

WHY SOCIAL ENTERPRISE?

A guide for charities



In association with



Pilotlight has worked with over 300 charities and social enterprises. For many, social enterprise is seen as an excellent opportunity for developing their organisation, particularly in light of recent changes in the funding environment. In our work with charities we have repeatedly been asked for advice on what they should consider when setting up a social enterprise. We wanted to produce a clear and concise guide to enable charities to learn more about social enterprise and explore whether this exciting and growing area is right for them.

Pilotlight is a unique, capacity-building charity offering free, tailored strategic planning support to charities and social enterprises who are tackling disadvantage in the UK. We match directors from charities and social enterprises with teams of senior business people who coach them through the process of planning for sustainability, development and growth. Each organisation also has a dedicated Pilotlight project manager who coordinates and facilitates the process.

We are currently working with over 70 charities and social enterprises across the UK. One year after working with Pilotlight our partner organisations increase their income, on average, by 50 per cent and are able to double the number of people they reach.

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Many charities are now asking 'is social enterprise for us?' This guide is designed to help them think through this question, and answer it. It is aimed at charity leaders, senior managers and trustees to help them understand what the transition to social enterprise might mean for them.

The social enterprise movement is growing around the globe, and is gaining support from the public, private and voluntary sectors. In the UK alone there are approximately 68,000 social enterprises contributing at least £24bn to the economy. Many traditional charities are adopting the social enterprise approach. The journey isn't always easy, and it isn't right for everyone. But many who have made the transition say social enterprise has opened up a huge range of possibilities for their organisation, and enabled them to achieve sustainable growth and increased social impact.

We hope you find the guide useful and practical, and that it helps you decide whether social enterprise is for you. Perhaps you are an individual who is already committed and you have a strong vision of how it will work. But many of your stakeholders – trustees, beneficiaries, funders, may need some help understanding what you are suggesting. This guide should help you explain and tell the story.

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1. The social enterprise approach

What are social enterprises?

A social enterprise is a business that trades for a social and/or environmental purpose. You probably already know a few. Have you ever bought a bar of Divine Chocolate? Eaten it over a copy of the Big Issue? Maybe you've visited Jamie Oliver's Fifteen or the Eden Project? Perhaps your local gym is run by GLL, one of the UK's biggest social enterprises.

Social enterprises are businesses. Their mission is social and they achieve it by selling products or services.

They come in many shapes and sizes from large national and international businesses to small community-based enterprises. There is no legal definition of social enterprise and there is no particular legal form you must take. It's being a real business whose main purpose is social or environmental that makes you a social enterprise.

All social enterprises:

- Are businesses that generate their income by selling goods and services, rather than through grants and donations.
- Are set up to specifically make a difference – this is in their governing documents.
- Reinvest the profits they make in support of their social mission.

What's the difference between a charity and a social enterprise?

Social enterprises and charities are not completely different – many organisations that describe themselves as social enterprises are registered charities (see page 16) but there are important similarities and differences:

What's the same?

- Charities and social enterprises both exist to fulfil a social mission.
- Charities and social enterprises both reinvest the majority of their profits (charities often describe these as surpluses) in doing social good.

What's different?

- Charities traditionally aim to fund their social mission through grants and donations.
- Social enterprises aim to fund their social mission through trading activities - selling products and services to customers.

What are trading activities?

Trading activity is when a customer pays a charity or social enterprise to deliver a product or service – this could be an individual paying for a t-shirt from a social enterprise retailer or the NHS paying for a social enterprise counselling service to deliver counselling to people in a local area.

2. What needs to change?

Why it's a good time to become a social enterprise

If you're thinking that social enterprise sounds right for your organisation, the good news is that there couldn't be a better time to become a social enterprise in the UK.

Changes to the public sector:

The public sector landscape offers opportunities and challenges to charities and social enterprises. Whilst funding cuts mean some contracts previously delivered by social enterprises and charities are now not being funded at all, the public sector remains the single biggest buyer of goods and services in the UK – and successive governments have committed to expanding the role of social enterprises in delivering public services.

