The viability of the low-profit limited liability company:
What it will take for the L3C to become social entrepreneurship's next big thing

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Abstract

The low-profit limited liability company (L3C) has emerged as a result of the growing fourth sector of the American economy. As social entrepreneurship grows and a desire for businesses to make a social impact along with profits continues, some believe the solution is a “for-profit business with a non-profit soul” as the L3C creator Robert Lang has dubbed the new legal entity. L3C legislation has been ratified in eight states, starting with Vermont. Due to the ambiguity and newness of the L3C, there are a number of unanswered questions about the legal status, from funding to branding. Debates have swirled about the legitimacy and necessity of the L3C status since its inception. This paper attempts to answer the question of what must change for L3Cs to become the legal option of choice for social enterprise. By conducting phone interviews with founders and managers of 16 Vermont-established L3Cs and asking questions about the hurdles, hardships and happenings of L3Cs, this paper concludes L3Cs should take advantage of their branding platform to advance as the legal status of choice for social business, and that L3Cs must individually pursue foundations with nearly identical social missions if they hope to acquire program related investments. Using qualitative-interpretivist exploratory interviewing methodology, this is one of the first qualitative research studies on low-profit limited liability companies.
Introduction

Social Entrepreneurship at Large

With the rise of for-profit businesses such as TOMS Shoes pushing the envelope for what is possible for social achievements in the for-profit sector and seeing the sustainable business success of the non-profit Acumen Fund, organizations in the for-profit and non-profit sectors have begun blurring the lines between the two types of legal entities. However, as opportunities and desires to create social ventures grow, the traditional ways, including the traditional laws and legal statuses of business, are no longer whetting the appetite of social entrepreneurs. A fourth sector of the economy has emerged through social entrepreneurship, adding to the original three sectors of for-profit business, non-profit organizations and the government.

The fourth sector has the potential to attract a large number of small businesses, startups and entrepreneurs. Entrepreneurs are creating organizations that revolve around change, and they refuse to conform to the ways of old, especially when it comes to legal organizational entities. Social entrepreneurship is the fourth-sector of the economy, encompassing roles from the other three and tidying them into one powerful package. This sector creates social change, and it is looking for new sources of capital, new funding structures, new legal options, and new opportunities to shape the future of business.
This fourth sector is growing in size and interest, but the laws surrounding social business are quickly becoming outdated. This new breed of entrepreneur pushing for social change has found that “outmoded law and inappropriate old-style legal entities hamstring their socially transformative plans” (Kelley, 2010: 3). Critiques of the fourth sector being a fad have been heard for more than a decade, but Thomas Kelley (2010) says hybrid social enterprise is growing rapidly and has widened the scope of for-profits doing charitable work formerly done by non-profits. Kelley (2010) also suggested that social entrepreneurs have seen plans hindered by the current laws regarding social enterprise, which were written for a three-sector economy.

These new social ventures belong to neither the for-profit, nor the non-profit sector, and the laws and regulations that govern those old sectors are not well suited for the multi-purpose goals of social enterprise (Kelley, 2010). Social entrepreneurs need new legal avenues to pursue opportunities for social change that encompass the mission of an organization and the ability to be sustainable outside of grants and donations. The traditional non-profit and for-profit statuses do not fit the mold for social entrepreneurship, and the need for hybrid legal entities is growing.

As social enterprise grows, these entrepreneurs must make difficult decisions about how to best create and operate an organization. The fourth sector has opened doors for the emergence of for-profit businesses with non-profit causes at the core of organizations. If social entrepreneurship continues to grow, more legal options must
be created. More legal options means more opportunity to create sustainable social businesses that can positively affect society as well as attract new forms of capital that have largely been untapped. The three-sector economy has limited capital opportunities—the government is in massive national debt, there are over one million 501(c)3 organizations that rely on grants and donations, and the traditional for-profit businesses are all vying for the same capital. New legal options means more opportunities for funding, more opportunities for making an impact on society, and more startups being created. There simply must be more opportunities and choices for social entrepreneurs in order to sustain the growth of social entrepreneurship from a capital standpoint. The low-profit limited liability company (L3C) is a legal option that combines a for-profit business with a non-profit purpose.

**The Introduction of the L3C**

Before 2008, there were only two broad legal options for startup social businesses: non-profits and for-profits (most commonly created in the most versatile business entity, the limited liability company or LLC) (Callison, 2009). In 2006, the L3C was conceptualized to bridge the gap between non-profits and for-profit ventures, specifically with social entrepreneurship in mind. In an L3C, income is a secondary purpose instead of the main priority, fulfilling the essence of social entrepreneurship (Hopkins, 2009). The L3C status is “unique in that it allows the organization to diversify its funding pursuits and allocate risks to allow a higher rate of return to private investors” (Morral, 2010: 1). The legal status of L3Cs allows private
foundations to make investments as an alternative to grants in the form of program related investments or PRIs (Hopkins, 2009).

The central premise of the L3C is the ability to tranche investments in order to give a varied degree of financial returns spread over multiple investors (Clement, Lang, & Jatar, 2010). Tranche investing is the idea of layering investments in an organization and providing differing rates of return to the multiple investors involved. The goal and key factor in this layered investment tactic is to have private foundations become the first investors, providing the base layer of capital through program related investments. In this scenario, foundations would opt to receive low returns and shoulder the high-risk initial investment all for the benefit of promoting charitable progress (Searing, 2008). Ideally, once the foundations have made the base-level investment, other investors would begin channeling capital into the L3C. These secondary investors are then able to achieve near market-rate returns while also promoting social progress. The risk and returns would then be unevenly distributed across investors, with the lowest return and highest risk going to the foundations. Some investments, specifically those made by investors seeking higher returns, would then be considered safe in the L3C. At the same time, the foundation could shoulder risk and achieve marginal returns, making the investment similar to a grant but with the possibility of a small financial return (Clement, Lang & Jatar, 2010). This has all been enabled by program related investments, which allow foundations to allocate funds into riskier investments.
without jeopardizing their 501(c)3 statuses (Americans for Community Development [ACD], 2009).

**Investment Dollars**

As many social entrepreneurs struggle to raise capital for starting up or expanding, they have defected from the non-profit sector, but they have not seen their woes fully eased in the form of for-profit ventures either (Allianze, 2007). In the midst of an economic recession, investors of all types have become more frugal with their resources, which means startup businesses of all types have found more difficulty in acquiring funding. However, it is estimated that there are currently 120 billion dollars in private wealth investment capital designated for “socially productive and profitable” firms (Weber, 2010: 1). Investors are looking to make a social impact as well financial returns, and social enterprise provides that opportunity (Miller & Wesley, 2010). L3Cs provide an alternative to charitable giving for private foundations and have the potential to create profits and social change all in one hybrid organization (Hopkins, 2009).

Investors are looking to make an impact with their money, and social ventures are desperately in need of capital—it seems like a match made in heaven. Unfortunately the newness of social ventures and the unproven track record of this new sector of the economy have made acquiring capital difficult. Market-rate investors are hesitant to invest in for-profit businesses operating like non-profits for fear of low financial returns. These hybrid social ventures have been cut off from typical sources of funding
in the form of grants and government capital because they are not non-profits, and venture capitalists are hesitant to invest because of the low probability of high financial returns (Allianze, 2007). It is no secret that these hybrid, multiple-bottom line organizations are unlikely to produce significant rates of return on investments (Allianze, 2007).

