SOCIAL ENTERPRISE BUSINESS MODELS

A CASE STUDY

OWP® Pharmaceuticals, Inc.

PURPOSE: This case study is designed to introduce readers to the nuances of structuring a business that has complementary (and sometimes competing) goals of generating significant profit and achieving a social purpose at scale.

The Problem

After 27 years in the pharmaceutical industry working for big players like Bristol-Myers Squibb and Abbott, Scott Boyer grew increasingly bothered by the "Rest of World" (ROW) line on the bottom of global sales reports. (See Fig. 1) The pharma industry was growing rapidly in the U.S., and excellent progress was being made in many therapeutic areas. Meanwhile, the "Rest of World" literally died from conditions regularly treated and resolved in the developed world.

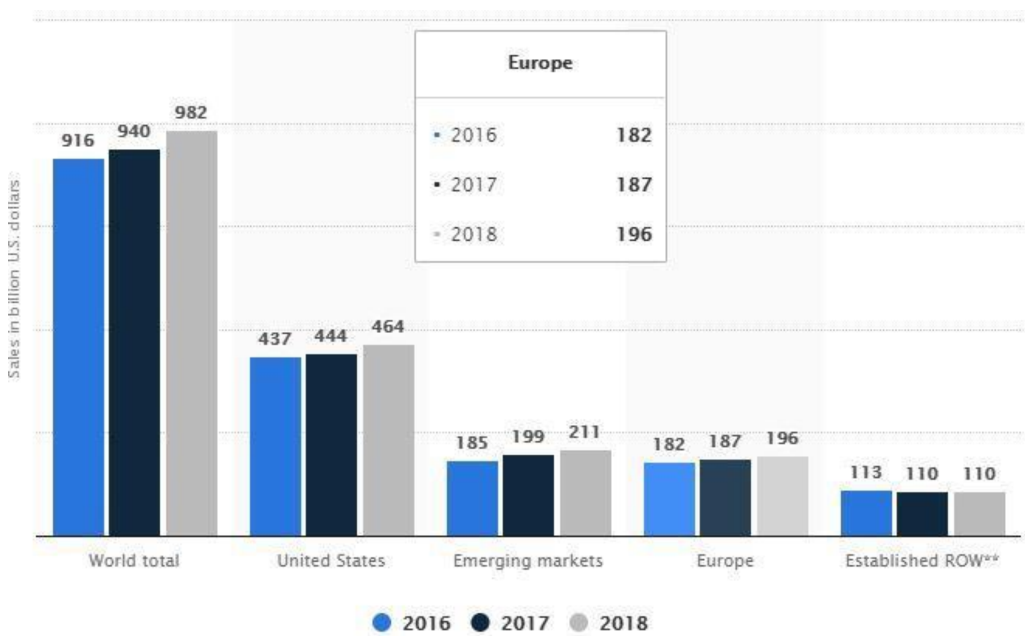

Fig 1: The pharmaceutical industry earns over $1 trillion a year with half of that number coming from the U.S. and Canada.

The Global Epilepsy Situation

Given his experience in the neuroscience medication space, Scott was especially interested in epilepsy as a treatable condition. Epilepsy affects approximately 50 million people worldwide, with 80 percent of affected people living in low- and middle-income countries. Of these 80 percent, three quarters of patients go undiagnosed and untreated—in Africa the treatment gap is 90 percent. In the developed world, the story is quite different. In fact, 75-80 percent of epilepsy conditions are treatable, and patients with access to treatment can live a relatively normal life.

Untreated patients face grim circumstances including social stigma and exclusion from school and employment. They are often abused and victims of human-rights violations. Perceptions in many low-income countries include myths: people with epilepsy are contagious, insane or demon possessed. Social stigma is strong, and, beyond treatment, these patients need advocates and community educators to support them.

What could Scott Boyer do with his experience and know-how that might address the global epilepsy treatment gap?