The Public Services (Social Value) Act 2012 comes into force in January 2013. The Act compels public sector agencies – including councils and parts of the NHS – to consider wider social value when they're commissioning services. That means that rather than just awarding contracts to the company that offers the lowest price, they will be expected to consider the social benefits offered by organisations such as social enterprises.

The rise of social investment:

As well as having strong support structures for social enterprises, the UK is home to the world's fastest-growing market for social investment – that means investment in businesses that offer both a financial and social return.

Earlier this year, the government launched Big Society Capital – a finance institution that has £600 million to invest in developing the social investment market. It invests in social investment intermediaries – specialist organisations that, in turn, invest in social ventures.

Becoming a social enterprise does not mean changing the ethos and values of your organisation. Your social mission remains the same and is the starting point for your social enterprise. The aim is to fulfil that social mission in a profitable and sustainable way.

So, for example, LEYF (see pages 10 and 11) is a charity that exists to provide high quality childcare, founded on the belief that all children deserve the best start in life.

Changing your language:

Customers

As discussed in chapter one, a key difference between a social enterprise and a traditional charity's approach is the move from grants and donations to trading.

A big part of that shift is the move from satisfying your funders to satisfying your customers. In some cases this is a practical issue but in other cases it's just a question of language. For example, if you're moving from receiving a grant from the local authority to delivering a contract for them, your funders and customers may be the same people but your relationship with them will be different.

The 'p' word: Profit

Profit is a problem. It's a problem for both social enterprises and charities. It's a problem for social enterprises because making a profit is sometimes difficult. It's a problem for charities because they generally don't like to use the word.

Social enterprises are for-profit companies. Even when they sometimes (confusingly) describe themselves as 'not-for-profit' companies. Social enterprises aim to make more money from delivering their products and services than it costs to deliver them. Charities do too but becoming a social enterprise means being clear about it.

Culture

Becoming a social enterprise doesn't mean you and your colleagues suddenly need to prioritise profit above all else and stop caring about the social impact of the work you do.

Social enterprises are focused on delivering a social mission but they do that in a business-like way.

That means being clear about what you're selling and who you're selling it to. Social enterprises have to sell products or services. A product is not necessarily a slice of cake or a t-shirt – it could be 12 weeks of mental health awareness training you sell to a local authority.

Another element of a socially enterprising culture is constantly looking for new opportunities to do business:

- Are there new customers who might buy your current products or services?
- Are there new products or services you could deliver to your current customers or different ones?

It's not completely different from a charity applying for a grant or launching a fundraising appeal for a new project. The difference is that your starting point is the market. The aim is to create new products and services that someone will want to buy, and that help to fulfill your social mission.

Activities

The fact that social enterprises are businesses that have to sell things may seem like an obvious point but it can be a stumbling block if you are attempting to move from a charity to a social enterprise approach.

When making the transition, you can divide the activities your charity currently carries out into three different categories:

1. They already generate income and could easily become social enterprise products or services if you chose to describe them in that way.
2. They have customers (or potential customers) and have the potential to become social enterprise products or services.
3. They are definitely not products or services because either nobody wants to pay for them – or not enough people want to pay for them to cover the cost of providing them.

A social enterprise can't deliver an activity that loses money **unless it generates enough money from other activities to pay for it**. This is often called cross-subsidisation. You may sell goods and services that have a low social impact in order to pay for the services you want to provide that have the highest social impact but are difficult to fund.

It's very important to be clear about which activities are which. Some must make **enough profit** to subsidise the others, otherwise the business will fail.

Commercial mindset

Most products or services that you deliver need to be paid for by someone – whether that's the end user or an organisation buying the service on their behalf. Products or services not paid for by someone have to be cross-subsidised (see above).

This doesn't mean that your organisation can't provide any products or services 'free' to some (or even all) of the people who use them but your business does not receive any income to just be there and exist, and this must always be kept in mind.

Adopting a commercial mindset is not just about selling things. It's about selling things at a **profit** – or at a loss that you understand and have budgeted for.

One element of having a commercial mindset is understanding how much it costs you to deliver a product or service. For example, if you run a community café, the cost of delivering a cup of tea does not just include the cost of the tea bag and the milk and sugar you put in.

