Dana Brakman Reiser, Steven A. Dean and
Giedre Lideikyte Huber (eds.)

Social Enterprise Law
Droit des entreprises sociales

A Multijurisdictional Comparative Review
Une étude comparative multi-juridictionnelle

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Edited by
Dana Brakman Reiser
Steven A. Dean
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GENERAL REPORT

The Social Enterprise: A New Form of the Business Enterprise?

Dana Brakman Reiser and Steven A. Dean*

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Résumé

Élaboré sous les auspices de l'Académie internationale de droit comparé, ce rapport général synthétise les données recueillies par une équipe de chercheurs et de praticiens établis dans plus de deux douzaines de juridictions sur six continents et disposant d'une grande expertise en la matière. En tant que rapporteurs spéciaux, chacun d'entre eux a répondu au questionnaire détaillé sur le traitement juridique, dans la juridiction concernée, des entités qui utilisent des méthodes commerciales pour réaliser le bien social. Trois rapports spéciaux complémentaires traitent de questions qui dépassent le simple cadre d'un pays ou d'une juridiction. Ensemble, ces rapports témoignent de l'ampleur remarquable de l'innovation juridique entourant l'entreprise sociale au niveau mondial. Le rapport général met en évidence les principales similitudes et différences, en fournissant des exemples illustrant chacune d'entre elles. Les rapports spéciaux contenus dans ce volume et le recueil en ligne qui l'accompagne contiennent plus de détails sur les résultats.

En premier lieu, le rapport général souligne le rôle clé que jouent les contextes politiques, culturels et juridiques dans l'élaboration du statut juridique des entreprises sociales. Il convient de souligner que les juridictions ont des points de vue très différents sur le rôle des restrictions de distribution dans les entreprises sociales. Certaines considèrent ces restrictions comme essentielles, d'autres les rejettent comme anathèmes. Ces perspectives opposées reflètent à la fois les principes fondamentaux d'une juridiction et son besoin ressenti de formes juridiques ou de certifications spécialisées pour les entreprises sociales.

Ensuite, le rapport général compare les nombreuses formes spécifiques et certifications qui ont été développées pour identifier les entreprises sociales dans le monde entier. Les formes juridiques sont proposées exclusivement par les gouvernements et concernent une seule juridiction, tandis que les certifications peuvent découler ou non de la législation de l'État ; elles peuvent également être propres à une juridiction ou en concerner plusieurs. La comparaison de ces outils offre des pistes aux législateurs des différentes juridictions qui souhaitent continuer à développer des formes et des certifications spécialisées pour les entreprises sociales.

Enfin, le rapport général explore l'impact de ces éléments sur les mesures incitatives en faveur de la poursuite de buts sociaux à l'aide de méthodes commerciales. La confiance que suscitent les restrictions en matière de distribution et la surveillance réglementaire semble essentielle à l'octroi de subventions étatiques ou d'autres privilèges aux entreprises sociales. En l'absence de ces protections, les incitations étatiques en faveur des entreprises sociales restent largement absentes.

Social enterprise presents a remarkable opportunity. Harnessing the power of business methods to generate public benefits brings potent weapons to bear on

critical problems. From global threats like climate change to local challenges like inclusive hiring, social enterprises have delivered compelling solutions that have eluded both charities and conventional for-profit businesses.

Yet social enterprise remains an enigma. No precise definition of the term exists.[1] Built to generate both private rewards and public benefits, social enterprises defy easy categorisation. The many opportunities that creates for misunderstandings makes nurturing social enterprise a challenge.

In a simple world in which public and private capital flowed easily to deserving projects, an entrepreneur would see a clearly marked path towards a brighter tomorrow in blending doing well and doing good. In practice, trust makes funding a social enterprise through either the private marketplace or from public coffers challenging.[2] Economists might think of it as a stag hunt.[3] Funders and entrepreneurs each need to demonstrate their commitment to pursuing the stag their shared vision represents – delivering public benefits relying on business methods – but may struggle to communicate that resolve, dooming the hunt.

With no clear path to follow, policymakers and private actors have pursued a wide array of efforts to build the trust necessary for social enterprises to raise the capital they need to realise their ambitions. Even when funders suspect they share an entrepreneur's aims, they might hesitate to provide the necessary capital. Without receiving a robust showing of commitment to their joint vision by an entrepreneur, taking that leap of faith might prove costly.

Social enterprise law strives to make it possible for these hybrid organisations to embrace and broadcast those commitments, attracting the public and private capital necessary to thrive. Trust – or its absence – proves pivotal for that stag hunt and for social enterprise. In many legal systems, standard business law threatens to pit social entrepreneurs against investors. They might join forces to pursue an ideal of private rewards combined with public benefits. But to succeed they must trust one another not to make a grab for the profits. In these contexts, social enterprise law exists to bolster that trust, permitting ventures to turn to markets to raise the private capital they need to turn brilliant ideas into vital, growing mission-driven businesses.

Not all legal cultures embrace such a rough-edged vision of capitalism. Yet even where a long-standing commitment to addressing the needs of workers

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1 One of the special non-national reports contained in this volume tackles this very issue. *See* Sheehy and Diaz-Granados, Social Enterprise: A Legal Definition of the Term.

2 *See* D. Brakman Reiser and S.A. Dean, *Social Enterprise Law: Trust, Public Benefit, and Capital Markets*, Oxford University Press, New York 2017 (highlighting the importance of trust for a social enterprise's capacity to raise capital and describing an array of public and private mechanisms capable of generating that trust).

3 *See id*. at 12. ('Social enterprise founders and investors confront their own version of the stag hunt. Rather than a stag, their big prize combines social and financial returns').

and other stakeholders would seem to make social enterprise an organic part of business culture, social enterprise law has emerged to build trust. The distribution constraints required of many social enterprises – whether or not organised as charities – limit their capacity to distribute profits to owners. Regulatory oversight provides further assurances these constraints will be obeyed. With such signals of commitment in place, social enterprises can often lay claim to public capital in addition to – or in place of – private capital.

Changemakers everywhere have worked hard to provide social enterprises the tools necessary to demonstrate commitment. Increasingly over the last decade, their efforts have given rise to an array of specialised legal forms and certifications for social enterprises. Predictably, the contours of those interventions have been far from uniform.

In most jurisdictions, experimentation remains in its earliest stages. Despite that, these legal innovations often already bear the hallmarks of their varied origins. Colombia's 2018 Companies of Collective Benefit and Interest certification, China's various locally driven social enterprise certifications, social cooperatives available in many Western European jurisdictions, and the United Kingdom's community interest company (CIC) would never be mistaken for one another. Each reflects the distinct legal cultures that gave birth to them while striving to provide the trust social enterprise demands.

The utilisation of these distinctive interventions likewise differs from place to place. Most are still very new and relatively little used. In some cases, however, social enterprise legal innovations have proliferated more significantly. Social cooperatives and the UK CIC impose meaningful distribution constraints often together with regulatory supervision and have seen some significant use. Specialised corporate forms for social enterprise now widely available across US states – including a variant under Delaware law – have experienced slow but observable uptake. The US forms, which rely on owners alone to ensure a social enterprise will not be stripped of its mission, have as yet garnered relatively little interest from entrepreneurs or investors, leaving the impact of these innovations contested. Trust remains essential.

1. PRELIMINARIES

This general report relies on the labour and insights of experts in social enterprise law on six continents, each detailing the steps taken to preserve trust in a specific national context. Our special national rapporteurs describe how their jurisdictions understand the concept of a social enterprise, the industries in which they operate, and what distinguishes their business models. Together, the 25 special national reports published here, and additional materials developed for this project, have provided an extraordinarily rich data set from which this general report's insights are gleaned.

Each special national report also addresses the legal forms social enterprise takes in its jurisdiction. This entails assessing how well traditional for-profit and non-profit forms can accommodate social enterprises, as well as describing any specialised forms designed for social enterprise that have been developed and the extent to which these have been embraced. To understand how social enterprises take shape in each jurisdiction, special national rapporteurs detail the procedures for creating, maintaining and dissolving them. In addition, each special national report explains whether and how social enterprises can earn certifications from private or public sources attesting to – and what metrics exist to measure – their impact.

Special national rapporteurs explore the public and private sources of capital social enterprises draw on to bring their visions to life. Public subsidies, where they exist, will be made available to some, but not all, ventures that might view themselves as social enterprises. Likewise, the extent to which private capital supports social enterprise varies widely from place to place. Understanding how social enterprises fund their operations and growth reveals a great deal about the role these organisations play in the economic life of each state.

Four special non-national rapporteurs address issues that transcend borders. Benedict Sheehy and Juan Diaz-Granados' report tackles the challenging question of defining social enterprise. The term has been widely used in some jurisdictions, less frequently utilised in others, and is virtually unheard of in yet others. While it remains an impossible task to develop a definition that will capture the concepts in use in all our reporting jurisdictions, this report makes a theoretical argument for defining the concept in a way that will distinguish social enterprises from non-profit and for-profit forms.

Antonio Fici's report, on the European Union, offers a regional perspective. The EU and its Member States were early leaders in recognising the potential of social enterprises. Its 2011 Social Business Initiative prompted many of its Member States to pursue legislation or other tools to encourage social enterprise. The report on the EU tracks and reflects on these bold transnational efforts to foster legal change.

Carol Liao's report applies a valuable critical lens. It reveals how efforts to enact specialised legal forms for social enterprise can disrupt the trajectory of local law development, including the embrace of corporate stakeholder theory more broadly. In the context of the comparative project undertaken in this general report, the argument that officious legal transplants from one jurisdiction to another can be harmful becomes exceptionally salient.

The remainder of this general report proceeds in five sections. Section 2 explains the key role that cultural, political and legal baselines play in defining the role of social enterprise and the scope of social enterprise law. Section 3 focuses on a key issue that the special reports reveal social enterprise law around the world resolves in dramatically different ways: distribution constraints.

Remarkably, jurisdictions take diametrically opposed positions on whether social enterprises should be permitted to share their profits or residual assets.

This choice whether to constrain distributions by social enterprises – which in turn proves to have important consequences for the availability of public support – is only one component of the design challenge posed by creating specialised legal forms and certifications to identify them. Section 4 compares and contrasts the incredible diversity of approaches to that task described in the special reports. Section 5 considers an equally broad range of incentives nations have developed to encourage social enterprise. Finally, section 6 discusses regulation, in particular how governments are seeking to monitor the accountability and transparency of social enterprises operating in their jurisdictions. Together with the keen insights contributed by the dedicated team of special rapporteurs, these discussions begin to map the terrain of social enterprise law on a global scale.