The field of social entrepreneurship research is evaluating the impact social business is making in the for-profit and non-profit realm, but there is a need for more research on funding social ventures and the impact organizational legal status has on that process (Mair & Marti, 2006). To advance social change, entrepreneurs must determine the most effective way to legally create their businesses to make the largest impact. The L3C provides a legal structure where social goals are legally baked into the organization. When filing to become an L3C, Vermont Statutes require all entrepreneurs file their charitable or educational purpose in addition to fulfilling all of the requirements of an LLC (Vermont Secretary of State [Vermont SOS], 2008).

The funding dilemma was the main reason the L3C was created—to target PRIs from foundations for funding (Clement, Lang & Jatar, 2010). Technically, foundations are required to invest five percent of their total assets into charitable gifts or PRIs. This five percent is most often distributed in the form of grants and donations to non-profits (Searing, 2008). L3Cs are now trying to tap into that pool of capital to acquire PRIs.
In the midst of these funding woes, L3C legislation is advancing. Eight states now have L3C laws in place as of March 2011, and a number of other states have potential legislation in the works (Americans for Community Development [ACD], 2011). In the midst of new legislation, there are still plenty of questions surrounding the L3C. Is it truly a new type of business, or is it simply a gimmick or branding initiative? Are program related investments the solution to social ventures’ funding woes?

Speculation continues as states continue to bring L3C legislation to fruition in hopes of attracting new business and creating social change, but what do the people in the trenches have to say? Why are people creating L3Cs? What type of impact has the tax status had on their business goals? What type of funding are they acquiring? What is the next step to help the L3C movement grow, gain national attention, and attract more business in hopes of creating a hybrid model between non-profits and for-profits?

By conducting phone interviews with 16 individuals involved with Vermont-registered L3Cs and operating all across the nation, this paper hopes to answer the big underlying question related to L3Cs; what will it take for L3Cs to grow and thrive and become the premier legal option for social enterprise in the fourth sector? This paper will analyze the conversations with these entrepreneurs, discuss the hurdles and struggles of the organizations, reveal information about how these businesses have been funded, and determine what it will take to grow this legal status in an effort to promote social entrepreneurship across the nation.
Literature Review

LLC Roots

From the standpoint of the IRS, the L3C is identical to the limited liability company or LLC in nearly every way. LLCs are able to accept program related investments (although L3Cs are touted as being more acutely oriented to these specific foundation investments), combine the benefits of partnerships and corporations, and are currently the most popular form of for-profit businesses (Kleinberger, 2010). However, it is rare for any type of for-profit entity to receive an investment from a foundation in the form of a PRI. The rarity is likely due to the lack of familiarity surrounding program related investments from foundations. The process of ensuring the legitimacy of a PRI appears to be much more difficult than ensuring a grant is qualified in the eyes of foundations, but in reality the processes are very similar (Searing, 2008).

From the standpoint of the IRS, the L3C operates no differently than an LLC. Theoretically, L3Cs were created to prequalify for PRIs and tap into a new source of capital, but LLCs are eligible for PRIs as well (Kleinberger, 2010). L3Cs function in the same way as LLCs in the sense of having flexible ownership rules, management flexibility, ownership flexibility, pass-through tax status, state-based legislation and the opportunity for program related investments (Clement, Lang & Jatar, 2010). L3Cs
were created to combine the social aspects of a non-profit with the financial opportunities of an LLC and to prequalify for PRIs. (Lane, 2010)

**L3C Legislation**

With beginnings at the 2006 meeting convened by the Aspen Institute’s Non-profit Sector and Philanthropy Program, L3C creators Robert Lang and Marcus Owens first pitched the idea of the new legal entity in a discussion entitled “Exploring New Legal Forms and Tax Structures for Social Enterprise Organizations” (Baghramyan, 2010). Robert Lang called on lawyer Marcus Owens to draft the L3C legislation. Owens’ idea was to write the L3C legislation that nearly identically mirrored that of the PRI requirements in Section 4944(c) of the Internal Revenue Code (Kelley, 2010). The belief was that if Owens’ legislation for the L3C was ratified, the L3C would automatically qualify for a PRI based on the legal wording alone. This would ideally allow foundations to confidently invest PRIs into L3Cs because they would be prequalified to receive that type of investment. This would hopefully eliminate the need for a private letter ruling by the IRS (a costly and time consuming measure) that officially approves PRIs (Kelley, 2010).

Vermont became the first state to legally create the low-profit limited liability company. Since the Vermont L3C legislation, another seven states and two federal jurisdictions (The Oglala Sioux Tribe and the Crow Indian Nation of Montana) have also legalized the L3C (ACD, 2011). While the L3C was created to mirror PRI language and prequalify for the foundation investments, there is a mound of confusion
surrounding the legal wording of the low-profit limited liability company. To start, the wording of the L3C contradicts the name of the legal entity. The Vermont law for L3Cs states under part B, “No significant purpose of the company is the production of income or the appreciation of property; provided, however, the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involve the production of income or the appreciation of property (Vermont, 2009). This asks the question, does the first L of the L3C really stand for ‘low-profit’? There is currently no cap on the amount of profit that an L3C makes. In fact, the company is not legally allowed to pursue profits as a main purpose, but if it makes profits while pursuing its social mission that is legally acceptable. It is unclear how it would be determined if profits were a main purpose of an organization and if the IRS or the state would ever review the organization to ensure it is not primarily pursuing profits.

**Program Related Investments**

The program related investment is the single largest issue surrounding the entire L3C movement. The legal wording of the L3C mirrors the legal wording for PRIs almost identically, which was Marcus Owens’ intention in an effort to have L3Cs automatically qualify for the foundation investments (Kelley, 2010). In fact, the legislation for L3Cs in Vermont specifically cites the program related tax code in the Internal Revenue Code, as seen in the table in Appendix A.
PRIs were created through the Tax Reform Act of 1968 and allow foundations to make investments in the form of debt or equity to promote activities providing social benefits (Clement, Lang & Jatar, 2010). Program related investments “must also be investments that would not have been made otherwise except for their relationship to the exempt purposes, in other words, high risk, low return or both” (Clement, Lang & Jatar, 2010: 319).

The PRI allows for an exemption from excise taxes and allows a foundation to invest in entities it would not normally be able to due to high risk or financial return issues. The Internal Revenue Code (n.d.: 1) states,

A PRI is exempt from excise taxes under the SS4944(c) jeopardy investment rules, and this exemption allows a private foundation to make an investment in a for-profit entity without incurring excise tax, if (i) a return on investment is not a significant purpose of the investment and (ii) it will not jeopardize the carrying out of its exempt purposes.

This legislation allows foundations to make risky or low-return investments without putting the foundation in danger of a jeopardy tax. However, the PRIs could be reviewed and overturned by the IRS if it is determined that the charitable or educational goal of the L3C does not align with the primary mission of the foundation. Foundations that are aware of L3Cs, although they may be few and far between, are also aware of the risks of making a PRI that does not qualify.

As a part of the IRC, foundations are obligated to invest or distribute five percent of their net assets in the form of charitable gifts or PRIs (Searing, 2008). Qualified
distributions for this type of contribution include grants to 501(c)3 organizations and PRIs, which can be loans, credit, or equity. PRIs have a slight financial benefit over grants because any return from program related investments can be recovered, in addition to earnings, and then reinvested or reused in other organizations (Lane, 2010). Ideally, the L3C would utilize PRIs to leverage and attract other investments from private donors, allowing for organizations to be created with the intent to produce low financial returns but large social impact (Clement, Lang & Jatar, 2010).