The Business Climate

“Big Pharma” is not the respected industry it once was. Originally formed by doctors and scientists to improve the health of patients, in recent years we have seen companies fined for kickbacks and providers sent to jail for criminal behavior. Recent settlements in the opioid crisis illustrate both the harm done as well as callous and cavalier behavior toward others on the part of pharmaceutical representatives.

Pricing is another issue that creates mistrust of the industry. Pharma is seen as an engine for profit, charging exorbitant prices for medications. And, in fact, companies have become famous for prioritizing profit maximization—raising prices on drugs that had been on the market for years simply because the market could bear it. Research and development (R&D) is a legitimate and costly venture that companies must recoup, and sick people want companies to continue to invest in research for new treatments. In many cases, however, companies have simply bought the rights to a drug from a company that has already done the R&D work, and the acquiring pharma company is still charging a premium. For IP-protected (intellectual property) branded drugs, there is no competition, and the prices are high.

Social and political pressures, however, are coming to bear on this industry. The Sunshine Act forces transparency for any transaction between drug reps and physicians—even for a cup of coffee. In the U.S., though they are fighting it, pharma companies must soon disclose drug prices on their advertising. Pressure from consumers and insurance companies is mounting to address the skyrocketing prices. The availability of data may help pharma target customers better, but data also empowers the customer. The patient can wield far more power while shopping for healthcare solutions at the lowest prices. There is a keen need for pharmaceutical companies to focus on patients to win back any trust.

The Social Enterprise Climate

The shift from shareholder capitalism (maximizing profits for investors) to stakeholder capitalism (considering employees, customers, communities, and the environment as well as shareholders) has rapidly accelerated. There is an expectation that all businesses value social responsibility and prove it with their actions. The last decade has also given rise to a movement laser-focused on solving complex social challenges through business: social enterprise. These organizations are often for-profit companies that exist solely for their social mission. The current entrepreneurial environment provides a growing number of resources for social enterprises, from funding competitions and fellowships to accelerators and impact investments. Many prominent organizations have been supporting social entrepreneurs for decades, including Ashoka, Echoing Green, the Skoll Foundation, and more.

From a structural standpoint, many states now offer new legal entities that legitimize the double or triple bottom line priorities of a social enterprise. Beyond the typical C-Corp or LLC business structures, some states now offer the Benefit Corporation and L3C/Benefit LLC options, which are similar in management and tax status as their traditional counterparts, but have a legal mandate to pursue a stated social mission in addition to shareholder profit. (This is not to be confused with the B Corp certification by B Labs, a third-party "seal of approval" that measures and holds companies accountable to their social and environmental impact goals.)

Traditionally, the concept of business seemed to suggest a trade-off between social objectives and profit objectives. These are no longer seen as mutually exclusive. Many businesses being formed for social value creation as well as economic value are making it work, as are traditional businesses which have reoriented their objectives to include social impact.

The Goal: Profit and Purpose

Back to the dilemma faced by Scott Boyer. Leaning into savings and the security of a pension, Boyer searched for a way to power his mission with a profit engine. The idea of "blended value" was beginning to gain traction in various industries. He understood the economic opportunity in the branded pharmaceutical business, and knew he wanted it to fuel global humanitarian work that would provide education, diagnosis, and medication to treat epilepsy patients in the under-resourced world. Unlike medication for curable conditions, epilepsy patients would require on-going medication grants to keep seizures in check; therefore, his giving would have to be scalable and sustainable over time. He wanted to engage with projects and organizations to provide help that was long-lasting.

He knew that whatever structure he chose, generating revenue was going to be his driver. He was, after all, a pharmaceutical executive. While Scott could have considered a non-profit charity model as a primary structure (and benefited from donor funding and tax breaks), he saw it as a limitation in building a profit engine for the mission. His business plan outlined the production of a branded generic medication.

The generic drug business model is not profitable long-term, with low barriers to entry and many manufacturers competing for low margin business—so his future plans included IP patentprotected products. He settled on generic products in different formulations to those already on the market. The beauty of a generic drug is that you don't have to invest in the same research and development costs to bring it to the market, but if you release it in a formulation (pill, powder, suspension, dissolving tablet, etc.) unique to the market, it is like releasing a new product, and the profit margins are similar to branded drugs.