It includes a proportion of the cost of renting the premises, paying for staff (or volunteers' expenses), electricity, insurance and any other running costs.

You need to understand all the costs involved in running your business to be able to work out how many cups of tea (cakes, sandwiches) etc. you need to sell and how much you need to sell them for, for your business to make a profit.

A commercial mindset can actually enhance your social mission. Consider this example: a charity exists to get disabled people into employment. Traditionally many charities have undertaken advocacy and campaigning to change the environment so that more disabled people get jobs. But many organisations have set up as businesses in order to create jobs for disabled people. That is their social mission.

Case study – London Early Years Foundation

When June O'Sullivan joined Westminster Children's Society in 1996, it was a traditional charity running nine small nurseries in the London Borough of Westminster.

Founded in 1903, the charity had a long history of working to give children the best start in life and a staff team committed to the charity's objectives. As more funding became available under the New Labour government, the organisation was able to access new income streams but it remained dependent on a block grant from the local authority to support its work.

When she became chief executive in 2005, O'Sullivan decided that the charity had to become a social enterprise. She told Social Enterprise Live: **"I was determined to move us away from the charitable model. I really didn't like it at all. I didn't want to ruin the ethos and the fantastic history the organisation had but I didn't feel that if we were to rely on our charitable model we would survive."**

The challenge was to turn the organisation from a grant-dependent charity into a sustainable business while continuing to provide a service for children and parents who couldn't afford to pay for it.

Part of the answer was expansion. The charity, renamed London Early Years Foundation (LEYF) in 2009, began to move beyond Westminster and opened nurseries in other London boroughs creating economies of scale: **"Our business model is quite simple: increase occupancy; increase revenue; reduce costs. That's it. It's what you have to do."**

Initially, many LEYF staff were worried that the changes would mean they could no longer provide a service to the poorest children. It required a shift in culture and thinking to enable staff to understand the new approach and the benefits it would bring:

"What I had to explain to them is that we had to balance the business model so that you had a level of cash cow and a level of mixed-market – which is our majority – and that way we would actually be producing enough profit to give many more children a free offer."

LEYF was a Pilotlight partner organisation between April 2006 and April 2007 (more details about Pilotlight on page 2).



3. Structure/Options

As well as having a range of organisational forms, social enterprises have a range of legal forms. Social enterprises adopt whichever legal structure is best suited to delivering their aims, and they sometimes also have charitable status.

The most common legal forms include:

- Industrial and provident societies (most commonly used for co-operatives and community benefit societies).
- Community Interest Company (CIC, a form of limited liability company designed specifically for social enterprises that can be limited by guarantee or shares).
- Limited liability company (limited by guarantee or shares).

If you need more information, getlegal.org.uk offers clear guidance and information about legal structures for charities. It aims to help individuals, organisations and advisors to make informed decisions as they set up and develop charities, social enterprises and co-operatives. Social Enterprise UK members can also access free legal advice services. Please visit socialenterprise.org.uk for further information.

Do I need to adopt a social enterprise structure?

Becoming a social enterprise doesn't necessarily involve changing your legal structure. Different options are more or less relevant depending on size of organisation and the kind of activities you carry out:

1. Adopting the social enterprise approach within your existing organisation

LEYF (see case study) is an example of an organisation that chose to make the move from being a traditional charity to being a social enterprise.

If you go down this route, you are unlikely to have to change your legal structure at all. There is no legal barrier to charities carrying out trading activities as long as those activities are in line with

their social mission and if they steer clear of certain legal and tax restrictions. For example, if a charity is to carry out trading activities itself, it must have the power to do so in its governing documents.

What may change if you go down this route are the staff roles within your organisation. You will no longer be employing staff primarily to do fundraising – either through making grant applications or through public appeals.

The job of your staff team will be to generate business and provide products or services to customers. This will not necessarily mean a big change in the activities your organisation carries out but it will lead to change in the way you budget for them – and possibly in who the customer is.

Key benefit to this approach:

- You don't have to change what your organisation does.

Key risk to this approach:

- It may not be possible to turn your organisation's activities into products or services that someone wants to buy.