Unfortunately, PRIs have never been a formidable force of investing in for-profit social businesses because they are “generally burdensome and risky” (Kelley, 2010: 21). It is much simpler for a foundation to simply make a grant or donation to a 501(c)3 organization instead of going through the lengthy process of a PRI (Searing, 2008). From 2006-2007, program related investments from foundations totaled $734 million, while total distributions from foundations during the same time totaled $91.9 billion (Foundation Center, 2009). This shows PRIs account for .8 percent of total foundation investments or donations, a remarkably small portion of total foundation dollars. What does this mean? It means that L3Cs are specifically targeting a pool of money that is rarely distributed to for-profit organizations, but it also means there is a great opportunity for expanding PRIs and growing the capital opportunities. With all of the potential risks of taxation associated with non-approved PRIs, it is unsurprising that less than one percent of foundation capital flows through the channels of program related investments.
If a foundation wants to make a PRI, it must ensure that the missions of the organizations are closely aligned. Minnigh, Ingersoll and Rooney (2009: 5) provided the following example:

For example, if the stated purpose of a private foundation is to further cancer research, that private foundation may not invest in a L3C that has a social purpose of a community center, because the community center would not further the private foundation’s stated exempt purpose.

Adding complexity, the determination of the alignment of the organizations is subjective and ultimately up to the discretion of the IRS (Internal Revenue Code [IRC], n.d.) Also, if the L3C or other for-profit entity receiving a PRI changes its mission, the foundation would have to withdraw the investment (IRC, n.d.). This means the foundation must closely track the happenings of the organization receiving the PRI, or the two would have to draw up a very specific operating agreement, which is not technically required for an L3C to form as a legal entity (Vermont, 2008).

Foundations wishing to pursue PRIs have two unfortunate options. The first option is to negotiate and work with a potential recipient to make sure the missions of the two organizations closely coincide. If the missions are not aligned but a program related investment takes place, the IRS could retroactively rule the PRI as a jeopardy investment not qualifying officially as a PRI (Billitteri, 2007). This would then leave the foundation vulnerable to an IRS review. As Minnigh, Ingersoll and Rooney (2009: 5-6) noted,
because the IRS has not explicitly ruled on whether L3Cs qualify as PRIs, a private foundation’s investment in the L3C could be considered a jeopardy investment under §4944 and a 10% excise tax would be imposed on both the private foundations and its managers. Moreover, under §4942 if the investment were intended as a qualifying distribution than there could also be an excise tax of 30% on the amount distributed to the L3C.

Essentially, the foundation is subjecting itself to the potential of a huge tax if the IRS rules that the PRI was not qualified.

The second option to ensure PRIs are qualified is for foundations to pursue a private letter ruling from the IRS, which costs tens of thousands of dollars in addition to the amount of time it would take for a ruling to occur (“Dear IRS,” 2007). This is simply not a realistic option for a foundation to pursue, as they are paying to make an investment in a for-profit company when the funds could be distributed as a grant to a 501(c)3 organization with significantly less hassle and risk of an IRS ruling that could jeopardize the entire foundation’s assets to a 10 percent tax. In one private letter ruling requested by a foundation to give a PRI to an LLC, the IRS ruled in favor of a foundation; however, the request for a ruling was submitted June 13, 2005 and the ruling was not released until March 10, 2006, a nearly nine-month period for a single ruling (Department of the Treasury, 2006). This type of timeline is certainly a discouragement for foundations to pursue private letter rulings, and even PRIs in general. Unfortunately for L3Cs, they are not able to pursue the rulings, and only foundations can initiate IRS private letter rulings (Internal Revenue Service [IRS], 2011).
The goal of the L3C was to tap into the pool of capital in the form of PRIs, the first step to layered investment. Unfortunately, without the initial investment of a PRI in an L3C, it is unlikely that investors looking for market-rate or near market-rate returns will be interested in investing in an L3C (Minnigh, Ingersoll & Rooney, 2009). As researchers correctly predicted, very few (if any) private foundations will be willing to invest in L3Cs until other foundations have done so and have not suffered any negative tax consequences or until the IRS gives a private letter ruling addressing PRIs and L3Cs (Minnigh, Ingersoll & Rooney, 2009).

Foundations largely disregard PRIs due to a lack of knowledge surrounding the approval process. These foundations prefer giving grants rather than PRIs because they are more familiar with the grant approval process. However, as Searing (2008) notes, grants must qualify under IRS standards that are very similar to the standards set for PRIs. If foundations went through the same processes to internally approve PRIs as they do for approving grants, there would be less hesitation in pursuing PRI opportunities. While giving grants and PRIs are similar, there is one major difference between the two. A grant is a one-time donation, which means as long as the grant qualifies at the moment it is distributed it will not be retroactively overturned if the organization receiving the grant changes its mission or purpose. PRIs, on the other hand, are ongoing investments, and if the organization changes its direction, mission, goals, or charitable purpose, the foundation could be liable for a jeopardy tax if the IRS reviews it retroactively (IRS, 2011).
The bottom line is that program related investments are not simple investments. PRIs are complex, and the L3C legislation does not remove the complexity of program related investments (Kleinberger, 2010).

**L3C Debate**

PRIs aside, since its inception, the L3C has had major proponents and opponents pushing for and against the legal status. The lack of clarity surrounding L3Cs and the societal role the entities play have created a significant debate about the importance of this new legal status. One opponent called the L3C legislation adopted currently as “nonsensical and useless” (Kleinberger, 2010: 879). According to the creator of L3Cs, Robert Lang, when creating the concept of the L3C he was “hoping to make a modest change in the way that the philanthropic community approached the solution to social problems” (Lang, 2008: 1). A modest change may have been Lang’s hope, but the process of attempting to attract program related investment dollars to tranche investments is more of a major change than a modest change.

According to the Americans for Community Development (2009) website, a private letter ruling is not necessary for L3Cs to receive PRIs, but the organization acknowledges that federal legislation prequalifying L3Cs for PRIs would be beneficial. Americans for Community Development has introduced The Philanthropic Facilitation Act of 2010 and hopes to amend Section 4944 (c) of the Code to provide a process by which an entity seeking to receive PRIs can receive an official determination if a
foundation investment will qualify as a PRI (Americans for Community Development [ACD], 2010).

There are avid supporters and rabid opponents to the L3C legislation. Fleder (2010) argues that society, social entrepreneurs, foundations, private investors, and government all benefit from L3Cs as they provide new opportunities for new organizations and channels for capital to flow through. Society benefits from creating organizations for charitable purposes, and social entrepreneurs benefit from access to new capital. Foundations benefit from an opportunity to see returns from PRI rather than only making donations with grants. Investors benefit from near market rate returns if the investments are layered while also achieving charitable or educational purposes, and the government benefits from not having to give a tax exemption while still having charitable work be performed (Fleder, 2010).

In the midst of being an advocate of L3Cs, Fleder (2010) points out three major issues with L3Cs: a tension in fiduciary responsibilities between the L3C managers and the requirement to pursue charitable purposes, the layered returns of investments, and the term “low-profit” discouraging market-rate investors. These concerns are valid, but are just the tip of the iceberg of L3C issues.