Boyer and his co-founder, Bruce Duncan, could invest a large portion of the start-up costs themselves but would need some outside funding to launch their first drug. Getting additional funding meant finding the right partners who resonated with their mission. Their vision was for longevity in supporting their global impact goals, and an organization that was around for the long haul. They were reluctant to give away much, if any, equity, and wanted to see the company viable for many years to come. Most important, they were looking for a model that allowed for maximization of both profits and giving that was sustainable and scalable.

Searching for a Model

No matter the model chosen, the success of the business determined the success of the social impact. Each model seemed viable, but Scott was looking for something that would allow his social enterprise to be:

- Driven by a compelling social mission
- Financed by commercial success
- Structured to retain control
- Sustainable and scalable for the long haul

Scott considered the following models:

1. Fast Pharma

To get started quickly and scale fast, Scott could use the model he knew well in pharma. He could launch a for-profit company and pitch his plan to Venture Capital (VC) investors, who could accelerate his growth by providing large amounts of up-front funding. This would provide quick cash for development costs for medications, which are not insignificant. Once the drugs were FDA approved, they could also look to Private Equity (PE) for financing to launch a sales force and diversified marketing efforts that could blanket the market quickly. Manufacturing costs could be easily covered. While Scott could consider new legal forms like the benefit corporation, it's likely that typical pharma investors wouldn't want or need such a structure.

VC or PE investors are looking for quick and large return, and decision-making influence in the company. With the opportunity to scale fast, profits would come sooner and could then be donated by the company to global organizations through a corporate giving program. If investors pushed to take the company public, it could be sold for a large gain and the money distributed to global causes. While the profit potential in this model is large, the balance between control of the organization and the opportunity to scale quickly must be carefully calibrated.

2. **Two-as-One**

Scott explored another model that he found closer to home, which would involve simultaneously creating a for-profit and a non-profit organization. Tyndale Publishing House, a Christian publisher, was established in 1962 to publish The Living Bible. Ken Taylor gave all the royalties from this first publication to the newly formed Tyndale House Foundation. This provided an engine for grants that funded the distribution of printed materials, education, and social programs worldwide. In 2001, Taylor took the step to transfer ownership of the Publishing House to the Foundation, providing a solid dividend stream to the Foundation in perpetuity. In addition, Tyndale Foundation receives a bulk of distributed profits, plus royalties. The for-profit/non-profit combination allows the enterprise to utilize the best of both structures to achieve its mission.

In his research, Scott found several other companies that employ this kind of hybrid model, including Hershey's Chocolate, Hormel Foods, Novo Nordisk Pharmaceuticals, and Lundbeck Pharmaceuticals. These companies have done much good at scale over the course of their existence and growth, and the dividends keep flowing to their foundations as long as the businesses are profitable. In addition, most of the companies mentioned have given important voting stock to these foundations, ensuring that the foundation has the majority control if there was ever an opportunity for change of ownership—meaning the fate of the foundation is in its own hands. This model requires the launch and management of two separate, but linked, organizations, so the legal and organizational complexity is higher and must be considered.

3. **One-for-One**

At the time Scott was researching models, TOMS Shoes was at the height of popularity. The pioneers of the "one-for-one" model made a name for themselves by donating a pair of shoes to someone in need for every pair they sold. The mission, and its margin, was baked into the business model. By 2013, TOMS had $250 million in annual sales and had donated 10 million pairs of shoes in its first seven years. In 2014, the company was valued at $625 million. Profit had a direct link to purpose, and other companies were following in their footsteps. Warby Parker, the eyewear company with the "buy a pair, give a pair" promise, rapidly scaled from an online retailer to one with nearly a hundred brick and mortar stores thanks to a $300 million investment. Warby Parker focused their giving efforts in concert with non-profit partners who would provide glasses to budding entrepreneurs who would sell them in their communities.