2. Setting up a socially enterprising activity connected to your organisation

It may not be possible or desirable to find a socially-enterprising way of delivering your organisation's core activities but that doesn't mean you can't set up a social enterprise. You could do something different that will increase your social impact and may generate some income for your charity.

- Setting up a business where the main product or service fulfills your social mission:

For example, if you are a Council for Voluntary Services representing voluntary and community sector organisations in your local area, you could set up a social enterprise property management company to provide affordable office space for your members.

This social enterprise would need to be run on a commercial basis in order to continue to exist and provide the service but its reasons to exist would be to provide local organisations with accommodation.

- **The way you run the business fulfils a social mission:**

For example, Centre for Better Health is an organisation that supports people with mental health problems in East London. They have recently decided to set up an artisan bakery, with a high street shop, that will provide people who use their services with work experience and a potential route into employment.

The bakery is a business that will succeed or fail based on its ability to make and sell bread at a profit. But it exists to help fulfil the charity's social mission and, as long as it doesn't lose significant amounts of money, it will succeed in doing that.

Structure - In this situation, the best approach would be to set up a trading company owned by the charity – with any profits made either being spent on growing the business or being returned to the charity to be spent on fulfilling its social mission.

Key benefit to the approach:

- **It's a good way to increase the social impact of your organisation without changing your core activities.**

Key risk to the approach :

- **Underestimating the challenge of setting up and running a business that makes a profit while also delivering social outcomes.**

For example, in the case of Centre for Better Health, it's vitally important that the person in charge of running the bakery is a specialist in running a bakery rather than a specialist in mental health.

Setting up a social enterprise owned by your organisation to generate income for it

You can set up a business that has no direct connection to your social mission but generates income that you can spend on fulfilling your social mission.

The Salvation Army (see pages 18 and 19) runs a number of businesses that exist to make a profit which the organisation can spend.

Structure - In this situation, the best approach would be to set up a trading company wholly owned by the charity.

Key benefit to the approach:

- **If the kind of trading you wish to undertake is relatively high-risk to the existing organisation, setting up a separate social enterprise can be a way of ensuring that any financial difficulties experienced by the social enterprise do not affect the parent-charity.**

Key risks to the approach:

- **The new company may require initial and/or ongoing funding from the charity.**
- **You will need to consider who will be on the board of the new social enterprise. Ideally there will be representatives from the charity (employees and trustees) as well as some independent board members who bring appropriate skills.**
- **The relationship between the charity and trading company needs to be robust and at arm's length. For example, the charity must not subsidise the trading company long term and should recover costs if there are any shared resources.**

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Trading as a charity:

The traditional model for charities is to generate income through grants and donations rather than trading. However, charities are often able to carry out trading activities.

If a charity is to carry out trading activities itself, it must have power to do so in its governing documents. There are two types of trading: **primary purpose trading** and **non-primary purpose trading**.

Primary purpose trading is trading which a charity carries out in fulfilment of its main or primary purpose e.g. educational charities charging for their courses or a social care charity selling care services to a local authority. Trading carried out by beneficiaries (e.g. a fair trade charity selling coffee grown by people in poverty) is also considered to be primary purpose trading.

Non-primary purpose trading is any other trading including trading which is in fulfilment of objectives outside the specific objectives in a given charity's constitution (for example an education charity which wishes to expand into healthcare). It also includes trading which is intended simply to raise funds for the charity. Broadly speaking, non-primary purpose trading is taxable unless a specific exemption applies.

If the intended trading does not fit within one of the exemptions, then generally, the best way to deal with this is for the activity to be carried out by a separate social enterprise – usually set up in the form of a trading company which is wholly owned by the charity (see opposite).

Setting up a Trading Company

The basic mechanism for using a trading company works like this:

- The charity sets up and funds a company limited by shares. All the shares are owned by the charity (which means that the charity has ultimate control over the activities of the new company).
- The trading company carries out the trading activity. Since it is not itself a charity, there are no restrictions on its ability to trade.
- Since it is not a charity, the trading company will be liable to pay corporation tax. But the profits which the trading company makes are paid up to the parent-charity under the gift aid scheme. This reduces the trading company's taxable profits – in many cases – to zero, which means that it has no tax to pay.
- As the new company is a separate legal entity, it has its own limited liability so there is a much-reduced risk of any of the new company's liabilities being passed on to the existing charity. This approach also means that there is no need to make any amendments to the structure of the existing charity.