2. BASELINES

Social enterprise can appear radical. Yet in some contexts its balance of business methods and public benefits seems all but inevitable. Political and cultural baselines in particular jurisdictions – often reflected in norms regarding how much social provision will be undertaken by public institutions – can fuel the demand for and development of private capacity as a substitute or complement.

To be blunt, nations vary considerably in the size and scope of their public welfare systems and cultures differ as to how much social support citizens expect their governments to provide. Those jurisdictions and cultures committed to comprehensive public provision of health care, education, job training and other social services will have less need for private institutions with parallel objectives. At the other extreme, in countries with few public social supports, there will be ample room for private institutions to play significant roles in social service provision.

This political baseline dictates not only the necessity and space for social enterprises, but also for traditional non-profits and ordinary businesses. Describing his perception of Americans' unique attraction to forming associations (his term), de Tocqueville noted

> Americans of all ages, all conditions, and all dispositions, constantly form associations. … Wherever, at the head of some new undertaking, you see the government in France, or a man of rank in England, in the United States you will be sure to find an association.[4]

[4] A. de Tocqueville, *Democracy in America* (1835), J.P. Mayer (ed.), G. Lawrence (trans.), Doubleday, Garden City, NY 1969, Book II, chs v–vii.

Special national rapporteurs too have identified this variation. For example,

> due to the rapidly developing German social welfare state with government-subsidised welfare institutions, the idea of social enterprise spread much less quickly in Germany than in developing and emerging markets, as well as in the Anglo-Saxon industrialised countries, where social security systems are often based on inadequate or largely private provision of social services.[5]

In some nations and some periods, the social sector can be swallowed by the state, as the Poland report notes occurred there after 1945, resulting in cooperative 'self-government bec[oming] a fiction' and non-governmental organisations' inability to operate at all.[6] When less pro-social activity resides in the private sector in general, the impetus toward social enterprise can be muted.

However attractive, the simple arithmetic of more government producing less social enterprise does not always hold. Ventures dedicated to doing both well and good might simply be oriented in other directions. By no means do all social enterprises pursue objectives overlapping with those of governments.

In nations where health care or job training is already largely provided by public institutions, social enterprises (and traditional non-profits and for-profits) might pursue environmental objectives or international development agendas instead. Moreover, public versus private social provision can represent a false choice. Social enterprises and public institutions can collaborate to pursue pro-social goals. In Singapore, for example, the state is deeply involved in developing the social enterprise sector, funding individual social enterprises through various bodies and state-linked corporations.[7]

Baseline expectations can also be shaped by legal norms and doctrine. Consider the impact of corporate legal cultures that prioritise the needs of stakeholders. As the Japan report explains, 'it is natural for Japanese business corporations to involve themselves with social issues.'[8] The rapporteur cites a 2015 Cabinet Office survey of small and medium-sized enterprises in the service industry in which

> 62.5% of companies answered either 'very well applicable' (17.6%) or 'applicable' (44.9%) to the question whether their main business purpose was to solve social issues rather than pursuing profits.[9]

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5 Social Enterprises in Germany, p. 251.
6 Social Enterprises in Poland, p. 443.
7 *See* Social Enterprises in Singapore, pp. 480–81.
8 Social Enterprises in Japan, p. 345.
9 *Id*.

Company forms in Germany may be created for any lawful purpose[10] and the co-determination system enshrines a stakeholder perspective.[11] The report from the United Arab Emirates argues it is ripe for social enterprise development due to the strong influence of Islam on its law and culture, as 'the key governing principles of Islamic business, founded in the Sharia, demonstrate the centrality of the social mission in any business enterprise.'[12]

The special non-national report offering a critical perspective provides a rich description of the stakeholder baseline applied to for-profit corporations in Canada.[13] Two Canadian Supreme Court cases expressly reject share price or short-term value for shareholders as the *sine qua non* of corporate objectives, instead embracing a stakeholder model[14] and a corporate duty to act as a 'responsible corporate citizen.'[15] Statutory amendments in 2019 codify the stakeholder approach[16] and remedies stand ready to enforce it. Strong stakeholder norms and protections enhance the ability of social enterprises to thrive using traditional for-profit forms.

When legal systems expect investor primacy from for-profit businesses, however, social enterprises will less easily fit the mould. Romania, for example, has been 'reluctan[t] to impose any limitations on the profit-oriented purpose of private economic activity' and '[t]he fiduciary obligations of the directors of commercial companies to pursue the interests of the shareholders and to maximise profits' are quite strict.[17] Chile's Supreme Court has described corporate purpose as 'none other than to achieve the maximum possible profit through the corporate activity.'[18] Colombia's *sociedad por acciones simplificada*, a limited liability for-profit form designed to ease access to the formal economy and credit markets, 'may advance any social purpose, [but] must not compromise profits in the process, which clearly denotes a scheme of priority in which profits are first.'[19]

New Zealand has also traditionally had a strong shareholder primacy norm for companies, though this position is not textually required by its company law and the issue is currently in a state of flux.[20] In the United States, commentators debate the strength of the shareholder primacy norm, but at least in Delaware

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10 *See* Social Enterprises in Germany, p. 257.

11 *See* G.M. Hayden and M.T. Bodie, *Reconstructing the Corporation*, Cambridge University Press, Cambridge 2020, pp. 173–74.

12 Social Enterprises in the United Arab Emirates, p. 570.

13 *See* Liao, B Corporation, Benefit Corporation and Neoliberal Greenwash, pp. 680–81, 683–88.

14 *See Peoples Department Stores Inc (Trustee of) v. Wise* [2004] SCC 68, [2004] 3 SCR 461.

15 *BCE Inc v. 1976 Debentureholders* [2008] SCC 69, [2008] 3 SCR 560 (BCE).

16 Canada Business Corporations Act (CBCA), RSC 1985, c. C-44, s. 122.

17 Social Enterprises in Romania, p. 459.

18 Social Enterprises in Chile, p. 142.

19 Social Enterprises in Colombia, p. 190.

20 *See* Social Enterprises in New Zealand, pp. 401–04, 408–09.

law on corporate takeovers, it remains strong.[21] The contexts in and degree to which jurisdictions treat the interests of owners of for-profit businesses as paramount varies, but any version of investor primacy can hinder the ability of social enterprises to thrive as traditional businesses.

Legal baselines matter even in jurisdictions that straddle investor primacy and stakeholder perspectives. Singapore law expressly permits the consideration of employee interests by company directors, although there is no compulsion to consider the interests of employees or any other stakeholders when the company is solvent.[22] In Belgium, the Supreme Court in 2013 defined the corporate interest 'as the "collective profit interest of the company's current and future shareholders"', but its 2019 Code of Companies and Associations established an opt-in regime, which 'explicitly allows companies to include in their articles of association other purposes besides profit distribution.'[23] How these positions will be harmonised remains uncertain. Australian company law defaults to treating shareholder value as the primary corporate objective, but case law permits fiduciaries to pursue social objectives if doing so is likely to generate benefits for the company.[24]

Linking stakeholder and shareholder value together is also common. For example, in Switzerland, '[a]s long as business decisions serve the long-term interests of the corporation, for-profit corporations enjoy discretion to pursue a social mission and to serve stakeholder interests other than those of investors.'[25] The United Kingdom likewise embraces a shareholder primacy default for companies limited by shares but also requires directors to consider the interests of other stakeholders. As the UK report points out:

> The obligation … is only procedural, imposing on directors a duty to take a degree of care in their decision-making process – foremost, to encourage long-term sustainable business success – while overall giving priority to the interest of members.[26]

Jurisdictions may also lack clear legal precedents clarifying their positions on the question of for-profit firm objectives. In China, 'companies are viewed as market sector entities, with the object of pursuing returns on investment for investors' but 'whether mixing for-profit objects with social goals is permissible is still a grey area.'[27] As in jurisdictions like the United States that lack consensus on what the law demands, and New Zealand where a shift in approach is underway,

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21 *See* Social Enterprises in the United States, p. 620.
22 *See* Social Enterprises in Singapore, p. 485.
23 Social Enterprises in Belgium, pp. 83, 85.
24 *See* Social Enterprises in Australia, pp. 68–69.
25 Social Enterprises in Switzerland, pp. 510–11.
26 Social Enterprises in the United Kingdom, p. 584.
27 Social Enterprises in China, pp. 163–64.

legal systems without clear guidelines on appropriate objectives for for-profit forms may find social enterprises reluctant to adopt them. Just as the boundaries of government shape social enterprise, legal systems' divergent baselines defining the proper province of for-profit firms has profound implications for the contours of social enterprise.

Any given blend of social returns alongside financial gains may align with an individual's idiosyncratic perspective. Take, for example, the question of whether to spend more today to use cleaner-burning fuel. That would in all likelihood burnish a venture's reputation. An enhanced image for environmental stewardship may in turn help attract new customers, elicit loyalty from employees and reassure regulators. All of which may – or may not – boost profitability. Reasonable people may disagree about whether the additional cost of purchasing clean fuel represents a sound financial investment.

But that individual perspective only represents part of the story. Whether founders or leaders of a for-profit entity see risk or opportunity in combining public good and business methods may depend less on who makes this decision than on where they make it. In jurisdictions with a greater tolerance for traditional for-profit firms or cooperatives centring the interests of employees, customers, local communities or the environment, entrepreneurs seeking to blend business methods and social goals will find traditional for-profit forms appealing. Legal systems adopting a clear stakeholder mandate for some or all for-profit entities make such forms even more hospitable to social enterprise. In these settings, social enterprises might broadcast their intention to prioritise a particular social value or public good to distinguish themselves against a field of companies merely required to consider non-shareholder interests by opting into specialised forms or obtaining certifications. But even without whatever protection specialised forms or certifications might provide, a blended vision will not threaten a social enterprise's existence as a for-profit firm.

Conversely, where law and culture insist for-profit entities prioritise financial profits or investor wealth, the impulse of social enterprises to pursue social value cuts against the grain. In such jurisdictions – especially in the absence of protections against claims by disgruntled investors – managers may choose dirtier inputs even when they find the business case for cleaner production compelling. When a shareholder primacy perspective dominates, or even where the issue remains unresolved, many social entrepreneurs will inevitably eschew the for-profit corporate form, selecting instead organisational forms more suited to their blended visions.

Under such conditions, specialised forms or certifications designed for social enterprise can be of existential importance. Whether such innovation will provide the only solution or just one alternative will depend upon the other options available. For the smallest social enterprises and in emerging economies, participation in the informal economy may suffice to meet the goals of entrepreneurs and managers.

