectives through business initiatives. Business promoters and investors alike understand that applied business associations law—and especially decisional law governing management fiduciary duties—presents challenges to the satisfaction of this public need. Specifically, the perception that business operations and management decision making must always place profits and shareholder wealth first—before other corporate objectives—has been a strong driver of social enterprise and related signaling mechanisms, including recognized third-party stamps of approval like the B Corporation certification program offered by B Lab (a nonprofit certification intermediary) and new, more holistically mission-driven statutory forms of business entity (including principally benefit corporations, but also low-profit limited liability companies—L3Cs—and social purpose corporations).

Along similar lines, start-ups and small businesses unable to attract angel or venture capital backing often feel shut out of financing options after personal and friends-and-family sources of funding are exhausted. Moreover, individuals of limited financial means may have strong desires to incrementally fund start-ups and small businesses but not be able to locate ventures to support. Crowdfunding supplies and fulfills these unsatisfied demands and desires of businesses and funders.[12]

Grassroots public support, together with focused political engagement, has firmly established both social enterprise and crowdfunding in the lexicon and in business practice. Each has been termed a "movement" or evidence of the rise of "populism."[13] These terms may be seen as having different meanings in a social science context.

> Whereas social movements emerge from autonomous forms of collective action undertaken by self-constituted civic groups or networks, populism typically involves an appropriation of popular subjectivity by dominant personalities who control the channels, rhythms, and organizational forms of social mobilization. Indeed, populism does not require that mass constituencies engage in collective action at all, beyond the individual act of casting a ballot in national elections or popular referendums. Although both forms of popular subjectivity contest established elites, social movements mobilize that contestation from the bottom-up,

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[12] *See* Payal Jain, *A Crowd-Funder Value (CFV) Framework for Crowd-Investment: A Roadmap for Entrepreneurial Success in the Contemporary Society*, *in* CROWDFUNDING FOR SUSTAINABLE ENTREPRENEURSHIP AND INNOVATION, *supra* note 4, at 288, 300 ("Crowd-funding is a useful tool that responds to the unmet needs and wants of the public by providing investment opportunities to crowd-investors and through the support and promotion of the entrepreneurial projects.").

[13] *See*, *e.g.*, Lawrence A. Hamermesh & Peter I. Tsoflias, *An Introduction to the Federalist Society's Panelist Discussion Titled "Deregulating the Markets: The Jobs Act"*, 38 DEL. J. CORP. L. 453, 468 (2013) ("The JOBS Act's crowdfunding exemption offers an attractive mix of financial populism and deregulatory philosophy."); Christine Hurt, *Pricing Disintermediation: Crowdfunding and Online Auction IPOs*, 2015 U. ILL. L. REV. 217, 260 (2015) (describing social enterprise as having a "populist quality"); J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1, 4, 5, 26, (2012) (referring to the "social enterprise movement"); Anjanette H. Raymond & Abbey Stemler, *Trusting Strangers: Dispute Resolution in the Crowd*, 16 CARDOZO J. CONFLICT RESOL. 357, 373, 392, 394 (2015) (referring to the "crowdfunding movement").

> whereas populism typically mobilizes mass constituencies from the top-down behind the leadership of a counter-elite.[14]

The development of social enterprise and crowdfunding has been characterized by both bottom-up and top-down efforts. While parts of current social enterprise and crowdfunding initiatives stem from disaggregated, unmanaged social and economic activities at a grassroots level, each has benefitted from political engagement and legal changes that represent coordinated public activities led by counter-elites.

Specifically, social enterprise fills a market niche—a gap in the market for business governance and business entities. Specifically, social enterprise offers a place in internal governance and choice-of-entity decision making for businesses that support more than financial objectives and serve more than owner interests. For-profit social enterprise governance structures contest a presumed (even if not legally defined) shareholder wealth maximization norm by expressly pursuing a double or triple bottom line. For-profit social enterprise entities codify this double or triple bottom line and at the same time allow for equity funding and private inurement, which are not available to nonprofits of any kind.[15] The demand for social enterprise undertakings is broad-based and originated from efforts to fill these spaces undertaken at the ground level—with entrepreneurs and other business principals.

Yet, to focus and concretize those disaggregated efforts, leadership groups emerged. These constituencies spearheaded initiatives that resulted in targeted responses in the form of private certification (including predominantly B Corporation certification) and

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[14] Kenneth M. Roberts, *Populism, Social Movements, and Popular Subjectivity*, *in* THE OXFORD HANDBOOK OF SOCIAL MOVEMENTS 696, 687 (Donatella Della Porta & Mario Diani, eds., 2015). Roberts goes on to note:

> These distinctions are not universally recognized or acknowledged, in part because populism is a notoriously elastic and contested concept that is subject to different meanings. When conceptualized in minimalist discursive or ideological terms, populism is easily conflated with social movements that discursively construct the political order as a binary realm of contestation between an authentic popular will and unaccountable and unrepresentative power elite.