Whether the trading company is to take the form of a simple company limited by shares or a Community Interest Company (CIC), the process for establishing the new company is largely the same and is as follows:

1. **Decide on the governance structure of the new organisation – i.e. will it be a company limited by shares which is wholly owned by the charity? Who will appoint the board of directors of the new company? (These are decisions which will need to be approved by the charity's board).**
2. **Draft an appropriate governing document. In the case of a company limited by shares or CIC this will be a set of Memorandum & Articles of Association which is tailored to reflect the new company's proposed activities and structure.**

3. Complete Companies House form IN01 (and if a CIC is being established, form CIC 36).

4. Seek the approval of the charity's board in respect of the draft documents and forms and the make up of the board of the new company. One of the trustees will need to be given authority to sign the documents on behalf of the charity.

5. Submit the documents to Companies House for incorporation.

Case Study – The Salvation Army

The Salvation Army is a Christian Church and registered charity with over 50,000 members and over 4,000 employees in the UK.

The organisation runs several organisations across what Steve Coles, who works for the organisation as Social Enterprise Development Manager, describes as “a spectrum of social enterprise”.

That spectrum includes the Salvation Army Trading Company Ltd (SATCoL), which manages a number of businesses that operate on a commercial basis and generate income for the organisation. These organisations include charity shops, clothing recycling and a company selling brass band instruments. The Salvation Army also owns a bank and an insurance company.

According to Steve Coles: “Their job is to sell stuff at a profit and hand the money over to the Salvation Army.”

Although there is some crossover between these businesses and the organisation's work – the bank mainly receives deposits from church members – the businesses do not have specifically social goals in themselves.

The organisation also runs charitable services on a socially enterprising basis. These are:

- **Employment Plus** – a back to work service that receives 90% of its income from contracts, mainly from delivering the Work Programme as a sub-contractor.
- **Homelessness services** – which run 65 hostels providing accommodation for homeless people and generates income from housing benefit and Supporting People contracts.

Both Employment Plus and several of the hostels run their own social enterprises providing training and work experience for people who use their services.

Employment Plus runs a Portable Appliance Testing (PAT Testing) business. This business provides services both to the internal market within the Salvation Army – the organisation owns numerous buildings across the UK – and to outside organisations.

It has trained 76 hostel residents in its first three years of trading, with 88% ending up with accreditation enabling them to seek employment in the electrical testing business.

For the Salvation Army, a social enterprise is “a market-led venture, aiming for profit but achieving at least 70% of income from trading, while striving to achieve social impact for those furthest from the labour market.”



4. What do I need to do?

1. Know why you're doing it

Bad reasons:

- Because you've heard social enterprise is the next big thing.
- Because you think it must be easier than writing funding applications.
- Because you've tried everything else and now there's no money left.
- Because one of your board is a social enterprise enthusiast and wants you to 'rebrand'.

Good reasons:

- You want to make your organisation more sustainable.
- You want your success to depend on whether your products and services are good – and whether people want to buy them.
- You want to make enough money to invest in your organisation and grow its social impact, because you believe in it.

2. Discuss with stakeholders

Trustees – may initially need to be reassured that the transition to a social enterprise model won't cause the organisation to lose its values and ethos. Once they support the idea in principle, they will need to be reassured that the social enterprise model you are proposing to follow will work. This will call for a business plan. But you may not want your first conversation with the trustees to be when you whip out a fully-designed business plan that changes the charity's main activities.

You may want to introduce the idea of transition as part of your ongoing talks about the mid-to-long term strategy. And it is important to remember that the idea of social enterprise can make people nervous. If you are already 'there', try to remember when it felt like a scary (but exciting) idea in your head. What helped you to understand it and what helped you envision what the future might be like?

Members/Service Users – if you're a charity that provides free or subsidised services for its members or service users, you may choose to discuss what a transition to social enterprise would mean for them, and any ideas they have about how it could work. Again, remember that the idea may be new and a bit daunting for them. You might want the idea to be discussed and considered before putting a proposal on the table.