Opponents claim L3Cs do not have any edge over LLCs in promoting program related investments, and that “the L3C construct is unnecessary, unwise, and inherently
misleading” (Kleinberger, 2010: 896). Past research notes the L3C movement initially gained the majority of its momentum from claiming L3Cs would be given special preference from foundation investments, but that claim has now been proven erroneous (Kleinberger, 2010). Also, the naming of the organization itself as a “low-profit” limited liability company, is confusing if not contradictory. Vermont law states “no significant purpose of the company is the production of income or the appreciation of property” (Vermont, 2009).

The table in Appendix B compares the main arguments for and against the L3C as a necessary legal status. In the midst of the debate, there has yet to be any research conducted on the actual operations of L3Cs. In the review of current literature, the researcher did not discover a single piece of research, qualitative or quantitative, that interviewed founders and managers of L3Cs. This research hopes to advance L3C research as a whole by contributing potentially the first qualitative study done on L3Cs.

**Methods**

In order to get to the heart of what must happen for the L3C movement to grow, it seemed there was no better way than talking to those actually involved with L3Cs. A number of studies have been conducted on the legalities of L3Cs, and a significant amount of research debates the legitimacy of the status. Few, if any, have engaged actual L3C entrepreneurs to understand their perspective on why they believe the L3C
is the best option for their organization. By conducting a qualitative study on the realities of operating an L3C, this research sheds light on the issues facing this new type of legal entity by hearing directly from those running the businesses.

To find a large enough sample of entrepreneurs and also to eliminate bias by simply contacting only a few connected through the researcher’s personal network, the researcher chose to use the database of registered L3Cs on the Vermont Secretary of State website (Vermont Secretary of State [Vermont SOS], 2004). Vermont has the largest number of registered L3Cs, unsurprisingly, as it was the first state to ratify the status. The volume of registered L3Cs in Vermont provided the largest database of organizations, allowing the researcher to speak to a diverse spread of entrepreneurs from different industries and backgrounds. The database contained the registered name of the L3C, the active status, the file number, state of origin, origin date, description of services and social mission, registered agent, address, manager, and last annual report date. This database, however, provides narrow, base level information for the organizations listed. Unfortunately there was no direct contact information listed for the L3C or founders other than a registered postal address for the organization.

To find electronic contact information (such as email addresses or websites with email contact forms) for the founders of the L3Cs, the researcher conducted Internet searches by typing in the name of the company followed by “L3C” on an Internet search engine. The researcher sifted and sorted through data until it was clear that the
business listed on the Secretary of State website appeared in the results. After attempting to find contact information for a founder or manager of each of the 130 (as of February 1, 2011) Vermont-based L3Cs, the researcher was able to find contact information for 59 organizations. An email explaining the nature of the research and requesting an interview to discuss L3Cs was sent to a founder or manager of the organization according listings on company websites or information found on the Secretary of State website. After sending out 59 emails, 21 individuals replied with interest, and 16 Vermont L3C founders or managers were interviewed based on the time constraints of this study.

After setting up a time to talk with the entrepreneurs, interviews were conducted via Google Voice, an over-the-web free phone service. Each interview was recorded with a computer software program called Tape Deck, which allowed the conversations to be quickly saved digitally and clearly organized. Recording the data digitally allowed for convenient access to the interviews for the researcher in further analyze the data after the interview. During the interview, the researcher typed the responses in shorthand to capture interviewees’ responses.

It was important to conduct the interviews over the phone for a number of reasons. First, it allowed the researcher to connect with the owners and managers and answer any questions they had about the research. Second, it allowed the researcher to verbally confirm to the interview participants that data results would be anonymous.
Finally, it allowed the researcher to ask clarifying questions around any of the responses to ensure a full understanding of what the owners and managers were trying to communicate through responses.

The research method is considered qualitative-interpretivist-exploratory methodology, and it was chosen because minimal qualitative research has been conducted on low-profit limited liabilities. This methodology, used by Bulearca and Bulearca (2010), consists of semi-structured interviews with mainly open-ended questions that allowed the researcher to probe answers from interviewees if necessary. Interview times ranged from 15 minutes to 60 minutes, depending on how in-depth the L3C entrepreneurs’ responses were. All questions listed in Appendix C were asked to each individual. Participants in the study were notified that they were not required to respond to any questions they did not feel comfortable answering and could end the interview at any time. A number of questions were removed from the original list of questions based on developing a better understanding of how L3Cs functioned. For example, one original question asked, what will your organization do if the L3C status is outlawed by the IRS? According to further research and talking with a number of interviewees from Vermont L3Cs, it was discovered that the IRS did not have jurisdiction over the states’ decisions to create the new tax status. Also, the IRS legally sees L3Cs just as they do LLCs, and there is currently no differentiation from a tax
standpoint. The only thing the IRS could do is rule PRIs given to L3Cs as unqualified investments.¹

During each conversation, responses of each interviewee were transcribed in abbreviated note form. After finishing the abbreviated transcription, the recording and document of responses were saved together for review after all data had been collected. After finishing conversations with 16 individuals directly involved with L3Cs in a founding or managerial role, each conversation was reviewed and information not captured in the first transcription was added to the typed responses for each interview. In order to eliminate any interviewing bias, a second researcher also analyzed the data. Analyses were consistent with the primary researcher. Thus, no bias was found.

**Results**

Based on the results of the conversations with 16 founders and managers of L3Cs, there was a wide range of issues discovered from the legal issues, funding issues and organizational issues of the L3C. In order to capture the nature of the industries L3Cs

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¹ The IRS does not have jurisdiction over legal business statuses, as states individually create laws surrounding legal entities. However, because the IRS has jurisdiction over private foundations and their 501(c)3 status, the IRS has the ability to rule a program related investment as unqualified for the five percent of assets that must be distributed to maintain the tax-free status. If a PRI is ruled as unqualified, the foundation would be subjected to a 10 percent tax on its entire assets and a 30 percent tax on the capital distributed through the PRI that was ruled unqualified (IRS, 2011).
were conducting business in, the 130 companies listed were categorized into the Fama/French 48 industry classification codes (Fama & French, 1997). There were 16 industries from the 130 companies listed on the Secretary of State website and 16 companies from nine different industries appeared in the data collected from interviews.

According to the classifications of the industries, the following occurrences of industries appeared in the 130 organizations listed on the Vermont Secretary of State website, as classified by the researcher. The number indicates the number of occurrences, followed by the industry the organization operates in:

- 8 Agriculture
- 1 Apparel
- 1 Healthcare
- 2 Pharmaceutical Services
- 1 Construction Services
- 5 Food Production
- 4 Utilities
- 1 Communication
- 32 Personal Services
- 46 Business Services
- 3 Travel
- 3 Retail
• 8 Banking
• 2 Real Estate
• 11 Entertainment
• 3 Publishing

The high concentration in the business services and personal services sectors is to be expected due to the wide-encompassing nature of those industry classifications. It is also unsurprising that only 16 out of the total 48 industries appeared, as L3Cs are in a niche area and are not necessarily effective for a number of industries.

Background information determined that the founders and managers all had at least some university-level educational experience, 14 had at least a bachelor’s degree and seven had a graduate degree of some form. The time each founder or manager spent in the industry that the L3C was formed in ranged from one year to 40 years.