Id.; *see also* Agatha Bordonaro, Populism Is a Dominant Theme This Political Season — and Don't Expect It to Go Away Anytime Soon (Nov. 4, 2016), https://www8.gsb.columbia.edu/articles/no-association/populism-has-been-dominant-theme-election-and-don-t-expect-it-go-away-november-9 (defining populism as "a political movement by ordinary citizens to regain control of their government from a small circle of powerful elites").

[15] *See* Dana Brakman Reiser, *Benefit Corporations-A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 617 (2011) ("Due to the nondistribution constraint, equity capital will not be available to social enterprises formed as nonprofits").

business entity legislation (including predominantly benefit corporation legislation).[16] Notable in this group of social enterprise leaders is B Lab, which published a white paper, drafted model legislation, and lobbies for passage of that model legislation in state general assemblies.[17] The push toward legislation is especially notable.[18] Others also promoted benefit corporation legislation on a national or local level.[19] In Tennessee, for example, the Chamber of Commerce (supported by B Lab) was a catalyst in promoting the adoption of a benefit corporation statute, overriding the views of members of the Business Law Section of the Tennessee Bar Association (which typically has a leading role, together with the Tax Law Section, in writing and vetting business entity legislation proposed for adoption in the State of Tennessee). These efforts have resulted in the adoption of benefit corporation legislation in over 30 jurisdictions in the United States.[20]

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[16] *See* Benjamin M. Leff, *Preventing Private Inurement in Tranched Social Enterprises*, 45 SETON HALL L. REV. 1, 2–3 (2015) ("The social enterprise movement has been accompanied by what might best be called a social enterprise legal reform movement. . . . Many states have enacted laws to provide new business entity designations for social enterprises, and such new business-form statutes include benefit corporations, L3Cs, flexible purpose corporations, benefit LLCs, and others."); J. Haskell Murray, *The Social Enterprise Law Market*, 75 MD. L. REV. 541, 572-81 (2016) (describing interest group engagement with U.S. social enterprise initiatives); Antony Page & Robert A. Katz, *Is Social Enterprise the New Corporate Social Responsibility?*, 34 SEATTLE U. L. REV. 1351, 1361–62 (2011) ("The idea of social enterprise has been embraced by a growing number of influential leaders and institutions. Some leading proponents of social enterprise seek to promote and facilitate social enterprise formation through business organizations law, most notably by supplying social entrepreneurs with new legal forms designed specifically for social enterprises.").

[17] *See* J. Haskell Murray, *Defending Patagonia: Mergers and Acquisitions with Benefit Corporations*, 9 HASTINGS BUS. L.J. 485, 488–89 (2013) ("B Lab, a nonprofit organization, began certifying companies as 'Certified B Corporations.'" Eventually, B Lab also started lobbying states to pass benefit corporation statutes . . . .").

[18] *See* Sean W. Brownridge, *Canning Plum Organics: The Avant-Garde Campbell Soup Company Acquisition and Delaware Public Benefit Corporations Wandering Revlon-Land*, 39 DEL. J. CORP. L. 703, 719 (2015) ("In addition to providing a procedural framework for legislators adopting benefit corporation legislation, B Lab distributed Model Benefit Corporation Legislation . . . ."); Brett McDonnell, *Benefit Corporations and Strategic Action Fields or (the Existential Failing of Delaware)*, 39 SEATTLE U. L. REV. 263, 282 (2016) ("[T]here is at least one organization strongly pushing for benefit corporation legislation (B Lab itself) . . . ."); Joseph W. Yockey, *Does Social Enterprise Law Matter?*, 66 ALA. L. REV. 767, 798 (2015) ("B Lab lobbied to get versions of its Model Act passed in most of the states that now feature benefit corporation legislation.").

[19] *See*, *e.g.*, Joseph Karl Grant, *When Making Money and Making A Sustainable and Societal Difference Collide: Will Benefit Corporations Succeed or Fail?*, 46 IND. L. REV. 581, 582 (2013) (adding the American Sustainable Business Council and William H. Clark, Jr.—a primary drafter of the B Lab model legislation—to the list of benefit corporation advocates in state legislatures).

[20] *See* State by State Status of Legislation, Benefit Corporation, http://benefitcorp.net/policymakers/state-by-state-status (last visited July 3, 2017).

Similarly, crowdfunding is founded in a perceived public need to democratize fundraising for worthy businesses and projects, especially those not easily able to access or participate in traditional business finance offerings. Without coordination from any leadership group, crowdfunding effectively arose from the primordial soup of market activities—growing organically on its own as a merger of e-commerce and social media tools and behaviors in an environment characterized by sincere belief in the viability of products and services and those who provide them and a willingness to contribute to something bigger than oneself.

> For some time 'Crowds' have been forming affinities around interests and missions, creating new products and services, feeding innovation and, to use Wired journalist Jeff Howe's words, they've been "*using the Internet to exploit the spare processing power of millions of human brains.*" One of the results has been a new mindset built on trust and participation, ready to embrace diversity, capable of reinventing itself, and empowered to change the world. Our need to support and get involved in projects we care about is deep rooted in our humanity as much as our tendency to improve things and innovate in order to live better. Crowdfunding can be seen as a natural response to fill the gap left in capital formation and funding models in the modern society.[21]

In this setting, the crowd, together with those seeking funding from it, designed, built, and popularized crowdfunding using the tools and capacity of the Internet.[22] Internet access empowered members of the crowd and the businesses and projects they aimed to fund to self-assemble and increase their market power.