Non-profit forms can also fit their needs, depending again on the applicable legal baselines for the conduct of such entities. After all, non-profits' focus on providing socially valuable goods and services will overlap substantially with many social enterprises' objectives.[28] Two elements of a jurisdiction's non-profit baseline matter above all. First, the extent to which jurisdictions impose limitations on commercial or trading activity by non-profits or the subset of non-profits that receive tax benefits may render the question moot. In legal systems with broadly permissive attitudes toward non-profit trading, like Poland,[29] or which offer non-profit forms designed to accommodate commercial activity, like Denmark's enterprise foundation,[30] social enterprises may find that using non-profit organisations to conduct their desired activities presents little difficulty.

Most jurisdictions, however, impose at least modest limitations on commercial activity by non-profits, especially those granted charitable status, tax advantages, or both. A 2010 case in South Africa can be understood to adopt the most extreme position: a wholesale prohibition on any commercial activity by non-profit organisations.[31] In such a restrictive setting, few social enterprises will find non-profit forms fit for purpose.

Many legal systems instead take a more measured approach, curbing commercial activity by non-profits (or charitable or tax-advantaged non-profits) rather than banning it. Relatedness often provides the relevant threshold. In Kazakhstan, for example, 'a [non-profit] should have a specific social or public interest goal(s) declared and pursued, while any trading activity is prohibited if it does not serve to achieve such goal(s).'[32] When non-profit companies limited by guarantee in Ireland hold charitable status, they are permitted to engage in trading only if it is 'directly associated with the primary purpose of the charity.'[33] Jurisdictions such as the United States do not bar unrelated commercial activities, but engaging in them can decrease tax benefits available.[34]

Trading restrictions also sometimes address the proper balance between commercial and non-commercial activity by non-profits. For example, non-profit foundations and associations in Brazil may only 'conduct … economic

[28] *Cf.* Social Enterprises in Peru, pp. 423–25 (noting that many in Peru would understand the concept of a social company *to be* a non-profit for this reason).

[29] *See* Social Enterprises in Poland, p. 449 (explaining that it is possible for trading 'to become the main subject of [a] foundation's activities').

[30] *See* Social Enterprises in Denmark, pp. 208–12.

[31] *Cuninghame and Another v. First Ready Development*, 249 2010 (5) SA 325 (SCA).

[32] Social Enterprises in Kazakhstan, pp. 373–74.

[33] Social Enterprises in Ireland, p. 306.

[34] *See* Social Enterprises in the United States, p. 623. In Belgium, even related commercial activities by non-profits can risk or reduce their eligibility for tax benefits. *See* Social Enterprises in Belgium, p. 87 (noting also that Belgium prohibited all but 'incidental' commercial activity by non-profits before legislative changes in 2019).

or profitable activities on a secondary basis.'[35] A 'hazy' commerciality doctrine limits trading activity by US non-profits seeking to maintain charitable tax exemption both in terms of relatedness and scale of operations.[36] Regulations prohibit such entities from being 'organized or operated *for the primary purpose* of carrying on an unrelated trade or business.'[37] Switzerland and Germany also preclude tax exemption for non-profits that primarily pursue commercial activity; 'a legal entity may not get a tax exemption if its main purpose is to conduct a commercial activity (e.g. to run a restaurant), even if all the profits from this activity are allocated to charitable purposes.'[38]

In legal systems that restrict trading activity by non-profits or otherwise impose commerciality restrictions as criteria for tax benefits, whether non-profit legal forms will suit individual social enterprises will depend on their particular business plans and models. Non-profit forms might easily house work integration social enterprises in jurisdictions with relatedness requirements, and social enterprises taking these forms may easily qualify for charitable tax advantages. Engaging in job training for underemployed workers fundamentally relates to the charitable purposes of these entities, whose business plans rely on earned revenues from the trainees' output. Relatedness restrictions may make non-profit forms or charitable status inapt, though, for social enterprises innovating sustainable manufacturing processes or employing a buy-one-give-one model. If trading restrictions address the extent of commercial operations rather than their relatedness to a non-profit's social mission, none of these business models may fit within a non-profit form. Even when they do, their methods may still not be compatible with accessing charitable tax advantages. The impact of jurisdictions' limitations on trading by non-profits will vary by individual social enterprise and will shape the contours of emerging social enterprise sectors.

Likewise, when contributions from donors are a key component of an individual social enterprise's plans for accessing capital, its leaders will strive to design their commercial activities to preserve eligibility for donor tax benefits. Such firm-level decisions will aggregate to mould the industries, business models and legal forms that typify a jurisdiction's social enterprise sector. When enough potential social enterprise models become foreclosed to non-profits by a jurisdiction's baseline approach to non-profit trading, specialised – and more hospitable – legal forms are more likely to take root.

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35 Social Enterprises in Brazil, p. 121.

36 J.D. Colombo, 'Commercial Activity and Charitable Tax Exemption' (2002) 44 *William and Mary L. Rev*. 487, 533; *see also generally* J.D. Colombo, 'Reforming Internal Revenue Code Provisions on Commercial Activities by Charities' (2007) 76 *Fordham L. Rev*. 667.

37 Treas. Reg. §1.501(c)(3)–1(e)(1) (emphasis added).

38 Social Enterprises in Switzerland, p. 516; *see also* Social Enterprises in Germany, p. 262 ('Non-profit corporations are [wholly] exempt from income taxes provided they do not maintain a commercial business operation' other than pure asset management as their main activity).

The other key element of a legal system's baseline for non-profits is its application of comprehensive distribution constraints,[39] which prohibit distribution of a non-profit entity's midstream profits and residual assets to those with control over it.[40] The special national rapporteurs describe comprehensive distribution constraints imposed across a wide range of jurisdictions, at least as a requirement for tax benefits (if not for non-profit organisational existence). Notable exceptions, such as Japan's general incorporated association, offer a non-profit legal form subject to a partial distribution constraint only.[41] It cannot distribute midstream profits and is prohibited from contracting to pay out residual assets on dissolution in advance. When the moment of dissolution arises, however, distributions of assets to members are permitted if voted by the member meeting. Despite such anomalies, an unyielding distribution constraint applicable to non-profits serves as a near-universal fixture across the legal systems represented in this general report.

Yet the impact of this ubiquitous feature of non-profit law on social enterprise is inconsistent. Jurisdictions take conflicting positions on whether distribution constraints should extend to social enterprise. Some jurisdictions view such constraints as essential features to apply to social enterprises – either in whole or in part – while others treat them as an intolerable defect social enterprises should be spared. For some legal systems, distribution constraints have become constitutive of pro-social entities. Without them, efforts to mix business methods and social goals cease to be worthy of the social enterprise label. Where non-profit formation remains unfavourable for social enterprises due to trading restrictions or other reasons, such jurisdictions have begun to develop social enterprise forms or certifications that duplicate some or all of the elements of a non-distribution imperative.

Other legal systems come at the distribution constraint question with quite different priors. Social enterprise in these jurisdictions has value precisely because of its capacity to deliver social goods alongside private rewards for owners and leaders. The power of invested capital – anathema to an asset lock – to unleash firms' capacity to scale and to provide incentives for effort and excellence justifies whatever costs permitting distribution imposes. Although

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39 Idiosyncratic features of nations' non-profit law can also frustrate their utility for social enterprise. For example, 'a recent judicial decision from the Chilean Constitutional Court affirmed that members of the board of directors of a non-profit organisation cannot be paid for their job.' Social Enterprises in Chile, p. 138.

40 *See* H.B. Hansmann, 'The Role of Nonprofit Enterprise' (1980) 89 *Yale L.J.* 835, 838 (identifying this 'nondistribution constraint' as a defining feature of non-profits under US law). Non-profit scholars often use Hansmann's 'nondistribution constraint' term to speak of comprehensive distribution constraints prohibiting both sharing of midstream profits and residual assets with those in control, as do some of our special national rapporteurs. For clarity given our purposes here, we refer to distribution constraints imposed midstream and at dissolution separately.

41 *See* Social Enterprises in Japan, pp. 348–49.

the distribution constraint question will be explored in detail in the next section, the impact of this baseline on the adequacy of non-profit forms for social enterprise deserves consideration here as well. Where distribution constraints match legal and cultural expectations for social enterprises, non-profit forms will be well suited to operating them. Where constraints on non-profit distributions are viewed as an obstacle, social enterprise founders will seek alternatives, including – where needed – specialised forms or certifications.

3. DISTRIBUTION CONSTRAINTS

The value of distribution constraints has been explored most thoroughly in the context of non-profit organisations. As noted above, such organisations face a near universal legal ban on distributing their midstream profits and residual assets, often as a condition of their very existence but sometimes only to obtain advantageous tax or other government benefits. Compensation to employees and for goods and services received remain permissible, but profit-sharing – whether during regular operations or on dissolution – violates the prohibition. This kind of unrelenting distribution constraint offers significant value to non-profit organisations subject to it, though it also introduces costs.

The primary benefit of imposing comprehensive distribution constraints lies in promoting trust. The inability of leaders and managers to siphon out a non-profit's earnings provides reassurance to the various constituencies these organisations rely upon for support. For many non-profit organisations, donors serve as a key financial resource. With a comprehensive distribution constraint in place, individuals, families and entities offering financial support to a non-profit and receiving nothing but promises to do good in return can trust that their contributions will not be used for the personal gain of those running the organisation. And managers know they will never face pressure to distribute profits, since no distributions may – under penalty of law – ever be made.

Trust by purchasers of a non-profit's services can be enhanced by distribution constraints as well. In many industries in which non-profits operate – education, health care, religious activity – those paying for their offerings stand in a poor position to evaluate the quality of what they produce. Parents do not receive the educational services they pay for directly, nor do many of those paying for health care services. In both cases, and arguably more so in the case of religious services, the quality of services rendered is difficult to assess in real time – if ever. In these situations of 'contract failure', distribution constraints again can bolster contributors' confidence.[42] Whether or not consumers can determine

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[42] Hansmann, *supra* note 40, at 845; *see also* B.M. Leff, 'Some Implications of the Agency-Cost Theory of the Nonprofit Firm' in B. Means and J.W. Yockey (eds), *The Cambridge Handbook*

if the education, health care or religious instruction they received represents good value for the financial contributions they (or others) made, at least those in charge will have less incentive to skimp on quality to line their own pockets.