After analyzing the responses for the inspiration for creating these L3C organizations, the results showed that all 16 of the organizations had an underlying motivation to help communities and individuals or to spread an idea through education. Of the 16 interviewed, five mentioned either wanting to make a larger personal impact on society or desiring to pursue a different career track personally.
From the standpoint of measuring business success, a number of different metrics were mentioned. Seven of the organizations mentioned a social goal as the primary metric for measuring business success. Three of the organizations said breaking even or financially surviving as an organization was a top success metric for business achievement. Two of the organizations interviewed said they are not measuring business success in any way, either because the organization was formed as a hobby or it has since taken a backseat to other projects. Six of the organizations mentioned generating profits to further expand the organization as a business metric for success.

When asked what the largest barrier to company goals was, access to capital was the foremost concern. Eight of the founders or managers mentioned funding issues. These responses surfaced in the form of tight budgets, access to credit, or access to interested investors. One organization mentioned that investors disliked the term “low-profit.” Two organizations mentioned the lack of understanding about L3Cs as an issue, and two also said a lack of time was an issue as the L3C was being pursued as a secondary venture. Overall, those involved with the L3Cs said funding was the largest barrier keeping the organizations from reaching its goals.

The researcher asked individuals to quantify the organization’s focus on profits versus social impact on a scale of one to five, with profits being most important ranking a one on the scale and social impact being most important ranking a five. No interviewee responded lower than a three. There were three individuals that rated their business a
three on the scale, putting equal emphasis on profits and social impact. Two organizations rated themselves slightly more focused on social impact at a 3.5, three organizations that ranked a 4, and six organizations that said social impact was most important at five. Two organizations declined to answer this question. The mean score was a 4.14 and the median was 4.

Individuals were asked why the organization was formed as an L3C as opposed to a non-profit or a for-profit organization. Eight of the individuals cited some type of financial issue as the reason for being an L3C, such as being able to generate profits or be self-sustaining without reliance on grants. Four organizations formed as L3Cs primarily for the opportunity to receive PRIs from foundations. Nine of the individuals said the L3C status most clearly exemplified their organization and its efforts to make a social impact while also having the opportunity to generate profits. Three organizations did not want to form as a non-profit due to the requirement of a governing board or the lack of ability to use profits at their own discretion.

Interviewees were asked to list the largest benefits they have seen from being an L3C. Ten of the 16 organizations interviewed mentioned an aspect of the status related to branding or press opportunities as a major benefit. Although none had actually received a PRI, four of the organizations cited the potential for receiving money from foundations as a top benefit. Two specifically mentioned the opportunity to combine or tranche different types of funding such as private and public funding. One
respondent was unsure of the benefits on the whole but mentioned the potential for attracting different forms of capital as a theoretical benefit. All interviewees cited at least one actual or theoretical benefit of being an L3C.

When asked about the drawbacks of being an L3C, six respondents said they had not experienced any. Five of the founders and managers said the lack of understanding and awareness of the public, lawyers and foundations was a major drawback. Seven interviewees mentioned an issue with funding in some capacity, either with attracting outside investors or being able to acquire a program related investment from a foundation.

The interviewees were asked if their organization considered forming as a different type of legal entity. Two of the respondents considered forming as an LLC and an additional five converted from an LLC to an L3C, which would have put a total of seven in the traditional for-profit realm without the L3C status. Five organizations considered a non-profit as their first option, with reasons for not moving forward being regulations. One interviewee said the L3C was the only option considered for the organization. One considered being a non-profit with a for-profit arm, and one organization is an L3C arm of a non-profit organization.

Those interviewed were asked how the organization’s founders discovered the L3C status. Two heard of the L3C through legal professionals, six discovered it via the
Internet, three heard about it at a conference, four discovered it through a personal network, and one discovered it through an MBA program. Of those who discovered it from conferences, two specifically noted they heard from one of the founders of the L3C, either Marcus Owens or Robert Lang. The Secretary of State website for Vermont was the source of information for two of the online discoveries.

Funding, a major concern for social entrepreneurs, brought out interesting results. The L3C claims to be a funnel for PRIs, investments that are the key piece in allowing organizations to tranche investments and give different levels of financial returns; however, of the 16 organizations, none had officially received a PRI and only one was in the process of working with a foundation to receive a PRI. Eight of the organizations were funded solely through the founders' initial investment. In one organization, the founders invested 93 percent of the capital into the organization and had a single outside investor contribute the other seven percent. One organization had 88 private investors that contributed anywhere from $1 to $50,000. Another organization was funded through a 501(c)3 parent organization. One Vermont L3C was funded through credit and loans. One was created through 50 percent of the founders’ personal investment and the other half was contributed from outside individual investors. Three angel investors funded one of the organizations. Two organizations did not disclose their capital financing structure.
Conclusions

As noted in the results, the most major finding was that no organization had officially received a program related investment at the time the study was conducted, and only one organization was in the process of receiving a PRI. For a legal status that was created to mirror the legal language of program related investments, it is incredible to see that the main advantage according to the founders of the legal status has had absolutely no significance in the furthering of a Vermont L3C.

As expected, all founders or managers mentioned a charitable or educational purpose at the heart of what inspired the organization. Since naming a charitable or educational purpose is a requirement for creating an L3C according to Vermont law, it is reassuring to see Vermont L3Cs are operating as the law intends. These organizations are not being formed to simply ride the wave of social entrepreneurship for their own benefit—they are being created to make a social impact on communities.

It was interesting that only seven of the 16 organizations mentioned a social goal when measuring business success. Survival became a common link for three organizations, once again pointing to the funding issues of Vermont L3Cs. Generating profits was a goal for six organizations, but none mentioned profits being more important than social impact, once again staying consistent with the Vermont L3C law, which states
profits cannot be a primary goal of the organization. According to this information, the L3Cs are functioning as the laws intend.

Funding was the most commonly cited major barrier keeping Vermont L3Cs from reaching their goals. Half of those interviewed mentioned funding as an issue. It is interesting that the L3C was formed in an attempt to attract foundation capital in the form of PRIs, but in reality funding has been the thorn in the flesh for Vermont L3Cs. Market-rate investors are discouraged by the term low-profit, and foundations have said they are unwilling to invest because the L3C is not qualified as a guaranteed PRI.

Based on the responses about the L3Cs’ focus on profits versus a focus on social impact, not a single individual said there was a higher focus on profits, not even slightly. Every response was a three or above on the scale, ranging from equally split on profits and impact to more focused on social impact. The organizations that rated their business in the dead center of the scale of organizational focus said they had equal orientation toward generating profits and creating social impact. A number of organizations said their entire focus was on social impact, rating their business as a five on the scale. This once again shows that these founders and managers are adhering to the original intent of L3Cs being organizations focused on social change and pursuing profits as a secondary purpose. A few individuals qualified their responses by saying profits were important only to reinvest back into the organization in an effort to further the social mission.
It is interesting that while the main purpose of the L3C is to open the door to PRIs, only four of the organizations formed specifically for the opportunity to receive PRIs according to the interviewees’ responses. Nine of the organizations, however, stated that the idea of a L3C being a “for-profit with a non-profit soul” was at the heart of what the organization was doing. The organizations are trying to be sustainable or break-even without having to rely on grant money, and the L3C fits that mission. What this shows is that the Vermont L3C is viewed as more of a branding platform than an investing platform. The L3C movement’s mission of creating a hybrid between a for-profit and a non-profit shows that core values are more important than capital attraction according to the interview responses.