Most early crowdfunding efforts focused on rewarding members of the crowd with altruism or promotional benefits through donative, rewards-based, or pre-sale crowdfunding. Some, however, offered small financial benefits. Unfortunately, early crowdfunded offerings in which income or revenue was promised to investors were then illegal under U.S. law, because the financial benefit converted the funding interest from a

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[21] Daniela Castrataro, *A social history of crowdfunding*, Dec. 12, 2011, https://socialmediaweek.org/blog/2011/12/a-social-history-of-crowdfunding/ (hyperlink deleted).

[22] *See*, *e.g.*, Adelia Gregory, *Crowdfunding: A Grassroots Revolution in Startup Investment*, March 11, 2016, http://cmr.berkeley.edu/blog/2016/3/crowdfunding-grassroots-revolution/ ("Crowdfunding is truly a grassroots-level revolution in the finance/investment world . . . . Now, regular people can take a Bernie Sanders-style campaign approach, and seize on a democratic revolution in investment strategy."); Claire Millard, *A Return to Our Roots: A Brief History of Crowdfunding*, Jan. 7, 2016, https://fundwise.me/en/blog/return-our-roots-brief-history-crowdfunding (describing the financial, social, and technological factors that have enabled crowdfunding).

charitable or commercial interest into an investment instrument—a security.[23] Securities offerings are regulated under U.S. federal and state law. Absent an applicable exemption, this regulation includes expensive and time-consuming offering registration requirements that often present a barrier to access to financial capital for start-ups and small businesses.[24]

Accordingly, legislation was needed to enable U.S. securities crowdfunding, to overcome human and financial capital barriers to capital market access for these fledgling firms. Engagement with the legislative process involved transitioning the broad-based, disaggregated crowdfunding movement into a more focused effort designed to have transformative impact in the political realm. This created some dissonance in capital markets.

> Internet crowdfunding developed as a grass-roots, democratic movement for activities like non-profit fundraising, financing creative ideas, and peer-to-peer lending. As the Crowdfund Act legalizes crowdfunding investment in start-up companies, though, crowdfunding's democratic ethos intrudes on capitalism's domain of start-up company investing—just as the capitalist forces of start-up company investing collide with democratic participation in crowdfunding.[25]

Yet, the collision has not been fatal. Quite to the contrary.

The eventual legislative process that facilitated securities crowdfunding involved efforts to marshal and coordinate political activity to mobilize the crowd. The rising elite behind these initiatives hailed from various spheres of professional activity—including investment banking and law, as well as politics and government.[26] Leaders of U.S. securities crowdfunding legislation efforts hailing from the private sector have gone on, in the aftermath of the adoption of the CROWDFUND Act, to form crowdfunding trade associations and engage in related business initiatives.[27] Marrying the joint powers of e-

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[23] *See generally* Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933,* 78 TENN. L. REV. 879 (2011) (describing the early environment for securities crowdfunding in the United States, outlining legal issues, and proposing a process for resolving those issues).

[24] *See id.* at 907-21.

[25] John S. Wroldsen, *The Crowdfund Act's Strange Bedfellows: Democracy and Start-Up Company Investing*, 62 U. KAN. L. REV. 357, 400 (2013) [hereinafter *Bedfellows*].

[26] *See* Jack Wroldsen, *Creative Destructive Legal Conflict: Lawyers As Disruption Framers in Entrepreneurship*, 18 U. PA. J. BUS. L. 733, 776 (2016) ("The fight to pass crowdfunding legislation encompassed a wide variety of constituencies advocating on behalf of an emerging industry. . . . Crowdfunding laws were changed proactively through a combination of pressure from many corners: social media, business leaders, academics, politicians, entrepreneurs, and investors.").

[27] *See*, *e.g.*, John Cook, *Crowdfunding gets serious as leaders form trade group*, May 7, 2012, https://www.geekwire.com/2012/crowdfunding-industry-leaders-form-industry-trade-group/ (describing the role of Sherwood Neiss in both the legislative efforts and the

commerce and social networking and harnessing crowd theory and public choice theory, crowdfunding has enabled the masses to transform business finance for, among other things, social good.[28]

The parallel development of modern social enterprise and crowdfunding is intriguing in and of itself. Each project stemmed from market alienation and frustration and activist determination initiated on Main Street; each needed a spark from emergent elites more aligned with Wall Street to concretize and motivate the adoption of structures designed to enhance the viability and sustainability of what began as a grassroots movement. The transition from social movement to populist mission occurred naturally and almost seamlessly.