These effects also allow distribution constraints to play a more general, trust-enhancing role on a societal level. Non-profits frequently produce true economic public goods – those which cost no more to produce for many consumers than for one and which once produced cannot be provided exclusively to those who paid for their production.[43] Clean air and public art come close to being pure public goods, and government is the classic solution used to generate incentives for people to contribute toward their costs of production. But governments will not optimally produce all desirable public goods, either due to a shortfall in revenue or their responsiveness to political realities like interest group power or the median voter.[44]

Non-profits can supplement governmental provision of public goods but need to be trustworthy enough to attract funding to produce them from contributors who understand they will not be able to secure the goods' benefits solely for themselves. By removing managers' ability to financially benefit from non-profit firms, a comprehensive distribution constraint enhances their ability to draw in such contributions. Without the ability to direct savings to their own accounts, managers have less incentive to short-change the public on the quality or quantity of public goods produced, diminishing the likelihood of hollow virtue signalling like greenwashing and social washing more generally.[45]

Even amongst those who do not provide direct financial support to non-profit entities, legal rules preventing them from operating as personal profit centres for their leaders reinforce the legitimacy of these organisations as oriented toward the public. As such this requirement often backstops not only access to the non-profit form, but also to public subsidies like tax relief and procurement preferences. Locking assets into the charitable stream enables non-profits to produce goods society desires and facilitates government efforts to incentivise them.

Finally, distribution constraints provide a clear distinction between non-profit and for-profit entities. Not all non-profits are heroic and trustworthy. Moreover,

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of Social Enterprise Law, Cambridge University Press, Cambridge 2018, pp. 401, 403–07 (applying Hansmann's contract failure theory to the social enterprise context).

43 *See* Hansmann, *supra* note 40, at 845 (citing R. Musgrave and P. Musgrave, *Public Finance in Theory and Practice*, 2nd ed., McGraw-Hill, New York 1976, pp. 49–80).

44 *See* B. Weisbrod, 'Toward a Theory of the Voluntary Non-profit Sector in a Three-Sector Economy' in E. Phelps (ed.), *Altruism, Morality and Economic Theory*, Russell Sage, New York 1975, p. 171.

45 They might simply seek to work less or less hard, but here government regulation and disclosure provide some additional corrective.

weak enforcement of distribution constraints can undermine their power to seed trust. The prominence across nations of comprehensive distribution constraints for non-profits, however, testifies to their merit in identifying firms whose differences from ordinary businesses inspire trust they will produce social value. When eligibility for tax advantages turns on the distribution constraints too, it likewise plays a role in identifying those organisations worthy of public support.

A social enterprise benefits from using a non-profit legal form for precisely the same reason as any non-profit. A social enterprise's mission, whether education, poverty relief, housing security or any other, organically draws interest from capital providers. When government incentives – such as tax deductions – are available, this surely matters as well. The comprehensive distribution constraint imposed by their form helps non-profit social enterprises engender trust needed to unlock public and private resources to their cause. In fact, one secret to the success of the United Kingdom's community interest company (CIC) may be that it permits a venture to choose to be either a non-profit company limited by guarantee or to adopt a conventional for-profit company form limited by shares. Many more have chosen the non-profit option.[46]

Comprehensive distribution constraints, however, also have downsides. The opportunity to share in profit and asset distributions can motivate investment. Non-profits too need capital to fuel and scale their efforts – and their objectives to generate public good may be even more important to fund than those of for-profit companies. But placing distribution beyond the pale eliminates a powerful driver of capital formation: equity investment. Without the ability to raise equity, non-profits remain consigned to donations, borrowing and earned revenue strategies to meet their capital requirements. The comprehensive distribution constraint eliminates a potential financial upside not only for outside investors but also for founders. Embracing non-profit distribution constraints does not foreclose compensation – especially some idea of reasonable compensation; without equity, though, crafting incentive pay schemes becomes more difficult.

These disadvantages of distribution constraints mirror precisely the great advantage of for-profit production: access to equity capital. Equity provides a powerful incentive to both founders and external funders, enhancing a firm's capacity to scale. But for-profit firms rarely attract donors and under-produce public goods. To the extent trust is a valuable commodity for traditional businesses, they cannot employ distribution constraints' bright lines and

[46] *See* CIC Regulator, *Annual Report 2021–22*, https://www.gov.uk/government/publications/community-interest-companies-regulator-annual-report-2021-to-2022/cic-regulator-annual-report-2021-to-2022#key-statistics-1 (reporting CICs limited by shares constituted only 4,240 of over 26,000 total registrations); *see also* Social Enterprises in the United Kingdom, p. 586 (noting the two variants of CIC and that 'in particular the uptake of the format of CIC (CLS) has not been as fast as some predicted').

reassurances to generate trust from patrons and society. Combating concerns about corporate greenwashing is just one front in this effort.

Jurisdictions do offer considerable tax advantages to for-profits to encourage economic development in general or for particular industries. These subsidies, however, are premised on firms' or industries' financial success being linked to societal benefit. They are not underwritten out of faith that they will be charitable institutions or pursue broadly public-oriented goals.

Just as many special national rapporteurs describe social enterprises in their jurisdictions organised using traditional non-profit forms subject to comprehensive distribution constraints, several describe social enterprises formed using standard for-profit entities without any legal limits on distributions. Sometimes they report the existence of both. In each case, a social enterprise will benefit from the advantages attendant to its chosen form and will strive to combat its corresponding disadvantages.

When jurisdictions create specialised forms or certifications for social enterprise, they must choose where to fall on this spectrum. The choices made by jurisdictions covered in this general report span a wide range of options. As noted above, for entrepreneurs and regulators in many jurisdictions, the concept of a social enterprise remains inextricably bound up with the notion of constrained distribution. When these legal systems experiment with specialised forms or certifications, a complete or partial distribution constraint is a crucial component. In jurisdictions that look to empower social enterprises to access equity investment, specialised forms and certifications can also play an important role. Without a distribution constraint as an identifier, these legal systems design specialised forms and certifications for social enterprise using other criteria to differentiate them from ordinary for-profits.

A comprehensive distribution constraint represents one possibility, foreclosing both midstream profit disbursals and the distribution of residual assets on dissolution. As noted, many of the special national reports describe social enterprises in their jurisdictions using non-profit forms of organisation subject to just such a constraint. None, however, yet report the adoption of a specialised form or certification for social enterprises imposing such a strict prohibition on distributions. Even in Italy, where the national third-sector entity (ETS) classification prohibits distribution of both midstream and residual assets, its rules include an exception allowing social enterprises adopting a corporate form to distribute some dividends.[47]

Creating a specialised form or certification for social enterprises that includes a comprehensive distribution constraint could be viewed as superfluous when non-profit forms already serve this purpose. In Belgium, a proposed provision regarding a social enterprise certification for non-profits 'was deleted during

[47] *See* Social Enterprises in Italy, pp. 330–32.

the parliamentary process, because non-profit associations were deemed social enterprises by nature in light of their non-distribution constraint.'[48] But the existence of non-profit forms does not guarantee that they will be hospitable to social enterprise in jurisdictions where such ventures might find a strong distribution constraint desirable. The restrictions on non-profit trading described above might create barriers to social enterprises making use of non-profit organisational forms, even if they would welcome comprehensive distribution constraints. In such cases, there remains room to develop specialised social enterprise forms or certifications that replicate the non-profit ban on profit distribution midstream and at dissolution but broaden the capacity for adopters to engage in commercial activities.

The German proposal for a GmbH-gebV form envisions a comprehensive distribution constraint but would differentiate its adopters from standard non-profits in quite a different way. Relying on the strength of its constraints on distribution alone, the proposed form would not require adopting entities to adopt any social purpose whatsoever.[49] The form was designed with a broader field of use cases in mind, enabling steward ownership for entities like family businesses as well.[50] If enacted, advocates contend it could be used by social enterprises to enshrine social mission and protect against its erosion. Critics, however, have questioned whether it is necessary and raised concerns that it lacks sufficient governance mechanisms for its comprehensive distribution constraint alone to ensure against misuse.[51]

In the numerous jurisdictions that have established social enterprise legal forms or certifications thus far, they have instead featured only partial distribution constraints. These tend to permit limited distribution of profits midstream and entirely ban distribution of residual assets on dissolution. The United Kingdom's community interest company (CIC) conforms to this pattern, at least for companies limited by shares that adopt the form,[52] as do state-sponsored certifications in Denmark (registered social enterprise or RSV),[53] Belgium,[54] France,[55] Italy (social enterprise)[56] and Romania,[57] and some private certifications as well.

48 Social Enterprises in Belgium, p. 83.
49 *See* Social Enterprises in Germany, pp. 269–73.
50 *See* A. Sanders, 'Binding Capital to Free Purpose: Steward Ownership in Germany' (2022) 4 *Eur. Co. & Fin. L. Rev*. 622, 635.
51 *See* Social Enterprises in Germany, pp. 269–73.
52 *See* Social Enterprises in the United Kingdom, p. 586. CICs organised as companies limited by guarantee already operate without share capital. *See id*., p. 584.
53 *See* Social Enterprises in Denmark, pp. 214–17.
54 *See* Social Enterprises in Belgium, p. 98.
55 *See* Les entreprises sociales en France, p. 237.
56 *See* Social Enterprises in Italy, pp. 331–32.
57 *See* Social Enterprises in Romania, pp. 463–64.

Even within this general approach, tremendous variation exists across both time and jurisdictions. The CIC Regulator has used its authority to raise dividend caps for CICs multiple times, in an effort to encourage greater investment of capital. This cap now stands at 35%,[58] also the upper limit permitted for annual profit distributions by Danish RSVs.[59] Belgium uses a different methodology. Its social enterprise certification, which is available only to cooperatives, entails a cap on the distribution of profits 'by dividend or otherwise, up to a particular rate of return on the amount actually paid by the shareholders on the shares, currently set at 6% per year.'[60] Each of these examples also bars distribution of residual assets.

Rather than capping dividends directly, several cooperative and social cooperative forms and social enterprise certification regimes instead impose mandates for reinvestment of profits.[61] Sometimes these reinvestment mandates are paired with an explicit lock on residual assets. For example, Romania requires that each entity holding social enterprise status 'allocates at least 70% of the profit or surplus obtained to the social purpose and to the statutory reserve' and 'undertakes to transfer the assets remaining after its liquidation to one or more social enterprises.'[62] Under the Social Enterprise Action Plan developed by Taiwan's Ministry of Economic Affairs, a social enterprise would be an entity that 'reserve[s] at least 30% of its economic surplus for social welfare purposes.'[63]

In other jurisdictions a reinvestment mandate stands alone. Cooperatives in Hungary, for example, must place some of their income 'into a non-distributable community fund', but may also distribute profits to members.[64] Similarly, 'the surpluses that a [UK community benefit society] receives must be used to benefit the community and cannot be distributed to members by way of dividend', but adopting a residual asset lock is optional.[65] Firms seeking certification as social enterprises in Abu Dhabi in the UAE too face only a constraint on profit distribution; they must 'commit to reinvesting at least 30% of profits.'[66] Likewise, for three of the four types of entities eligible to be listed as 'subjects of social entrepreneurship' in Kazakhstan, 'a set amount of their income must be reinvested into their qualified social entrepreneurship activities' but no explicit rule blocks distribution of residual assets.[67]

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58 *See* Social Enterprises in the United Kingdom, p. 586.