Branding was far and away listed as the largest benefit of the Vermont L3C. The branding of the organization opened up doors for press, interviews and discussions with clients about what purposes L3Cs serve and what missions they promote. PRI opportunities were cited four times, but the responses were theoretical, as none of the organizations that mentioned PRIs had actually received any type of investment from foundations. One interviewee said the large opportunity for L3Cs to receive PRIs was erroneous. This once again shows that the primary reason for creating the L3C, foundation dollars from PRIs, is not a major benefit that any of the Vermont organizations are experiencing. The idea of PRIs may attract these organizations to the
L3C status, but the results and promises from L3C advocates saying foundations will fund these ventures have not occurred in Vermont L3Cs.

Funding was noted as the largest drawback by seven of the 16 interviewees. This once again shows that the main thrust of Vermont L3Cs, the opportunity for foundation PRIs, is not occurring. L3Cs are in a unique and difficult situation from a funding perspective. The goal is to attract foundation capital in an effort to tranche investments, provide a high-risk, low-return investment from the foundation PRIs, and give more market-rate returns to private investors. However, this does not appear to be happening in Vermont L3Cs. Funding is an issue because private investors are worried about the “low-profit” tag attached to L3Cs, and foundations are hesitant to invest due to the tax liability if PRIs are reviewed by the IRS and deemed unqualified. The thrust of the L3C movement being funding is, to be frank, a sham if the Vermont L3Cs are an indicator of low profit limited liability companies as a whole. If anything the L3C moniker has troubled more than it has advanced the movement towards new types of funding for those organizations in Vermont. On a positive note for the L3C movement, however, is that six interviewees said that they had not experienced any drawbacks to being an L3C. That is quite a feat for a new legal status that is still struggling to gain national recognition with the public, investors, and foundations.

Nearly half of those interviewed said they would have formed as an LLC without the L3C status or actually were LLCs before converting to an L3C. Non-profits were a
less popular option, with qualifiers being that forming as an L3C was much simpler and did not require and operating agreement. Only one organization was sure from its inception that the L3C was the right choice. Other social enterprises that are functioning as for-profits may consider the L3C status if they became aware of it based on the information presented.

Since the legal status is relatively new, it is no surprise that many founders are discovering it through the Internet. Personal networks have played a vital role in spreading the word as well, and conferences about social entrepreneurship are an important platform too. As the word continues to spread, conferences, online information, and educational outlets will likely be major opportunities for the L3C movement to gain traction and disseminate into the public realm.

Funding was a major issue for a number of the organizations. The founders themselves funded the majority of firms, and only five organizations had outside investors of some type. None of the organizations interviewed had any type of layered investments. The creators of the L3C status heavily, and almost solely, promote the ability for L3Cs to tranche investments, but this theoretical idea is far from the reality of how Vermont L3Cs are being formed.

**L3C Branding**

While the L3C may not have been created for branding purposes, it is clear that is the main thrust of many founders of Vermont L3C organizations. Branding came up time
and time again in conversations with L3C managers and founders. First of all, the L3C moniker is required to be in the name of the organization according to Vermont regulations. This has, according to the founders and managers interviewed, brought about the inquiry of many asking about what it means and stands for. These conversations have the potential to be a giant springboard for L3Cs. More than the opportunity to attract foundation capital or tranche investments, branding is at the heart of advantages for Vermont L3Cs. Only one organization that was interviewed was even in the process of obtaining a PRI, but 10 of the 16 interviewees mentioned branding as a key advantage of L3Cs over other types of legal entities.

Kelley (2010) has accurately speculated that the L3C could become the first branded entity of social entrepreneurship, realizing it can promote fourth-sector growth. The growth of the fourth sector is incredibly important in order to tap into new pools of capital as well as encompass the roles of the original three sectors under the umbrella of a single organization. Social enterprises promote social good and ease the burden from charities and the government in helping create social change, while also aiding the economy through the generation of revenues. If the L3C becomes the de facto legal status for social entrepreneurship, there is a huge opportunity to increase public awareness, attract foundations as investors, and expand the reach of social enterprise.

However, Kelley (2010) also predicted the new status would impact capital formation, and it appears this prediction has not yet come to fruition. The L3C has the potential to
become the legal entity of choice for social entrepreneurs because the status has social orientation legally ingrained in its structure, but again, capital formation will not come any easier until large foundations climb aboard or the IRS makes an official ruling on an L3C receiving a PRI. Unfortunately, even one ruling might not turn the tides in favor of L3Cs, as PRIs are ruled by the IRS on a case-by-case basis to ensure they are qualified (IRC, n.d.).

**New Directions in L3C Research**

Through interviews with founders and managers, a number of previous assumptions about L3Cs are questioned. First, the Vermont L3C does not guarantee that a PRI is a qualified investment, as Clement, Lang, Jr. and Jatar (2010) claimed. Being an L3C does not automatically qualify an organization for a PRI. For example, if a foundation’s main charitable purpose is urban development, giving a PRI to an L3C that conducts research for HIV/AIDS would not align with what the foundation does, making the PRI unqualified. Also, the IRS has made no rulings on if L3Cs simply in their nature meet the requirements for program related investments. It is true that the wording of the L3C was set up to mirror PRIs, but without an official IRS ruling, foundations are exercising a large risk by investing PRIs in L3Cs—a potential 10% tax on its entire endowment in addition to another 30% tax on the PRI placed into an L3C if it does not qualify (IRC, n.d.).

Again according to Clement, Lang and Jatar (2010: 321), “The parties involved in the L3C are encouraged to act in a manner that is consistent with non-profit law.” While it
appears Vermont L3Cs are acting as non-profits in the sense of pursuing social impact equally or more directly than profits, this assumption is a lofty one. “Encouraging” L3Cs to follow non-profit law, especially when the organizations do not qualify for any of the charitable advantages of a non-profit is a stretch. There is simply too much confusion around L3Cs and how they are “supposed” to operate. Although the organizations may have a non-profit soul, they are still for-profit businesses, and many of the organizations interviewed are acting like non-profits but operating like for profits.

Kelley (2010: 43) argues that the L3C addresses most of the major challenges that social entrepreneurs articulate. It addresses entrepreneurs’ capital formation problems by parroting the IRS’ program related investment language in its enabling legislation, thereby encouraging private foundations to furnish capital through PRIs.

It is obvious that the L3C language is nearly identical to that of the PRI regulation, but that does not necessarily mean L3Cs are obtaining the foundation dollars through PRIs. None of the organizations interviewed received any capital from a foundation at the point of the interviews, and as research by the Foundation Center (2009) shows, less than one percent of foundation capital is distributed via PRIs. There is still too much risk associated with the PRIs being directed toward L3Cs. Without an IRS ruling on a national scale or even a single private letter ruling for a foundation in favor of an L3C organization, the road to PRIs for L3C will continue to be steep, rocky and uphill.
Minnigh, Ingersoll and Rooney (2009: 1) said the core of the L3C is a “profit-generating entity with a social mission as its primary objective.” Legally, L3Cs must declare a charitable or educational purpose when filing. Unfortunately, profit generation is another concern altogether. Although the organization is a “low-profit” company, the legal wording clearly states the organization may not primarily pursue profits. The question is, who is determining if an L3C is primarily pursuing profits? If the organization is not pursuing profits, as legal regulations require, then what is the incentive for investors looking for near market-rate returns? Finally, how can it be determined if an organization is directly pursuing profits? That appears to be a judgment call based on the opinion of the IRS.