This common evolution also is important because it may show promise that social enterprise can capitalize on the benefits of crowdfunding, and vice versa. Contemporary social enterprise and crowdfunding augment pre-existing markets in business entities and business finance, respectively, in potentially symbiotic ways. Social enterprise crowdfunding exists at the confluence of those market transformations.

Financing Social Enterprise through Crowdfunding

There has been much written about uncertainties in the capital funding of social enterprise businesses over time. Despite documented interest (including from investors) in social enterprise firms, "social enterprises generally remain quite small and complain of a desperate need for capital."[29] Two law professors who have focused significant research and writing on social enterprise finance provide a telling description of the financial circumstances in which social entrepreneurs find themselves:

Crowdfunding Professional Association); Our Story, Crowdfund Capital Advisors, http://crowdfundcapitaladvisors.com/our-story/ (last visited Jul 1, 2017) ("Jason Best, Sherwood Neiss, and Zak Cassady-Dorion the founders of Crowdfund Capital Advisors (CCA), led the crowdfund investing movement in the United States, lobbied for its passage, and wrote the framework signed into law by the President in 2012.").

[28] *See* Joan MacLeod Heminway, *How Congress Killed Investment Crowdfunding: A Tale of Political Pressure, Hasty Decisions, and Inexpert Judgments That Begs for A Happy Ending*, 102 KY. L.J. 865, 875 (2014) [hereinafter *Happy Ending*] ("Over a five-year period, crowdfunding—including some investment crowdfunding—grew from individual experiments in web-based business finance to a veritable international movement with, as is so often the case, regulators playing catch-up with the market."); Wroldsen, *Bedfellows*, *supra* note 25, at 359-60 ("Crowdfunding grew out of 'crowdsourcing,' which, instead of pooling money as in crowdfunding, concentrates collective knowledge on solving problems or accomplishing tasks, thereby celebrating the democratic 'wisdom of the crowd' over the specialized knowledge of experts." (footnotes omitted)).

[29] Dana Brakman Reiser & Steven A. Dean, *SE(c)(3): A Catalyst for Social Enterprise Crowdfunding*, 90 IND. L.J. 1091, 1095 (2015).

> Startups need capital, and social enterprise startups are no exception. A social entrepreneur with a vision can invest her own savings and max out her credit cards trying to build a company that produces both good for society and profit. Depending on her individual net worth and her pool of connections, she may be able to turn a good idea into a chugging small business. Eventually, though, she will need—or simply want—to fund her social enterprise with capital beyond the levels she and her personal network can supply. When she does so, she will face a daunting, and double-sided, trust problem. How can she identify investors with a commitment to a dual mission that matches her own, investors who will not push her to sideline her enterprise's social commitments in exchange for a greater financial return? And, if committed dual-mission investors can be found, how can she convince them she is not a wolf in sheep's clothing herself?[30]

It seems that the mutual trust necessary for successful investment relationships is difficult to achieve. A key concern of the social enterprise and investors include, as the quoted passage indicates, the possibility of management distrust or misunderstandings that lead to mission drift or, more starkly, a conversion of the social enterprise into a traditional for-profit venture or form.[31] Finding those willing to fund social enterprise and getting those funders to make credible commitments to the non-financial—as well as the financial—part of the social enterprise's mission is a formidable task.

In spite of these inherent trust questions, perhaps as a result of the common roots of social enterprise and crowdfunding, crowdfunding has proven to be a popular way to identify investors and engage them to provide desired levels and types of financial support to social enterprise.[32] A Social Enterprise and Crowdfunding Conference was held in each of 2013 and 2014.[33] Specialized crowdfunding platforms have been developed to serve social enterprise.[34]

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[30] Dana Brakman Reiser & Steven A. Dean, *Financing the Benefit Corporation*, 40 SEATTLE U. L. REV. 793, 795–96 (2017).

[31] *See* Robert A. Katz & Antony Page, *The Role of Social Enterprise*, 35 VT. L. REV. 59, 95-97 (2010) (describing circumstances in which "social enterprise may subordinate social mission to profits"); Murray, *supra* note 16, at 558 (describing the interaction between entity conversion and dissenters' rights in social enterprise entity statutes); Joseph W. Yockey, *The Compliance Case for Social Enterprise*, 4 MICH. BUS. & ENTREPRENEURIAL L. REV. 1, 6 (2014) ("[O]ne of the biggest challenges for a social enterprise is avoiding so-called mission drift, where the pursuit of profit starts to overshadow the pursuit of public benefit.").

[32] *See* Jain, *supra* note 12, at 301 ("Crowd-funding models are being used by social enterprises, some of which provide social finance to entrepreneurs for the creation of social and environmental value in society.").

[33] *See* Social Enterprise and Crowdfunding Conference, http://secfc.co (last visited January 28, 2017) (describing an event designed to "bring together social innovators from around the country to discuss social entrepreneurship, impact investing, philanthropy and crowdfunding."); Press Release, The Social Enterprise And Crowdfunding Conference, *Inaugural Social Enterprise and Crowdfunding Conference at Snowbird*, September 27, 2013,

Until relatively recently, however, securities crowdfunding for social enterprises was required to be conducted through a registered public offering. For most social enterprise firms, a public offering is too time-consuming and expensive.[35] This largely relegated social enterprise to other forms of crowdfunding—donative and rewards-based campaigns—until relatively recently.