Scott's vision of selling pharmaceuticals in the U.S. for market-rate revenue and using the profit to provide otherwise-inaccessible drugs to under-resourced countries could be designed as a one-for-one model. And certainly, a do-good pharma company could get some attention in an industry not known for its philanthropy. But this model would also require significant up-front capital while navigating a complex FDA process to launch effective drugs, and at the same time developing a giving program that could be responsibly managed and marketed upon launch.

Choosing a Model

Given the three options above, which model should Scott choose?

To consider the best option, discuss the following questions:

1. What are some pros and cons of each of the three models?
2. Should Scott take advantage of Venture Capital and Private Equity investors to scale quickly?
3. Which model(s) allows Scott to retain control of the company, and therefore the mission, for the long haul?
4. Which model(s) allows Scott to focus on the commercial success of his products, while allowing humanitarian experts to responsibly deliver global impact programs?
5. Which model(s) might allow Scott to realize long-term sustainability and scalability of the mission, long after he's gone?
6. What advantages does a for-profit structure have over a non-profit structure? What advantages does a non-profit structure have over a for-profit structure?
7. What model would you choose? What model do you think Scott chose?

⬇ **SCROLL DOWN TO SEE THE MODEL SCOTT CREATED** ⬇

Which Model Did Scott Choose?

Scott was skeptical of the fast pharma model, having seen too many examples of founders who were quick to give away equity and control of the company for fast cash. While large VC investments can solve a lot of problems for startups, patient capital can keep you focused and in control of the mission. Scott didn't want other people, who were more interested in large and rapid returns, influencing (or making) decisions.

While it would have been trendy to jump on the "one-for-one" bandwagon, Scott didn't see the benefit of having a pharmaceutical company attempt to simultaneously be a global humanitarian organization. While some companies have found success with the buy-one, give-one approach—Warby Parker (eyeglasses), Bombas (socks), and Soapbox (soap) —TOMS later ran into some of the problems that Scott was concerned about. In 2015, founder Blake MyCoskie sold 50 percent of TOMS to Bain Capital to raise funds. In 2020, having already scrapped the one-for-one model amid skepticism of its positive impact, TOMS faced $300 million in debt that couldn't be paid, and creditors took over the company, ending MyCoskie's ownership.

Scott and his co-founder, Bruce Duncan, decided to create a unique version of the "two-as-one" model, now known as the Tandem Hybrid™ model. OWP Pharmaceuticals (One World Pharmaceuticals) is the for-profit business that manufactures and sells medications for neurological and psychiatric conditions in the U.S. market, and ROW Global (Rest of World) is the non-profit organization that provides education, diagnosis, and treatment grants all around the world. Each entity (for-profit/non-profit) can focus on its strengths, and each benefit from the legal structure it operates within. ROW includes a private foundation (ROW Foundation) and a public charity (ROW Global Health) to funnel revenue from OWP and donations from the public into their global efforts.

The organizations are also legally joined through a unique structure called an IP Holding Company, which is an LLC that owns OWP's intellectual property (patents, etc.) and receives a portion of OWP's royalties from sales. ROW owns 40 percent of the IP Holding Company, meaning it is guaranteed to receive 40 percent of the business income in perpetuity. ROW also has veto power over any decision to sell or give away the assets. In addition, OWP makes regular gifts of products to ROW as well as an annual cash contribution, which is 10 percent of pretax profits. The 40 percent from the holding company, plus the 10 percent from OWP pretax profits, equals 50 percent of profits going to ROW—an unheard-of percentage in corporate giving.

This Tandem Hybrid™ social enterprise has already contributed over $21 million for medication, diagnosis, and training around the world, including grants for over 160,000 prescription-months of medication. ROW has more than 60 partnerships in more than 30 countries and is one of the most active organizations working to narrow the epilepsy treatment gap globally. OWP is currently a small but profitable pharmaceutical company, and expects to grow dramatically in the next couple of years with a number of new products. As OWP grows in profit, ROW grows in impact.

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