59 *See* Social Enterprises in Denmark, p. 216.

60 *See* Social Enterprises in Belgium, p. 98.

61 *Cf.* R. Bohinc and J. Schwartz, 'Social Enterprise Law: A Theoretical and Comparative Perspective' (2020) 15 *Oh. St. Bus. L.J.* 1, 13–14 (describing various methods for implementing 'mission-driven financial limits' on social enterprises).

62 Social Enterprises in Romania, p. 463.

63 Social Enterprises in Taiwan, p. 522.

64 Social Enterprises in Hungary, p. 290.

65 Social Enterprises in the United Kingdom, p. 587.

66 Social Enterprises in the United Arab Emirates, p. 574.

67 Social Enterprises in Kazakhstan, p. 372.

The special national reports also identified private social enterprise certifiers using this partial distribution constraint approach. Social Traders, a non-profit registered charity in Australia, offers a certified social enterprise status that can aid in securing procurement preferences.[68] Its guidance materials on certification explain that it will assess whether 'the total (direct) social costs and impact indicators are at least 50% of the prior year net profits after tax', but do not address distribution constraints on dissolution.[69] Singapore's primary social enterprise framework, laid down by the state-linked entity raiSE, sets a lower benchmark of just 20% resource allocation to social impact creation.[70] The Social Enterprise Mark (SEM) offered by a United Kingdom CIC also takes a reinvestment approach, but it bolsters this constraint with a lock on residual assets.[71] To earn the SEM, each certified entity 'dedicates a principal proportion (51%+) of any annual profit or financial surplus generated to social purposes', but also must either utilise a legal form that bars residual asset distributions or impose such restrictions in its governing documents.[72]

To whatever extent they apply and in whatever manner they are articulated, partial distribution constraints serve up assurances of trust to capital providers, regulators and society – albeit less robust assurances than would a comprehensive ban. They combine these assurances, however, with some ability for social enterprises governed by them to access equity investment. After all, a partial distribution constraint denotes not only the partial embrace of non-distribution but also its partial rejection. Investors' willingness to forgo some – but not all – potential financial rewards hardly guarantees a lasting pro-social partnership, but allows a social enterprise's funders and leaders each to offer a meaningful sacrifice as a show of good faith.

Some jurisdictions go further down the path away from comprehensive distribution constraints. Regarding limits on distribution as unnecessary to legitimise social objectives, its preclusion of equity investment as a serious impediment to scale, or both, these jurisdictions craft specialised forms and certifications for social enterprise that unambiguously enable profit distribution. Colombia's certification for companies of collective benefit (BICs), for example, imposes requirements for organisational purpose, fiduciary behaviour and

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68 *See* Social Enterprises in Australia, pp. 58–59 n. 4.

69 Social Traders, *Social Enterprise Certification: Guidance Notes and Standards*, https://assets.socialtraders.com.au/downloads/Full-Guidance-Notes.pdf.

70 *See* Social Enterprises in Singapore, pp. 478–79; *see also* British Council, *The State of Social Enterprise in Singapore*, https://www.raise.sg/images/The-State-of-Social-Enterprise-2021_FINAL.pdf, p. 15. Singaporean cooperatives, which raiSE treats as social enterprises automatically, are also subject to a variety of midstream distribution constraints. *See* Social Enterprises in Singapore, pp. 495–96.

71 *See* Social Enterprises in the United Kingdom, p. 591.

72 Social Enterprise Mark CIC, *Eligibility Criteria*, https://www.socialenterprisemark.org.uk/wp-content/uploads/2021/04/SEM-Qualification-criteria-Apr-21.pdf.

reporting, but includes no limits on distribution of midstream or residual assets.[73] Although the effort has since stalled, a proposal by the Ākina Foundation to develop a specialised legal form for social enterprises in New Zealand also focused on prioritisation of social mission in decision-making and disclosure, rather than imposing distribution constraints.[74]

China has seen a blossoming of certifications at the local level, a portion of which originally included partial distribution constraints. The Shunde certification, which was the first to be established for social enterprises in China, initially imposed a 30% dividend cap and a lock on two-thirds of residual assets.[75] The Shenzhen certification, which has become China's largest and the only one open to entities throughout China, formerly included a 35% dividend cap.[76] Both certifiers dropped these constraints in updated versions of their systems and two other Chinese certifications never imposed them. This change increases the flexibility and inclusiveness of their certification products, a feature especially desirable for the growing Shenzhen certification and also makes 'all four systems … similar to each other and more attuned to the Chinese context.'[77]

Perhaps no jurisdiction has seen a greater flourishing of new specialised forms for social enterprise than the United States, all of which operate without any constraints on profit distribution.[78] The first specialised form to come online – the low-profit limited liability company (L3C) – addresses only the firm's purposes, leaving the capacity to distribute profits conferred by LLC status unchanged.[79] The benefit corporation form, now available in over three dozen US states,[80] is far more prescriptive, but not with respect to distributions. Benefit corporation shareholders can receive dividends, subject only to limits that would apply to any corporation. Upon dissolution, benefit corporation shareholders function as residual owners, entitled to all remaining assets after creditors are satisfied. Other US legal form innovations, including most importantly Delaware's public benefit corporation, as well as social purpose corporations, benefit limited liability companies, and statutory public benefit limited partnerships in those jurisdictions where they exist, have followed suit. In sum, '[p]rotections of

73 *See* Social Enterprises in Colombia, pp. 191–92.
74 *See* Social Enterprises in New Zealand, pp. 409–10.
75 *See* Social Enterprises in China, p. 174 tbl. 4.
76 *See id*.
77 *Id*. at p. 172.
78 *See* Social Enterprises in the United States, p. 614 (describing 'social enterprise's underlying business and profit-oriented configuration over its public interest orientation' in all US specialised forms).
79 *See* 11 V.S.A. §4162 (2015).
80 *See* Social Enterprise Tracker, https://socentlawtracker.org/#/bcorps (listing 40 states but including Delaware's public benefit corporation form, which differs significantly from other benefit corporation enactments, in its count); *see also* Social Enterprises in the United States, p. 608 ('benefit corporations and variations on it are the most used specialised legal forms for social enterprise in the US').

members and shareholders' rights … are the same as their equivalent traditional forms of business organisation.'[81] The benefit company form available in British Columbia, Canada adheres to this same pattern.[82]

The global private social enterprise certification body B Lab, which was involved in developing the US and Canadian forms and includes regional spinoffs like Sistema B in Latin America, also proceeds without distribution constraints. As will be discussed in greater detail below, B Corporation certification is available to for-profit entities in 70 countries around the world.[83] To qualify, firms must only adopt stakeholder governance features and obtain a qualifying score on B Lab's proprietary assessment tool.[84] They need not restrict midstream profit distributions or investor access to residual assets in any way. Indeed, Sistema B's website explains non-profit organisations' ineligibility for its certification as based on '[t]he philosophy of B Corps … to prove that companies can take responsibility for solving socio-environmental issues through their business.'[85]

Social enterprise sits at the crossroads of trust and risk. Inevitably, the choice of where to site social enterprise forms and certifications on the distribution constraint continuum communicates important and often culturally dependent value judgements about the relative desirability of assurances of trust versus capacity for scale. Those missives have not always been internally consistent. Even within a single jurisdiction, this experimentation has sometimes led to more than one specialised form or certification with different distribution constraint perspectives coexisting and potentially competing. As noted above, China's four local certification schemes once imposed three different approaches to distribution constraints, though they have converged on a permissive approach. In the UK, the CIC form and privately available SEM both impose partial constraints, but in differing ways. The broad availability

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81 Social Enterprises in the United States, p. 625.

82 *See* Liao, B Corporation, Benefit Corporation and Neoliberal Greenwash, pp. 693–94 ('unlike other certifications and legal structures, there are no legal features requiring a reinvestment of profit or other economic constraints built into the benefit corporation to ensure the social purpose of the business is maintained').

83 *See* B Interdependent, 'About', https://www.binterdependent.org/#About. Australia and New Zealand appear to be exceptions to B Lab's typical for-profit only approach. *See* B Lab Australia and Aotearoa New Zealand, 'What organisations are eligible?', https://bcorporation.com.au/become-bcorp/guide/eligibility/ ('In Australia, not-for-profits can apply for certification if they have a Company Limited by Guarantee legal form, and do not have deductible gift recipient (DGR) status. In New Zealand, companies with charitable status must get their income from business activity – not donations – and intend to maintain this business model'); *see also* Social Enterprises in Australia, p. 74.

84 *See* B Lab, 'The Legal Requirement for Certified B Corporations', https://www.bcorporation.net/en-us/about-b-corps/legal-requirements; Sistema B, 'Certifying as a B Corporation', https://www.sistemab.org/en/b-certification/.

85 Sistema B, *supra* note 84.

of B Corp certification introduces a non-constrained option into many jurisdictions with specialised legal forms or governmental certifications that instead impose at least partial distribution constraints on qualifying social enterprises.

The diversity of approaches to distribution constraints represented in the special reports is extensive, but legislators and certification providers are not the only sources for possible regimes. Scholars have also developed alternatives. In earlier work, we proposed a new US 'mission-protected hybrid' (MPH) form that envisioned a partial distribution constraint, with the locked-in portion drawing down over time.[86] If dissolution occurred in the same year as formation, 60% of an MPH's assets would need to be donated to a charitable entity, but over 10 years this percentage would decrease, bottoming out at just 10%. At formation, each MPH would identify a charitable recipient that would also be empowered to challenge distributions that would not comply with the partial constraint. Writing about the low-profit limited liability company, J. Haskell Murray and Edward Hwang proposed partial distribution constraints based on investor intentions.[87] Their reform would require invested funds 'contributed mainly due to the charitable purpose' of an L3C to 'be retained in the social stream.'[88] Non-profit entities' contributions could simply be returned to them, while those invested by individuals or for-profit firms would have to be donated to a non-profit or another L3C with similar purposes. Only the creativity of specialised legal form or certification drafters limits the possible variations on distribution constraints available for adoption.

4. IDENTIFYING SOCIAL ENTERPRISES

A distribution constraint is one way that social enterprises can signal their commitment to generating public benefits to earn the trust of capital providers, employees, consumers, regulators and the public, but hardly the only one. Social enterprises can tout purposes to serve stakeholders such as employees, vulnerable populations or the environment, or attest to a track record of programmes displaying good workplace practices or environmental stewardship. They can adopt governance features that allow relevant constituencies to influence the entity's decision-making or make transparency commitments allowing them to track entities' progress toward their social goals.

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86 Brakman Reiser and Dean, *supra* note 2, at 47–50.