Specifically, the effectiveness of Regulation Crowdfunding in May 2016 implemented the long-awaited registration exemption for securities crowdfunding enacted by Congress in the CROWDFUND Act, signed into law in 2012. This exemption enabled social enterprises and others to use a specific manner of crowdfunding to find interested investors and offer and sell them securities over the Internet through a designated federally regulated portal. Change was in the air, and (for many) generated some genuine enthusiasm.

On the other hand, most recognized that the CROWDFUND Act and Regulation Crowdfunding establish a relatively narrow and expensive financing method (although not as expensive as a public offering). In particular, the required use of a federally regulated intermediary, the potential onus of presenting audited financial statements, mandatory disclosure obligations of other kinds at and after the offering stage, and the uncertain prospect of liability associated with new forms of offering and enforcement action contribute to the perceived and actual cost of conducting a financing under the

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PR NEWSWIRE (Sep 04, 2013, 18:48 ET), http://www.prnewswire.com/news-releases/inaugural-social-enterprise-and-crowdfunding-conference-at-snowbird-september-27-2013-222423481.html.

[34] *See* Devin Thorpe, *Eight Crowdfunding Sites For Social Entrepreneurs* (Sept. 10, 2012), https://www.forbes.com/sites/devinthorpe/2012/09/10/eight-crowdfunding-sites-for-social-entrepreneurs/#16a3d01a70fa. For reference, one of these platforms describes itself as follows:

> StartSomeGood is a crowdfunding platform exclusively for social change initiatives. We exist to help social entrepreneurs, non-profits and community groups to raise the funds they need to make a difference. We want to empower anyone with a great idea to make the world better. We provide unrivalled personalized support to enable campaign creators to launch great campaigns, rally a community of supporters and raise funds to create world-changing impact. Our team personally reviews and approves all projects on StartSomeGood.

StartSomeGood, About Us, https://startsomegood.com/about?view=what_we_do.

[35] There are, however, a number of publicly held B Corporations, and one benefit corporation recently closed an initial public offering. *See* Joan MacLeod Heminway, *Corporate Purpose and Litigation Risk in Publicly Held U.S. Benefit Corporations*, 40 U. L. REV. 611, 615-16 (2017) [hereinafter *Corporate Purpose*].

CROWDFUND Act.[36] Published reports indicate that businesses and projects seeking capital through securities crowdfunding may spend as much as $50,000 on professional services.[37] Commentators note that actual costs may be higher or lower and are likely to decrease as offering participants and their service providers become accustomed to the new regulatory regime.[38]

Although one might speculate uncertainties relating to social enterprise finance—taken together with the cost of an offering conducted under Regulation Crowdfunding and reservations about the faceless nature of transactions conducted over the Internet—might not be a winning combination, social enterprise firms are prominent among those engaging in securities crowdfunding under Regulation Crowdfunding. A triad of lawyers at Drinker Biddle & Reath LLP published reports in July 2016 and January 2017 on offerings filed under Regulation Crowdfunding. In each of these reports, social enterprise issuers represented a significant percentage (albeit a small absolute number) of crowdfunding issuers.[39]

> As we noted in our previous Crowdfunding Report, social enterprises . . . were disproportionately represented among the first 50 issuers. This trend continued

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[36] *See* C. Steven Bradford, *The New Federal Crowdfunding Exemption: Promise Unfulfilled*, 40 SEC. REG. L.J. 195, 216-17 (2012); Stuart R. Cohn, *The New Crowdfunding Registration Exemption: Good Idea, Bad Execution*, 64 FLA. L. REV. 1433, 1439 (2012); Heminway, *Happy Ending*, *supra* note 28, at 880-85; Jason W. Parsont, *Crowdfunding: The Real and the Illusory Exemption*, 4 HARV. BUS. L. REV. 281, 300-18 (2014) (comparing the cost of securities crowdfunding under the CROWDFUND Act to the cost of conducting Internet financings under Rule 506(c)); Britney Ocampo, *The State Answer to Flawed Federal Crowdfunding*, 9 THE CRIT: CRITICAL STUD. J. 1, 4-5 (2016).

[37] *See* Lizette Chapman, *U.S. Startups Fail to Attract Crowd of Small Investors*, May 19, 2017, https://www.bloomberg.com/news/articles/2017-05-19/u-s-startups-fail-to-attract-expected-crowd-of-small-investors ("NextGen data show companies typically spend from $20,000 to $50,000 on legal, accounting and marketing—a serious outlay for a startup that's only looking to raise a couple hundred thousand dollars."); *see also* Nate Nead, *The True Cost of Equity Crowdfunding*, https://investmentbank.com/cost-of-equity-crowdfunding/ (describing these costs).