Minnigh, Ingersoll & Rooney (2009: 2) appear to make an inaccurate assumption below:

By nature L3Cs are designed to be high-risk entities without profit as a primary goal. It is generally assumed that the L3C will produce less profit than a normal for-profit entity, presuming that commercial investors otherwise would have filled the space, and the subsidy provided by the foundation would be unnecessary—but not all L3C (sic) generate low returns.

One could assume that an L3C would make less profit, but there is certainly nothing limiting the amount of profit an L3C can make. The legal wording states that profit cannot be a primary goal, but profits are not technically regulated. One Vermont L3C said business had tripled over the past year—a good indicator of increasing profits.
Concerning the ability to tranche investments, Clement, Lang and Jatar (2010: 315) say,

The new business classification complies with the tax code and offers foundations an easier way to invest using program-related investments. Operating the L3C provides protections and flexible ownership with the option of receiving foundation investments at a low rate of return in the first risk tranche (layer).

The opportunity to tranche or layer investments is what the founders of the L3C entity say is a key component, but after talking with individuals actually involved in Vermont L3C organizations, layered investments simply are not happening. One may assume this is not happening because the key piece to the tranche system is having high-risk low-return capital, via a program related investment, and few investors looking for anything near market returns want to invest in an organization with high-risk, low-return promises.

Minnigh, Ingersoll & Rooney, (2009: 7) discuss the attractiveness of L3Cs in the eyes of for-profit investors saying,

Investment in a L3C by a for-profit entity may be attractive because the L3C operating agreement can be drafted to allow for layered interests, delivering returns according to the needs of the investor—i.e., low return to a private foundation, greater returns for the for-profit market-driven investor. Many philanthropic for-profits may be interested in being involved in charity work that may actually generate a profit for them. Private foundations will be taking on more financial risk in exchange for high social return by furthering their own charitable purpose. Further, if private foundations invest early their funding will attract more market-driven investments in the L3C.

Some of the Vermont L3Cs are not even creating operating agreements because they are not a necessary requirement to form as legal entities. Unfortunately, the researcher
did not ask any questions directly concerning operating agreements due a lack of knowledge surrounding them prior to interviews. During the interviews, some Vermont L3C founders and managers, said they did not create an operating agreement. Its also important to note that data from the Foundation Center (2009) has clearly showed foundations would rather make simple donations or grants instead of jumping through hoops to give to an L3C and subjecting the assets of the entire foundation to a potential tax if the PRI is deemed unqualified.

In theory, the L3C should be able to share risk, create opportunities for different investment and return levels, and invite traditional investors to achieve a market-rate return on a social enterprise (Lane, 2010). The goal of the L3C is to share risk and spread return, but that is simply not happening in Vermont L3Cs. Currently, it appears Vermont L3Cs are unattractive to many for-profit and foundation investors.

The Next Step for L3Cs

Based on research and conclusions, there are two major changes that must happen for low-profit limited liability companies to gain traction and expand into the public eye as the premier legal option for social enterprise. First, it is important to note that branding emerged time and time again as the largest benefit according to Vermont L3C founders and managers. The primary change the L3C movement should pursue is promoting itself as the most effective platform for social business entities. The L3C has gained the most national attention in the world of social entrepreneurship from a legal status standpoint, and the movement must continue pushing for legislation in
more states. L3Cs should pitch themselves as “the social entrepreneurship legal entity,” rather than just a hybrid between a non-profit and a for-profit. The largest opportunity for the L3C, in the researcher’s opinion, is to focus less on the opportunity to attract PRIIs and more on being the social business legal entity.

Second, if L3Cs are insistent on attracting PRI capital, an obviously difficult and lengthy process, the L3Cs must individually begin targeting private foundations. If the L3Cs pursue foundations that have missions aligned with their own, there is a greater likelihood of attracting PRI capital rather than simply waiting around for private foundations to seek them out. Many foundations see the grant process as simpler than the PRI process and do not want to perform the extra work of making sure a PRI is qualified. While a private letter ruling may not technically be necessary, if an L3C could sway a foundation in the direction of pursuing that type of ruling, it could spark interest in other foundations and show them L3Cs are worthy and legitimate recipients of these investments. The L3C should also draft an operating agreement that negates the risk associated for the foundation, giving the foundation the opportunity to withdraw funds if the basic mission of the L3C organization changes in any way. These two items could propel the L3C further in the realm of social entrepreneurship, advance the agenda of the movement, and potentially attract the limited, but largely untapped pool of capital in the form of PRIIs.
Limitations

As one of the first qualitative research pieces on low-profit limited liability companies, this research is incredibly limited. To start, only 16 organizations were interviewed, although that accounts for over 12 percent of the total L3Cs legally formed in Vermont. A more wide-scale study could be performed with a deeper insight into the day-to-day operations an L3C if a larger number of L3C founders were interviewed. Also, it would be helpful to expand to each industry the L3Cs are classified in, as well as attempting to achieve a sample of data and interviews that matches the spread across the industries for the entire registry of L3Cs.

Since L3C research, and specifically qualitative L3C research, is a new area of interest, there is very little current literature in the area. This research adopted the qualitative-interpretivist-exploratory research method, which is very broad and basic. It allows the researcher freedom to deviate from the script of questions, but also provides different depths of interviews for each organization. This limits the consistency of data across the organizations and reveals more information about some companies than others. Although this was an appropriate vehicle to gain a high-level view and understanding of each organization, it limits the depth of the data for some interviewees who chose not to share as much information as others, even after further questioning.
Due to a lack of full understanding of how L3Cs operated at the beginning of the research, the questions that were used were not as direct or in-depth as they could have been. As mentioned earlier, one question that was used in the first few interviews asked what the organization would do if the IRS outlawed the L3C status. The reality is the IRS would not make that type of sweeping ruling on the legal status, but would instead rule on the entities’ eligibility to receive PRIs. A more effective question would have been, how would your decision to form as an L3C be affected if you would have been aware that the IRS has not made any type of ruling on PRIs for L3Cs or how would the information that few if any L3Cs have actually received PRIs have affected your decision to form as an L3C? In sum, the questions lacked overall depth and limited the findings of this research.

The questions asked ranged from the background of the founders or managers, to the type of employee characteristics organizations are searching for, to questions about funding and legal formation all in the mix. This gave a wide breadth and overview for qualitative L3C research, but it did not allow the findings to give a clear picture in any specific area of the organizations. A more narrowed set of questions would allow for a deeper look into L3Cs. Specifically in the area of funding, more questions about how capital was acquired and the exact spread from different investors would be helpful for future L3C founders and their hopes of funding new enterprises.
Also, this study focused on only Vermont L3Cs, and now with another seven states and two territories having passed L3C legislation, it is important to see how L3Cs formed in other states differ. The legislation is similar across the different states and territories, but there could be different tax breaks and incentives for forming L3Cs in different states. Having the study limited to those L3C organizations that were formed in Vermont limits the full scope of the research. Although Vermont has the most L3C entities, there could be minor differences in those formed in other states.

Since not all founders were available for interviews, a number of the interviewees were managers in the organizations instead of the founders, providing a potentially different view than the founders would have. Founders could have provided a clearer picture on the reasons for founding the organizations, or at least pinpointed the exact reason, while managers who have not been a part of the organization since its inception are hearing secondhand about the reason for formation and the reasons for choosing the L3C status. On the whole, having founders only would have given more consistent responses across the board from the organizations interviewed.