87 *See* J.H. Murray and E. Hwang, 'Purpose with Profit: Governance, Enforcement, Capital-Raising and Capital-Locking in Low Profit Limited Liability Companies' (2011) 66 *U. Miami L. Rev*. 1, 51.

88 *Id.*

Social enterprise founders, managers and stakeholders can embrace these commitments through ordinary governance structures and contractual provisions within existing legal forms and without additional certifications.[89] For example, the UK report describes how some social enterprises using the cooperative form have experimented with community shares, which allow members to withdraw their financial investments, but not transfer their membership to others, and are endowed with governance rights.[90] These features allow capital providers to identify themselves as mission-committed and patient and the cooperatives who use them to embrace democratic governance.

Tandem structures using two or more traditional legal forms linked by contractual and governance mechanisms can also establish strong commitments to pursuing social good. '[H]ybrid double structure[s]' consisting of a non-profit association and for-profit subsidiary work this way in Germany, combining the association's social mission commitments with the operational flexibility and income generation of a connected business firm.[91] Similar structures are likewise in use in Turkey and Australia.[92] Social enterprises combining non-profit and for-profit entities in Ireland sometimes establish the non-profit as parent, other times as subsidiary, depending on the desired roles and activities for each.[93] The New Zealand report describes a social enterprise combining cooperative and corporate forms to attract capital needed to scale its impact.[94] Pursuing bespoke private ordering, whether using a single legal entity or multiple ones, will require considerable resources and effort from all parties involved.

When specialised legal forms or certifications for social enterprise incorporate any – and perhaps even all – of these techniques, they offer a less expensive, off-the-rack alternative.[95] Weaving distribution constraints, purpose or programme

[89] *See* Brakman Reiser and Dean, *supra* note 2, at 77–94, 143–61 (describing ways private ordering can be used to broadcast and enforce mission commitments).

[90] *See* Social Enterprises in the United Kingdom, p. 587.

[91] Social Enterprises in Germany, pp. 258–59.

[92] *See* Social Enterprises in Turkey, p. 542 ('There are examples where an association is established alongside a joint stock company or a limited liability company to meet the need for hybrid purposes'); Social Enterprises in Australia, p. 67 ('some social enterprises use hybrid group structures to capture the benefits of both entity types (for example, having a not-for-profit with the ability to attract charitable donations own shares in a for-profit company that may receive outside investment and pay dividends)').

[93] *See* Social Enterprises in Ireland, pp. 309–10 (reporting, however, that the 'use of group structures is not common among Irish social enterprises' and that '[r]ecent research found only 20% of Irish social enterprises were part of a group of organisations' perhaps in part because of 'a lack of awareness' about the technique and its advantages).

[94] *See* Social Enterprises in New Zealand, pp. 395–97 (describing this 'creative lawyering' solution used by Loomio).

[95] *Cf.* Bohinc and Schwartz, *supra* note 61, at 17–18 (describing the value of specialised legal forms and certifications for social enterprise over 'individually adjust[ing]' traditional corporate law).

requirements, governance, or disclosure obligations into the DNA of a specialised form or certification makes powerful signals of commitment available even to those without the deep pockets necessary for costly legal tailoring. Rather than necessitating that each social enterprise establish its pro-social bona fides, these approaches define membership in a new category upon which potential capital providers, stakeholders and regulators can rely.

In jurisdictions boasting mechanisms to identify social enterprises, the special reports reveal that specialised legal forms and certifications predominate. Legislatures enact new legal forms. Government or private actors construct certifications, which are generally available across a variety of legal forms. A particular jurisdiction may thus far have experimented with only one of these approaches, or many may be on display. The following examples only scratch the surface of the full richness of these experiments; greater detail resides in the special reports in this volume.

4.1. SPECIALISED FORMS

Those jurisdictions that have created specialised legal forms for social enterprise invariably modify existing options. The special reports illustrate myriad ways cooperative or corporate forms can be adjusted to identify social enterprises. The mix of distribution constraints, purpose requirements, and governance or transparency mandates each jurisdiction imposes outlines a category of social enterprise firms easily recognisable to capital providers, other constituencies and regulators.

4.1.1. Cooperative Forms

Cooperatives have a long history of blending business methods and the pursuit of collective good and are described by many of the special reports as a viable organisational form for social enterprise. As entities owned and democratically managed by their employees or other members, who share in the benefits of their production or their profits,[96] cooperatives by their nature adopt a stakeholder orientation. These features also make them well adapted to pursuing work integration and community and economic development objectives. Yet the overlap between traditional cooperatives and social enterprise remains imperfect.

Cooperatives' dedication to the collective interests of their members can be quite narrowly focused, as compared to the broader social purposes

[96] *See* B. Leff, 'The Boundary Between the Not-For-Profit and Business Sectors: Social Enterprise and Hybrid Models' in M. Harding (ed.), *Research Handbook on Not-For-Profit Law*, Edward Elgar, Cheltenham 2018, pp. 171, 182.

characteristic of social enterprise. Coordinating agricultural production for a group of highly successful farmers or providing housing for a small group of well-heeled individuals, for example, are proper collective purposes but may not be viewed as producing social good or public value. Cooperatives' ability to distribute profits and in some jurisdictions even their residual assets to members will also sit uneasily with visions of social enterprise founded on at least partial distribution constraints.

Here, as so often in the social enterprise context, definitions are critical and contested. The special non-national report on defining social enterprise prepared by Benedict Sheehy and Juan Diaz-Granados reviews numerous efforts by academics and policymakers to define the space, yet a single definition remains elusive.[97] Their proposal, to 'define the social enterprise as a *for-profit organisation* that provides some *non-market* distribution with a defined *social purpose*',[98] would capture some but not all traditional cooperatives.

In response, many jurisdictions have developed variations of their cooperative forms to identify a category of entities conforming to their visions of social enterprise or the social economy. Italy pioneered a social cooperative form with legislation in 1991.[99] Italian social cooperatives retain cooperative governance structures managed by members, but must either pursue general community interests or engage in work integration for disadvantaged persons and are subject to distribution constraints.[100] Though sometimes using different names, Croatia, the Czech Republic, France,[101] Greece, Hungary,[102] Poland,[103] Portugal and Spain have all since developed specialised cooperative variants,[104] and efforts to establish a social cooperative form are underway in Turkey.[105]

Each maintains the cooperative form's commitment to democratic governance by members but adds social purpose requirements, constraints on distribution, or both. In Hungary, as noted above, all cooperatives are subject to partial distribution constraints, but social cooperatives are restricted to activities related to work integration for disadvantaged persons.[106] Governance requirements also

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97 *See* Sheehy and Diaz-Granados, Social Enterprise: A Legal Definition of the Term, pp. 636–38.
98 *Id.* at p. 646 (emphasis in original).
99 *See* Social Enterprises in Italy, p. 329 and n. 11; (citing Law no. 381 of 1991).
100 *See* Fici, Social Enterprise in EU Law and Policies, pp. 657–60.
101 *See* Les entreprises sociales en France, pp. 238, 242, 247. France has not developed new cooperative forms per se, but instead uses some traditional legal techniques of the cooperative sector in the field of social enterprises.
102 *See* Social Enterprises in Hungary, pp. 290–91.
103 *See* Social Enterprises in Poland, p. 448.
104 *See* Fici, Social Enterprise in EU Law and Policies, pp. 657–58 (providing this list of EU nations).
105 *See* Social Enterprises in Turkey, p. 547.
106 *See* Social Enterprises in Hungary, pp. 290–91.

apply; all members must be natural persons, except that one member must be a charitable or governmental organisation. Hungarian social cooperatives may also qualify for public benefit status and its attendant tax benefits, but only if they impose a complete asset lock and meet other qualifications. Poland's social cooperative form likewise imposes significant constraints on distribution[107] and is restricted to firms that 'run a business … not so much to make a profit, but instead to socially reintegrate the members and employees of the cooperative or facilitate their employment.'[108]

4.1.2. Corporate Forms

Both jurisdictions in which cooperative forms have been successfully deployed by social enterprises and those without such options have experimented with modifying corporate entities to create specialised legal forms for social enterprise.[109] Again, each adaptation involves adding some mix of distribution constraints, purpose or programme requirements, governance norms, or transparency mandates to a standard incorporated legal form. Choices about which of these levers to employ and how to do so vary widely.

The United Kingdom's CIC takes an across-the-board approach. In addition to the comprehensive (for companies limited by guarantee) or partial (for companies limited by shares) distribution constraint described above, access to the CIC form turns on a 'community interest test' to ensure appropriate organisational purposes.[110] Adopting entities must operate such that 'a reasonable person would consider them to provide benefit to the community.'[111] CICs must also file annual reports detailing their financial and programme activities and efforts to engage stakeholders.[112]

Other specialised corporate forms make only a subset of these adjustments. Delaware public benefit corporations, benefit corporations in the various US jurisdictions where they have been created, and benefit companies in Canada's British Columbia province rely on a mix of broad purpose, governance and disclosure criteria while rejecting distribution constraints.[113] For example,

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107 *See* Social Enterprises in Poland, p. 448.

108 *Id.* at p. 7.

109 *See, e.g.*, Social Enterprises in Chile, pp. 139–40, 149–51 (describing the successful use of the cooperative form to nurture local social enterprise and legislative efforts to create a version of the Collective Benefit and Interest Company (BIC)).

110 Social Enterprises in the United Kingdom, pp. 585–86.

111 *Id.* at p. 6.

112 *See id.* at pp. 585–86, 601.

113 *See* Social Enterprises in the United States, pp. 613–14, 624–25; Liao, B Corporation, Benefit Corporation and Neoliberal Greenwash, pp. 680–82 (describing British Columbia law); *see also* Model Benefit Corporation Act, https://drive.google.com/file/d/1QyMrBS9_6fC9guMYotZ5DElsTxuD16K9/view; Delaware General Corporation Law §§361–68; British Columbia Business Corporations Act, SBC 2002, c. 57.

the purpose requirement for Delaware public benefit corporations mandates they are

> intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner … and shall be managed in a manner that balances the stockholders' pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit or public benefits identified in its certificate of incorporation.[114]

Governance changes worked by these forms impact director duties and shareholder votes. Benefit corporation and benefit company directors are required to 'consider' the interests of stakeholders as they conduct their duties[115] and Delaware PBC directors must observe a balancing imperative aligned to their tripartite purpose mandate, although the potential for monetary liability for failures to do so seems extremely small.[116] In addition to traditional requirements that shareholders approve amendments to corporate charters, benefit corporation and benefit company shareholders must approve any fundamental changes that would remove their social missions, often by a supermajority.[117]

The transparency obligations imposed on US benefit corporations, Delaware PBCs and benefit companies in British Columbia all require issuing regular reports to shareholders self-assessing their progress toward their social goals.[118] In the case of British Columbia benefit companies and US benefit corporations, these assessments must be available to the public and be keyed to a third-party standard.[119] Delaware's PBC requires disclosure only to shareholders, and only every two years.[120]

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114 Delaware General Corporation Law §362(a).