Potential Customers – you may include members/service users and public sector funders in discussions about the future. After all, you will need to find out whether anyone would pay for your products and services if you were selling them, so this is a good place to start.

3. Decide on your structure and business model

Are you going to adopt a social enterprise model for your entire organisation or set up a new social enterprise activity?

Can you operate in a different way under your existing company structure or do you need to set up a separate trading arm?

4. Write your business plan

Your business plan should be short and to-the-point – no more than 20 pages. It should answer all the big questions facing your new venture such as:

- **What is your vision:** What are your ambitions? In an ideal future, how will the world be different because of what your business achieves?
- **What is your mission:** What, in concrete terms, are you hoping to achieve?
- **What are your goals:** How is your mission going to be turned into reality?
- **What specific actions are you going to take – and over what timeframe?**
- **Who will your customers be?**

- What resources do you need to get started?
- How much money are you going to invest in your new model or trading company?
- Are you going to invest the charity's money or look for outside sources of finance?

To understand more about the basic elements of business planning, go to www.socialenterprise.org.uk, www.businesslink.co.uk or www.ncvo-vol.org.uk. Social Enterprise UK has a publication called Start your Social Enterprise that you can download from the SEUK website.

Case Study – Worth Unlimited

Worth Unlimited is a charity that works with young people across the UK who are suffering from the effects of poverty and deprivation. Two years ago it recognised a real need to help young people who had dropped out of school to develop the skills they needed to get a job or go on to college. They had already had an idea to open a bike-repair business and a bakery and realised that this would work well as a social enterprise, giving young people both work experience and transferable skills. As a result, Worth Enterprises was set up as a social enterprise arm of the charity. However, fairly quickly CEO, Tim Evans, realised they needed help with the vision for the new enterprise and how to plan for its future.

'We knew we had a good idea but we were struggling to really think things through and see how our new social enterprise would fit within our organisation. We needed help to develop our ideas and make it work across all our local branches.'

In September 2011, Worth Unlimited began working with Pilotlight which brought together a team of senior business people to coach them through the process of becoming more

sustainable and efficient. The Pilotlight team helped Worth Unlimited think through their social enterprise activity and acted as an expert critical friend. Tim says part of the challenge was getting staff to buy into the new venture and think in a totally different way.

'We needed our youth workers to switch their mindset to running a business, which was a big change for them. Pilotlight was able to help us with this and got us all thinking more as a business, which enabled us to put the structures and processes in place to be successful locally.'

The results have been impressive and the charity are now being supported by O2 to open a new bike shop, again run by young people as a social enterprise, as part of their Gear Up programme in Birmingham.

Tim says that having the opportunity to really think through how the new social enterprise was going to work made all the difference.

'We now have two fledgling enterprises which are growing and which we are using as the flagships for the rest of the organisation. We've learnt important lessons and our goal now is for every one of our local branches across the UK to have a social enterprise element as part of what they do.'



Social Enterprise UK

We are the national membership body for social enterprise. We offer business support, do research, develop policy, campaign, build networks, share knowledge and understanding and raise awareness of social enterprise and what it can achieve. Joining Social Enterprise UK means you get access to our networks, heavily discounted products and services, free information and advice about your business. If you are interested in joining please visit www.socialenterprise.org.uk/membership. We have a network of around 15,000 organisations and operate a very busy website with a growing social media presence.

We are doing an increasing amount of work with charities of all sizes who are interested in working more with social enterprises, changing their legal status or setting up social enterprise arms. Our training and consultancy work includes advising on the correct legal status to adopt, social impact measurement, and developing social franchises. To find out more about the services we offer to charities email business@socialenterprise.org.uk.



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The legal content of this guide has been provided by Abbie Rumbold and Sarah Cannings at BWB. We are proud of our reputation as the leading firm in this field. BWB has the largest team in the UK focused entirely on working for charities and social enterprises. Our clients range from household names to innovative start-ups and from international networks to local community groups. Chambers UK 2012 comments on the “strong values and ethics” and “deep-rooted knowledge of charity issues” in the BWB team.



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