[38] *See*, *e.g.*, s
Seth C. Oranburg, *Bridgefunding: Crowdfunding and the Market for Entrepreneurial Finance*, 25 CORNELL J.L. & PUB. POL'Y 397, 401 (2015) ("[T]he JOBS Act requires startups to spend up to $150,000 (e.g., to obtain independent audits, disclosure documents, filing fees, and legal fees) before selling equity via crowdfunding.") David J. Willbrand & Medha Kapil, *Blurred Lines: Crowdfunding, Venture Capital, and the Capitalization of Start-Ups*, 83 U. CIN. L. REV. 505, 511 (2014) (noting the substantial costs of Title III crowdfunding, but predicting that "compliance costs will not serve as a barrier for long").

[39] *See* Leaf et al., 2017 Crowdfunding Report, *supra* note 11; Marc A. Leaf et al., Leading the Crowd: An Analysis of the First 50 Crowdfunding Offerings (July 14, 2016), http://www.drinkerbiddle.com/insights/publications/2016/07/leading-the-crowd-first-50-crowdfunding-offerings [hereinafter 2016 Crowdfunding Report].

through the remainder of 2016. Approximately 16 percent of all issuers are either registered benefit corporations (e.g., Beta Bionics, Inc., a Massachusetts benefit corporation), certified B Corps (*e.g.*, Hawaiian Ola Brewing Corporation), or operate within traditional corporate forms with strong social and/or environmental missions (*e.g.*, Atmocean, Inc., a Delaware corporation that uses wave energy to power desalination without grid electricity).[40]

It is too early to tell whether all or a substantial number of these early crowdfunded securities offerings will result in successful financings or whether the prominence of social enterprises in the securities crowdfunding market will be sustained over time. Nevertheless, the relatively strong level of interest of social enterprises in securities crowdfunding in the early days of offerings under Regulation Crowdfunding is itself remarkable.

Crowdfunding in the Landscape of Social Enterprise Finance

The interest of social enterprises in crowdfunding (including securities crowdfunding) to date and the common impulses underlying crowdfunding and social enterprise indicate that crowdfunding may be a promising tool for financing social enterprise firms.[41] Indeed, others have noted this potentially symbiotic relationship—in some cases, citing to various factors and trends.

> [F]or-profit social entrepreneurship may find equity crowdfunding both appealing and available. For-profit social entrepreneurs may be able to use the crowdfunding vehicle to brand themselves as prosocial, attracting individual and institutional cause investors who may operate outside of traditional capital markets and may look for intangible returns. . . . [P]rosocial equity crowdfunders may rebut the conventional wisdom that early equity investors expect high returns or an exit mechanism. This avenue may be an attractive alternative to private equity financing, which may be tempting but may also lead to mission drift and loss of founder control.[42]

Depending on the type of crowdfunding used and the location of investors, crowdfunded social enterprise also may positively involve the community in which the social enterprise is organized or doing business.[43] Most of the perceived advantages of financing social

[40] Leaf et al., 2017 Crowdfunding Report, *supra* note 11.
[41] *See* Jain, *supra* note 12, at 301 ("Since social enterprises have a huge potential to positively impact society, it can, therefore, be argued that if social entrepreneurship and crowdfunding model[s] . . . are combined together, it may be possible to maximize and add societal value for the overall development and welfare of society.").
[42] Hurt, *supra* note 13, at 221.
[43] *See* Jain, *supra* note 12, at 301 ("[B]y adopting [a] social crowd-funding finance model, it may be possible to engage community members and help them become crowd-funders or entrepreneurs.").

enterprise through crowdfunding are still speculative, however. Time will tell whether potential synergies can be and are realized.[44]

In fact, a number of disadvantages to the use of crowdfunding as a method of finding social enterprise can be identified. These include general drawbacks as well as deficiencies in crowdfunded finance as well as concerns particular to social enterprise financings. Management and other decision makers should take into account these potential weaknesses in making decisions regarding the financing of social enterprise forms.

For example, the crowd may not want to fund social enterprise in the short term or long term. Although social enterprise firms have commenced a significant number of offerings under the CROWDFUND Act in its first year,[45] the overall success of those offerings (and others that have been and will be undertaken) and the sustainability of crowdfunded social enterprise remains to be seen. Commentators have questioned the existence of a significant or consistent investor audience for impact investing generally and for securities offerings in social enterprises, including benefit corporations, more specifically. Among other things, benefit corporations and other social enterprise businesses may offer little comfort to investors that the firm's commitment to non-financial objectives will be enforced.[46]

In addition, crowdfunding—and especially securities crowdfunding—may be too expensive for many social enterprises.[47] As earlier noted, the following aspects of securities crowdfunding under Regulation Crowdfunding combine to generate costs that many small businesses cannot afford to bear in reference to that amount of money required to be raised:

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[44] Sarah Tucker, *What makes a successful crowdfunding campaign?*, https://www.thersa.org/discover/publications-and-articles/rsa-blogs/2013/09/should-a-social-enterprise-crowdfund ("Whether as a social enterprise you are going to be more or less successful as a crowdfunding campaign is questionable – are people more likely to give backing to your social enterprise based on the feel-good factor of helping a good cause? The jury is still out on that . . . .").