115 Model Benefit Corporation Act §301(a), https://drive.google.com/file/d/1QyMrBS9_6fC9guMYotZ5DElsTxuD16K9/view.

116 *See* Delaware General Corporation Law §§365(a) (detailing director fiduciary duties); 365(c) (providing that 'no failure to satisfy that balancing requirement shall … constitute an act or omission not in good faith, or a breach of the duty of loyalty, unless the certificate of incorporation so provides' and leaving potential claims to violations of care subject to the business judgement rule's insulation); *see also* Model Benefit Corporation Act §301(c), https://drive.google.com/file/d/1QyMrBS9_6fC9guMYotZ5DElsTxuD16K9/view (eliminating liability for money damages for failures to consider stakeholder interests or produce general public benefit).

117 *See* Model Benefit Corporation Act §§102 (defining minimum status vote as a two-thirds majority of shareholders and requiring a minimum status vote to adopt or remove benefit corporation form through article amendment or other fundamental transaction); *see also* British Columbia Business Corporations Act, SBC 2002, c. 57, §51.995.

118 *See* Model Benefit Corporation Act §§401–02; Delaware General Corporation Law §§366; British Columbia Business Corporations Act, SBC 2002, c. 57, §51.994(2).

119 *See* Model Benefit Corporation Act §401(2); British Columbia Business Corporations Act, SBC 2002, c. 57, §51.994(2).

120 *See* Delaware General Corporation Law §366(b).

The GmbH-gebV proposal modifies Germany's GmbH corporate form using a different set of indicators to identify trustworthy entities. As noted earlier, it imposes a comprehensive distribution constraint, but bolsters this feature only with governance and transparency obligations. The new form would come with reporting requirements and would confer rights on a third-party institution with a mission to support steward ownership to seek dissolution of each adopting firm if its distribution constraints were seriously violated.[121] The proposal forgoes, however, any programme or purpose requirements, a choice which has been the subject of criticism.[122] Competing proposals in Taiwan take opposite positions on the appropriate criteria to identify social enterprises. A proposal for a 'benefit company' form would impose requirements for adopting entities to specify their 'social purposes'; a draft proposal for 'public interest companies' would instead rely on a partial distribution constraint buttressed by governance and transparency mandates.[123]

Commentators have advocated for improving specialised corporate forms' governance and transparency mandates to identify social enterprises more effectively, especially in the United States. Work by John Tyler, Evan Absher, Kathleen Garman and Anthony Luppino, as well as our own MPH proposal, calls for reconceptualising social enterprise fiduciary duties to require prioritisation of social mission over profit.[124] Emily Aguirre advocates both stakeholder board representation and socially conscious executive compensation requirements for Delaware 'PBCs that go public, are acquired, or exceed a certain size.'[125] Although not a direct recommendation to change social enterprise forms, Brett McDonnell has argued for encouraging stakeholder empowerment in social enterprise governance through tax and other incentives.[126]

On the transparency front, Haskell Murray identified the need for benefit reporting requirements to be bolstered by more specificity and penalties for non-compliance, points upon which other scholars have expanded.[127] Emily Winston

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121 *See* Sanders, *supra* note 60, at 640–53 (providing a detailed description of the German proposal and the process of its development); *see also* Social Enterprises in Germany, pp. 268–73 (describing and critiquing proposed supervisory structures for the new form).

122 *See* Social Enterprises in Germany, p. 273. Commentators have also raised questions about the adequacy of the governance provisions to ensure against mission drift. *Id.* at pp. 270–72.

123 Social Enterprises in Taiwan, pp. 529–30.

124 *See* J. Tyler, E. Absher, K. Garman and A. Luppino, 'Producing Better Mileage: Advancing the Design and Usefulness of Hybrid Vehicles for Social Business Ventures' (2015) 33 *Quinnipiac L. Rev*. 235, 289–91; Brakman Reiser and Dean, *supra* note 2, at pp. 32–33.

125 E. Aguirre, 'Beyond Profit' (2021) 54 *U.C. Davis L. Rev*. 2077, 2116–29.

126 *See* B.H. McDonnell, 'From Duty and Disclosure to Power and Participation in Social Enterprise' (2018) 70 *Ala. L. Rev*. 77, 118–24.

127 *See* J.H. Murray, 'An Early Report on Benefit Reports' (2015) 118 *W. Va. L. Rev*. 25, 47–51; *see also* B.J. Horton, 'Rising to Their Full Potential: How a Uniform Disclosure Regime Will Empower Benefit Corporations' (2019) 9 *Harv. Bus. L. Rev*. 101, 133–40 (proposing a uniform federal disclosure process for benefit corporations); M. Verheyden, 'Public Reporting by

further recommends greater beneficiary participation in benefit reporting.[128] These and other academic proposals to strengthen social enterprise forms' ability to effectively identify social enterprises show the plethora of options for experimentation even beyond those revealed by the special reports herein.

4.2. CERTIFICATIONS

Certification, whether conducted under governmental auspices or through private providers, can also identify social enterprises as meaningfully distinct. The special reports reveal numerous and varied social enterprise certifications. Again, these efforts frequently use distribution constraints, governance norms and disclosure obligations to identify trustworthy institutions. Programme or purpose mandates are ubiquitous but varied, combining with these other elements in myriad ways across jurisdictions.

4.2.1. Multifaceted and Varying Eligibility Requirements

Denmark allows entities taking a broad range of for-profit and non-profit legal forms to qualify for its RSV status.[129] In addition to a partial distribution constraint and disclosure obligations, it relies on a tripartite purpose mandate to define social enterprises as meaningfully different from traditional businesses, non-profits and government entities. Qualifying entities 'must have a social purpose', 'must be commercially operated' and 'must be independent from the public sector.'[130] RSV status does not require the use of specific governance structures, but certified entities must involve their stakeholders in governance and report on their efforts to do so in their mandatory annual reporting.[131]

Italy offers a nested set of three relevant classifications. Firms adopting the specialised social cooperative form qualify as 'social enterprises' per se. Non-profit and for-profit firms that impose a partial distribution constraint can also qualify as social enterprises, provided they engage in business activities in service of 'civic, solidarity and social benefit purposes, adopting responsible and transparent management methods and favouring the widest involvement of workers, users and other stakeholders in their activities', and issue social

Benefit Corporations: Importance, Compliance, and Recommendations' (2018) 14 *Hastings Bus. L.J.* 37, 86–94 (advocating various reforms to benefit corporation and PBC disclosure regimes based on a four-state study of compliance).

128 *See* E. Winston, 'Benefit Corporations and the Separation of Benefit and Control' (2018) 39 *Cardozo L. Rev*. 1783, 1834–42.

129 *See* Social Enterprises in Denmark, pp. 205–08.

130 *Id*. at p. 214.

131 *See id*. at p. 215.

reports.[132] Governance requirements vary by the type and size of organisation, but all social enterprises must appoint a supervisory board and the largest ones must empower stakeholders to elect one of its members.[133] Entities that qualify as social enterprises, along with distribution constrained mutual aid societies and non-profit associations and foundations, can also qualify for ETS status provided they pursue 'activities of general interest.'[134]

Other certification systems focus on organisational purpose by adding requirements that firms serve specific stakeholders or beneficiaries to be eligible. Romania's 'social enterprise' status imposes a maximum wage ratio between workers of 1:8 along with its social purpose and reinvestment mandates and lock on residual assets.[135] 'Insertion social enterprises' must meet these requirements and

> at least 30% of the personnel employed or cooperating members [must] belong to the vulnerable group (individuals or families at risk of losing their capacity to satisfy their daily living needs) or the cumulative working time of these employees represents at least 30% of the total working time of all employees.[136]

Kazakhstan's 'subjects of social entrepreneurship' too must support 'socially vulnerable people' either through employment, sale of goods or services they produce, or work integration efforts.[137] Work integration social enterprises were some of the earliest recognised examples of social enterprise activity, especially in European nations. Some continue to recognise only social enterprises with these narrow purposes, but more have now moved to an expansive approach.[138]

Each of China's four social enterprise certification systems call for applicants to operate independently and to articulate specific and measurable social goals, without constraining distribution or prescribing governance or disclosure. While the types of entities to which each certification is available differs,[139] the Shenzhen approach is illustrative. It requires:

1. The applicant shall be an independent for-profit or non-profit entity that has been lawfully registered in China for one year or more, has three or more FTE (full-time equivalent) employees, and has a formal and complete accounting mechanism.

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132 Social Enterprises in Italy, p. 336 (quoting Article 1 Legislative Decree 112/2017).

133 *See* A. Fici, 'The New Italian Code of the Third Sector: Essence and Principles of a Historic Legislative Reform' in A. Fici (ed.), *The Law of Third Sector Organizations in Europe: Foundations, Trends and Prospects*, forthcoming Springer 2023, p. 19.

134 Social Enterprises in Italy, p. 330.

135 Social Enterprises in Romania, p. 463.

136 *Id.* at p. 464.

137 Social Enterprises in Kazakhstan, p. 371.

138 *See* Fici, Social Enterprise in EU Law and Policies, p. 658.

139 *See* Social Enterprises in China, p. 174 tbl. 4 (reporting the Chengdu certification is available only to companies, Shunde's to companies and other for-profits, and the Shenzhen and Beijing certifications to non-profit and for-profit entities).

2. The applicant shall primarily pursue social goals of solving societal problems, improving social governance, serving vulnerable communities and communities with special needs, promoting community interests, or protecting the environment. It shall also establish mechanisms to ensure the focus on the social goals (to avoid mission drift).
3. The applicant shall innovatively solve social problems through market measures.
4. Its social impact and economic outcomes shall be clearly identifiable and measurable.[140]

Notably, most of the Chinese certifications pair with rating systems. Beyond their limited certification requirements, applicants' answers to questions regarding governance, distribution constraints for for-profits and organisational results will impact their ratings.[141] As local certifications designed to enhance their local markets, the Shunde and Beijing certifications also require qualifying companies to do business in the relevant municipalities.[142]

Both non-profit and for-profit entities in many jurisdictions can also qualify for private certifications based on purpose requirements combined with distribution constraints and periodic review by the certifying body.[143] SEM recipients in the UK and elsewhere must be reassessed annually to ensure they remain 'primarily dedicated to social objectives', 'earn at least 50% of income from trading', and maintain a partial profit and complete asset lock.[144] Their periodic social impact statements are posted online, and to receive a higher level of distinction, the Social Enterprise Gold Mark, additional governance and transparency requirements also apply.[145] Australia's Social Traders reassesses firms' compliance with its twin purpose requirements – its certified social enterprises must have a 'primary social, cultural or environmental purpose consistent with a public or community

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140 *Id*. at p. 173.