**Future Research**

There is an incredible need for future qualitative and quantitative research on L3Cs. Current research is mostly focused on a rehashing of the laws and different opinions on the necessity and focus of the new legal entity. A study on how many L3Cs that
have actually acquired a program related investment would be beneficial to future L3C founders and for foundations seeking more information about how to pursue these types of investments. Also, an in-depth study on the process of how L3C founders discovered the status, decided on forming, or decided to convert to an L3C would also shed light on the rational behind forming as an L3C.

Contrary to the original intent of the legal status, it appears that Vermont L3Cs are not acquiring capital from PRIs. In fact, capital opportunities were rarely cited as actual benefits of being an L3C, while many interviewees cited branding as the largest benefit. A study focused on how the branding aspect of L3Cs shapes investor, customer and public perceptions of the entity would be beneficial. It would also be interesting to conduct research from a customer or investor perspective to see their perceptions of the L3C entity. As the reality of funding issues sets in, branding will continue moving to the forefront of benefits for creating an L3C, and further research will help social entrepreneurs decide if the branding benefits justify creating an L3C organization.

Data on financial aspects such as profits generated, the capital formation process, and the achievement of financial business goals would be helpful to further L3C research as well. The lack of information surrounding the actual revenues and profits of L3Cs is certainly a hurdle for investors and social entrepreneurs alike. Research uncovering a
wide spread of financial information on these organizations would dispel some of the ambiguity surrounding the “low-profit” aspect of L3Cs.

The researcher believes the area of funding, since the opportunity to receive PRI capital was the reason L3Cs were created (and as noted above, the L3C language mirrors the language of program-related investment in the IRC), has the greatest opportunity to be explored and make an impact in L3C literature. The minor findings of this research showed that most L3C operations are self-funded, but more comprehensive research on organizations formed in other states as well as others formed in Vermont could provide a deeper level of understanding about how L3Cs are attracting capital.

Research on the construction of operating agreements for L3Cs would be valuable to see if these organizations are even creating this type of agreement that is not legally required to create an L3C. A well-crafted operating agreement could provide more clarity around specific PRI investments and could allow foundations to have a more clarity surrounding their contributions to L3Cs. This is a largely unexplored area of the L3C organizations, but could provide great opportunities to forge solid partnerships between foundations and L3Cs.

As more states begin passing L3C legislation, it would be interesting to examine if different industries of operation appear in different states, if there are different benefits
to creating L3Cs in different states, and if the area of operation has any direct impact on the success of the business in correlation with the awareness of L3Cs in that area. On the whole, this research paper is one of the first, if not the first, pieces of qualitative data directly examining L3Cs. As legislation expands to more states and public awareness of the new status grows, the L3C debate will continue, and funding problems may persist, but the L3C movement is not going down without a fight.
Appendix A – PRI and L3C Legislation

<table>
<thead>
<tr>
<th>Program-related investments</th>
<th>Low-profit limited liability company</th>
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<tbody>
<tr>
<td>Program-related investments are those in which:</td>
<td>(A) The Company significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the IRS Code of 1986, 26 U.S.C. Section 170 (c)(2)(B); and (ii) would not have been formed but for the company's relationship to the accomplishment of charitable or educational purposes.</td>
</tr>
<tr>
<td>1. The primary purpose is to accomplish one or more of the foundation's exempt purposes,</td>
<td>(B) No significant purpose of the company is the production of income or the appreciation of property; provided, however, that the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.</td>
</tr>
<tr>
<td>2. Production of income or appreciation of property is not a significant purpose, and</td>
<td>(C) No purpose of the company is to accomplish one or more political or legislative purposes within the meaning of Section 170(c)(2)(D) of the IRS code of 1986, 26 U.S.C. Section 170(c)(2)(D).</td>
</tr>
<tr>
<td>3. Influencing legislation or taking part in political campaigns on behalf of candidates is not a purpose.</td>
<td>(D) If a company that met the definition of this subdivision (27) at its formation at any time ceases to satisfy any one of the requirements, it shall immediately cease to be a low-profit LLC, but by continuing to meet all the other requirements of this chapter, will continue to exist as a limited liability company. The name of the company must be changed to be in conformance with subsection 3005(a) (Vermont SOS, 2008)</td>
</tr>
</tbody>
</table>

In determining whether a significant purpose of an investment is the production of income or the appreciation of property, it is relevant whether investors who engage in investments only for profit would be likely to make the investment on the same terms as the private foundation. If an investment incidentally produces significant income or capital appreciation, this is not, in the absence of other factors, conclusive evidence that a significant purpose is the production of income or the appreciation of property.

To be program-related, the investments must significantly further the foundation's exempt activities. They must be investments that would not have been made except for their relationship to the exempt purposes. The investments include those made in functionally related activities that are carried on within a larger combination of similar activities related to the exempt purposes. (IRC, n.d.)
### Appendix B – L3C Arguments

<table>
<thead>
<tr>
<th>L3C Proponents</th>
<th>L3C Opponents</th>
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<tbody>
<tr>
<td><strong>Program-Related Investments</strong></td>
<td><strong>Program-Related Investments</strong></td>
</tr>
<tr>
<td>• Prequalifies PRIs for investment (ACD, 2010)</td>
<td>• Unnecessary as any for-profit organization can accept a PRI (Kleinberger, 2010)</td>
</tr>
<tr>
<td>• Makes capital contribution from foundations easier (ACD, 2010)</td>
<td></td>
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<tr>
<td><strong>Legislation</strong></td>
<td><strong>Legislation</strong></td>
</tr>
<tr>
<td>• Mirrors the current PRI legislation to promote these foundation investments (Kelley, 2009)</td>
<td>• Low-profit wording is confusing (Kleinberger, 2010)</td>
</tr>
<tr>
<td>• Necessary to create new social entrepreneurship opportunities (Kelley, 2009)</td>
<td>• Legislation is ambiguous about profits (Kleinberger, 2010)</td>
</tr>
<tr>
<td></td>
<td>• LLC provides same opportunities and L3C is just a duplicate centered around branding, not funding (Kleinberger, 2010)</td>
</tr>
</tbody>
</table>
Appendix C – Interview Questions

What is your age?
What is your educational background?
What is your work experience?
How many years have you been in your current industry?
What industry is your organization in?
What inspired your company?
What is your company’s mission statement?
What is your company’s social goal?
How do you market your firm?
Who are your competitors?
What characteristics do you look for in your employees?
By what metrics are you measuring your businesses success?
What is the biggest barrier to your company goals?
On a scale of 1 - 5 rate your focus on profits vs. social impact. (Profits being most important would be a 1, social impact being most important would be a 5).
Why did you choose this legal status?
What do you believe are the largest benefits of the L3C legal status?
What do you believe are the largest drawbacks the L3C legal status?
Did you consider forming as a different type of legal entity?
Would you have formed as a non-profit or for-profit if L3C didn't exist, or not at all?
How did you discover the L3C legal status?
What percentage of capital in your firm did the founders contribute?
What other types of funding do you have?
Do you have a plan for transition if your organization is purchased?
Have you received any program-related investments from foundations? If so, which foundations?
References


http://www.nytimes.com/2010/10/10/us/10bcweber.html?_r=3