[45] *See supra* notes 39 and 40 and accompanying text.

[46] *See*, *e.g.*, Dana Brakman Reiser & Steven A. Dean, *Hunting Stag with Fly Paper: A Hybrid Financial Instrument for Social Enterprise*, 54 B.C. L. REV. 1495, 1516 (2013) ("[H]ybrid forms' failure to protect social mission poses a[n] . . . enduring barrier to investors' capital . . . . [I]nvestors that value a double bottom line over their own financial interests would be foolish to rely on an entrepreneur's promises."); Deborah Burand, *Resolving Impact Investment Disputes: When Doing Good Goes Bad*, 48 WASH. U. J.L. & POL'Y 55, 59 (2015) ("Whether impact investing can live up to its promise, however, is likely to turn on whether impact investments actually deliver on their multiple bottom lines--that is, their ability to deliver financial returns alongside measurable progress toward desired social and environmental impacts.").

[47] *See supra* notes 36-38 and accompanying text.

- the compulsory retention of a specific type of regulated intermediary through which the offering must be conducted;
- the potential need to engage accounting professionals at an early stage of business operations;
- the existence of specific, continuing mandatory disclosure requirements; and
- the potential applicability of additional, new types of disclosure liability.

In the social enterprise setting, these outlays, together with other associated professional fees and uncertainty costs, draw money away from more mission-centric investments.

Also, as a new form of capital raising, crowdfunding may be too risky—both alone and as used in the social enterprise finance context—including in particular as a means of funding the (also new) benefit corporation form of entity. For example, risk-averse issuers and investors may find the risk profile of crowdfunded social enterprises unappetizing because of the fear of fraud in both crowdfunding (because of general concerns about Internet fraud) and social enterprise (especially in the form of greenwashing).[48] Professor Alicia Plerhoples cogently explains the concept of greenwashing and provides a simple example involving a firm, "Nourish," that donates food products to economically disadvantaged people on a one-for-one (one donated item for each item sold) basis.

> Dual-mission management may result in "greenwashing." Although originally applied to environmental issues, greenwashing also applies to any firm's claim that its activities or actions improve the environment or society, or address an environmental or social problem. Greenwashing involves diversion, deception, and hypocrisy. Broadly, "there is wrongdoing, distraction in the form of a 'wash,' and at its heart, an underlying structural problem never receives proper redress." Notably, the actions that constitute greenwashing for a specific firm will depend on what the firm has committed to do. A firm cannot engage in greenwashing if it never committed to an underlying environmental or social action. Greenwashing is therefore a particularly acute problem for social enterprises, because they claim to create social and environmental value. For example, Nourish operates a one-to-one donation model. That is, for every nutritional bar sold, Nourish donates one nutritional bar to poor and low-income individuals. Nourish has committed to this one-to-one donation model and would be engaging in "greenwashing" if it instead donated one nutritional bar for every three nutritional bar sold. Nourish's deception

[48] *See* Thomas Lee Hazen, *Crowdfunding or Fraudfunding? Social Networks and the Securities Laws-Why the Specially Tailored Exemption Must Be Conditioned on Meaningful Disclosure*, 90 N.C. L. REV. 1735, 1769 (2012) (after describing at length the potential for fraud in crowdfunding, noting "[i]f history teaches us anything, the lesson is that social media technologies increase rather than decrease the potential for fraud."); Heminway, *Corporate Purpose*, *supra* note 35, at 627-28 n.67.

would also be illegal under federal truth-in-advertising laws and possibly state charity laws.[49]

Fraud in social enterprise crowdfunding may negatively impact the market for social enterprise, and fraud in social enterprise may negatively impact the market for crowdfunding. Moreover, frequent confrontations between social enterprises and crowdfunding investors about corporate purpose or corporate governance or significant numbers of business failures in social enterprise firms, may sour the market for crowdfunded social enterprise or generate ill will among crowdfunders.

Although platform curation processes—including, e.g., strict inclusion criteria for fund raisers and in-house or third-party due diligence procedures—may be effective in mitigating some investment risk, nothing can eliminate the risk that a business may misstate or misleadingly omit material statements of fact, fail to deliver on its actual or perceived promises, or fail from an operating or financial point of view. Of course, the price or contribution level for a crowdfunded offering and the compensation paid to the crowdfunding platform may be discounted to reflect the existence and amount of residual risk. The accuracy of that kind of discount, however, assumes that those engaged establishing the amounts requested, have identified the salient risks and precisely calculated their effects.

The perceived fairness and general quality of the markets for social enterprise funding generally and crowdfunding in particular also may be or become factors in the success of crowdfunding as a means of raising funds to support social enterprise. If only low-quality social enterprise issuers—those who engender or earn little trust in their ability to meet financial and non-financial objectives[50]—are attracted to crowdfunding, the market for crowdfunded social enterprises may fail to materialize, stagnate, falter, or suffer detrimental consequences. Similarly, if crowdfunding—and more particularly securities crowdfunding—is generally a market for lemons, then it may damage the reputation of social enterprise in financial (and perhaps other) markets.[51] However, one commentator speculates "crowdfunding might be less of a stigma for a social enterprise, which has the ability to use its populist quality for branding purposes."[52] Again, platform curation may limit, but is unlikely to eliminate, the existence of low-quality businesses and projects (including without limitation social enterprises) seeking financing through crowdfunding.

Even with well-intentioned social enterprises and platforms, however, the type of investor drawn to social enterprise through crowdfunding may not match the profile of the ideal social enterprise investor—one who is committed to the entire mission (financial and non-financial) of the firm. In a traditional business finance setting, social entrepreneurs

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[49] Alicia E. Plerhoples, *Social Enterprise As Commitment: A Roadmap*, 48 WASH. U. J.L. & POL'Y 89, 96 (2015) (footnotes omitted).
[50] *See supra* note 30 and accompanying text.
[51] *See* Hurt, *supra* note 14, at 254; Darian M. Ibrahim, *Equity Crowdfunding: A Market for Lemons?*, 100 MINN. L. REV. 561, 591-603 (2015).
[52] Hurt, *supra* note 14, at 260.

and managers of social enterprises may refuse private investments from those who are not committed to the firm's mission.[53]

> Capital formation is always limited by trust, and in a dual-mission enterprise trust gets harder. Entrepreneurs have to worry about investor commitment, lest they push them to marginalize their social goals for financial gains. Impact investors want to invest their dollars for social good but will have trouble monitoring the social value being generated. Unless both parties are willing to trust each other, investment will be limited and capital-constrained benefit corporations will be limited in the social value they can create.[54]

In crowdfunded social enterprise, firms and their investors connect, if at all, over the Internet. Their knowledge of each other is qualitatively different than it would be in a traditional private offering. The necessary predicate element of trust that characterizes a healthy investment relationship in the social enterprise setting (which is, as noted above, a general issue in social enterprise finance) may be more difficult to achieve in a crowdfunding environment.

In addition, the overall nature of the funding cycle for social enterprise may not easily or efficaciously incorporate crowdfunding—in particular, the crowdfunding of equity investments. All firms, social enterprises included, should look at their overall financing strategy and trajectory at inception and as operations begin and continue before raising capital. If social enterprise is financed through equity crowdfunding (securities crowdfunding in which corporate stock or other equity is offered and sold), certain avenues for later private or public financing may not be accessible. Specifically, seed or angel funding, venture capital financing, and registered public offerings may not be available or as easy to obtain if a firm has a large number of equity investors. In sum, "social enterprise firms may not wish to have later rounds of funding and an eventual IPO, which might be forestalled by a crowdfunding offering."[55]

The risks of crowdfunded social enterprise identified above may or may not materialize in practice. Query whether (and if so, how accurately) a crowdfunded social enterprise offering might discount for their probability . . . . If these or other risks do emerge as significant and are neither appropriately factored into the pricing of a crowdfunded offering of social enterprise securities nor otherwise recoverable by issuers or investors, social enterprise crowdfunding will not enjoy widespread success.

Conclusion

As young popular and populist corporate governance and corporate finance adventures, social enterprise and crowdfunding hold some attraction for and traction with

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[53] *See* Reiser & Dean, *supra* note 30, at 796 ("If the social entrepreneur believes an investor will push her to abandon her social commitments, she may well refuse the investment.").
[54] *Id.* at 818.
[55] Hurt, supra note 14, at 260.

each other. There are good reasons—emanating from the common origins of social enterprise and crowdfunding in grassroots public movements with progressive shared goals (filling gaps in the markets for entity choice and business finance)—for crowdfunding to be a frequent source of funding for social enterprise ventures. Social enterprise and crowdfunding seem naturally complementary. Yet, the envisioned public benefits of crowdfunded social enterprise may be illusory or infrequently realized in practice, and even if real and realized, those benefits may not outweigh financial, reputational, opportunity, and other risks and costs.

In particular, crowdfunded securities offerings for social enterprises present a number of significant challenges. Both social enterprise (including especially benefit corporations and other new mission-driven statutory forms of entity) and crowdfunding (including especially securities crowdfunding) are to a great extent early-stage experiments. A sustained use of securities crowdfunding for social enterprise firms will eventually provide empirical evidence of the success or failure (in the aggregate and in individual cases) of crowdfunding as a means of financing social enterprise. In the interim, the common geneses of social enterprise and crowdfunding as grassroots movements, together with a new, relatively light touch of regulation on benefit corporations and securities crowdfunding (lighter than had existed for for-profit social enterprise before the advent of benefit corporation legislation and for unregistered securities offerings before passage of the CROWDFUND Act), combine to create a laboratory in which social enterprises, crowdfunding platforms, other business finance intermediaries, and funders can engage in collaborative experimentation in capital formation under the watchful eye of academics and other researchers (as well as policy makers and industry leaders). Even if the outcome of the experiment is that the potential for mutual benefit is not realized or realizable (at all or in certain cases), we no doubt will learn much from the experimental process.