141 *See id.*

142 *See id*. at p. 174 tbl. 4.

143 *See* Social Traders, *Social Enterprise Certification: Guidance Notes and Standards*, *supra* note 69, at 3 ('trading for less than two years will undergo recertification each year, and every three years for those established for two years or more'); Social Enterprise Mark CIC, *Eligibility Criteria*, *supra* note 72; *see also* Social Enterprises in Australia, p. 58 n. 4; Social Enterprises in Ireland, p. 318 (noting a programme in which SEM CIC partnered with Social Impact Ireland to certify Irish social enterprises); Social Enterprises in the United Kingdom, pp. 591–92.

144 Social Enterprise Mark CIC, *Our Social Enterprise Accreditation Framework*, https://www.socialenterprisemark.org.uk/social-enterprise-mark-cic-accreditation-portfolio/#toggle-id-1.

145 Social Enterprise Mark CIC, *Eligibility Criteria*, *supra* note 72; Social Enterprise Mark CIC, *Our Social Enterprise Accreditation Framework*, *supra* note 144.

benefit' and '[d]erive[] a substantial portion of its income from trade' – and its reinvestment mandate every three years.[146] New Zealand's private Ākina impact supplier certification relies on evidence of 'positive social, cultural or environmental impact', trading with other businesses or governments as a key component of organisational income, and an organisational commitment to 'use profits and resources to grow [the] organisation's impact so that public benefit outweighs private gains.'[147]

4.2.2. B Lab Certification

The eligibility requirements for B Lab's private B Corp certification take the view that proper purposes, together with governance and transparency, will suffice to 'make business a force for good.'[148] B Lab's purpose requirements centre around its B Impact Assessment; Certified B Corps '[d]emonstrate high social and environmental performance', by achieving a score of 80 out of 200.[149] This online tool measures an applicant's worker policies, community engagement, environmental impact and customer relations, as well as its governance practices.[150] Usually open only to for-profit entities, as noted above, B Corp certification generally imposes no distribution constraints.

B Corp certified firms must, however, also legally commit to B Lab's vision of stakeholder governance. They may do so by adopting a benefit corporation (or benefit company) form, if one exists in their jurisdiction.[151] If not, B Lab works with applicants to adapt their organic documents to commit to combined social and profit-making purposes and to require firm leaders to consider impact on stakeholders in making management decisions.[152] As with the benefit corporation form itself, social purpose and stakeholder interests are included, but not prioritised. Certified B Corps may still prioritise shareholder value in particular decisions or even overall.

In addition to purpose and governance, B Corp certification emphasises transparency. As a requirement of B Lab's initial and triennial recertification

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146 Social Traders, *Social Enterprise Certification: Guidance Notes and Standards*, *supra* note 69, at 2.

147 Ākina, 'Impact Certification: Apply Now', https://www.akina.org.nz/social-enterprises/apply-now; *see also* Social Enterprises in New Zealand, p. 406 (describing the Ākina initiative).

148 B Lab, 'Home Page', https://www.bcorporation.net/en-us/ (capitalisation changed); *but see also* Liao, B Corporation, Benefit Corporation and Neoliberal Greenwash, pp. 680–82 (challenging this vision).

149 *See* B Lab, 'About B Corp Certification', https://www.bcorporation.net/en-us/certification.

150 B Lab, 'B Impact Assessment', https://www.bcorporation.net/en-us/programs-and-tools/b-impact-assessment?_ga=2.66584110.1476284050.1660602848–449235193.1660252134.

151 *See* Liao, B Corporation, Benefit Corporation and Neoliberal Greenwash, p. 678 and n. 26.

152 *See* B Lab, *The Legal Requirement for Certified B Corporations*, *supra* note 84.

process,[153] its website publishes information about each certified B Corp's performance assessed against the B Impact standards.[154]

B Lab has been actively involved in the development of legislation enabling the benefit corporation and benefit company legal forms and has been a strong advocate for their adoption in various jurisdictions.[155] These overlapping efforts can generate confusion, especially given the similarity of the B Corp and benefit corporation nomenclature. The two concepts, however, remain distinct. While the benefit corporation is a state-enabled legal form of organisation, B Corp status is a private certification bestowed by B Lab. A firm may hold B Corp certification and not be a benefit corporation, as there are many B Corps operating in jurisdictions without a benefit corporation form on the books. A firm may also be a benefit corporation without being B Corp certified. Although benefit corporations must apply a third-party standard to self-assess their purposes and report their progress, adopting firms need not use the B Impact Assessment to self-evaluate and certainly need not obtain external B Corp certification.

B Lab's advocacy work, its certification operations and its other products have proliferated thanks to a 'global network' of national and regional organisations,[156] many of which feature in the special reports in this volume. For example, the influence of B Lab's Latin American regional organisation Sistema B can be seen in some core elements of Colombia's BIC certification. Only for-profit legal entities can gain the BIC status,[157] which imposes no limitations on distributions, focusing instead on purpose, governance and transparency. Shortly after its initial adoption, however, the Colombian government in 2019 enhanced the BIC's purpose requirements to demand each BIC's 'purpose clause include at least one activity in each of five dimensions (business model, corporate governance, labour practices, environmental practices, and social practices).'[158] BIC directors also, like benefit corporation directors in the US and benefit company directors in Canada, must 'consider the collective benefit and interest' in their decision-making and BICs must issue annual impact reports.[159] Colombia's BIC status, however, adds further governance requirements to

153 *See* B Lab, 'Programs & Tools Overview', https://www.bcorporation.net/en-us/programs-and-tools.

154 *See* B Lab, 'About B Corp Certification', *supra* note 149.

155 *See* Liao, B Corporation, Benefit Corporation and Neoliberal Greenwash, pp. 675–76, 689–90 and n. 15; *see also* B. McDonnell, 'Benefit Corporations and Strategic Action Fields or (The Existential Failing of Delaware)' (2016) 39 *Seattle L. Rev*. 263, 281–82.

156 B Lab, 'Home Page', *supra* note 148 (listing the many national and regional organisations involved in B Lab's 'global network').

157 *See* Social Enterprises in Colombia, p. 181; *see also* Social Enterprises in Brazil, pp. 126–28 (describing the proposal for a 'Benefits Business' status advocated by Sistema B and following its model, currently stalled in government, which would also be open to for-profits only).

158 Social Enterprises in Colombia, p. 192.

159 *Id*. at p. 193.

bolster the certification's power. The required impact report must be approved by shareholders, and '[c]onsumers and anyone who can demonstrate that they have suffered any damage from a BIC' can petition for removal of the certification for compliance failures.[160]

4.2.3. Unique Certification Models

Not every jurisdiction follows the pattern of reliance on programme and purpose requirements to certify social enterprises. Peru's *Sociedad BIC* adopted in 2020 appears poised to rely especially heavily on transparency policed by government. Qualifying companies must adopt a social mission to positively impact social affairs or the environment.[161] To retain certification as a *Sociedad BIC*, however, firms

> must present a strategic plan that guarantees the fulfilment of their social mission. They must also produce and present an annual management report prepared by independent third parties. Both documents must be approved within 60 days by the Ministry of Production of Peru.[162]

Unfortunately, data on the implementation of this transparency-heavy approach, combined with governmental enforcement, are not yet available.

The special national reports also revealed one social enterprise certification limited to firms taking a particular legal form.[163] Although Belgium did experiment with a 'social purpose company' label open to various corporate forms at one time, in 2019 it abandoned this approach in favour of a new federal social enterprise certification available only to cooperatives.[164] In addition to the distribution constraints noted for Belgian cooperatives above, social enterprise certification requires a 'main purpose to "generate, in the general interest, a positive social impact on man, environment or society"'[165] and compliance with

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160 *Id.* at p. 193.

161 *See* Social Enterprises in Peru, p. 422.

162 *Id.* at p. 426.

163 The Australia special national report also discusses Supply Nation, a private certifier operating in Australia, which certifies the indigenous-owned status of entities that were not formed specifically as Aboriginal and Torres Strait Islander (ATSI) corporations under the special ATSI incorporation regime. This certification helps firms qualify for various government set-asides and procurement preferences. If indigenous ownership alone is understood to identify a firm as a social enterprise, this certification should also be viewed as an example of one available only to firms of a specific type. *See* Social Enterprises in Australia, p. 76. The rationale in Australia for treating indigenous status this way relates to the significant social and economic disadvantages that ATSI Australians face as a class and the role of indigenous businesses in assisting these disadvantaged communities.

164 Social Enterprises in Belgium, p. 88.

165 *Id.* at p. 98.

disclosure obligations.[166] In keeping with its application to cooperatives only, limitations on voting power by social enterprise members also apply.[167]

4.3. COMPARING IDENTIFICATION ALTERNATIVES

The mix of specialised legal forms and certifications revealed by the special reports invites a comparison of these alternative methods for identifying social enterprises. Analysing the advantages and disadvantages of each approach offers potential explanations for their development in different jurisdictions. It can also guide policymakers and advocates as they consider future proposals.

4.3.1. Differing Sources and Scope

The most basic difference between specialised forms and certifications for social enterprise lies in who creates them. Only governments can enact legislation creating specialised legal forms to house social enterprises, but the market for certifying social enterprises sweeps beyond public provision. Private parties too can create algorithms that identify organisations that not only boast of a commitment to a social mission, but can be trusted to deliver on those promises.

Governments actively create social enterprise certifications, statuses, designations and labels. National actors dominate the scene, but local governments have also developed social enterprise certifications. All four of China's four certifications originate from local government bodies or non-profits chartered or organised by them,[168] and the UAE's first and only social enterprise certification was developed by the emirate of Abu Dhabi.[169] Belgium's Brussels-Capital Region has also established a social enterprise certification.[170]

In some jurisdictions at some moments, enabling social enterprises to identify themselves will be politically desirable and expedient. Colombia's BIC certification was advocated by President Duque as his political star rose.[171] The CIC form was part of Prime Minister Tony Blair's

> 'third way' politics, committed to integrating market mechanisms and civil society into the British welfare state while withdrawing some direct state provision of public welfare services, which led to both reorganisation of the voluntary sector and extensive reform of public service delivery.[172]

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166 *See id.* at p. 99.
167 *See id.* at p. 97.
168 *See* Social Enterprises in China, pp. 171–72.
169 *See* Social Enterprises in the United Arab Emirates, p. 574.
170 *See* Social Enterprises in Belgium, pp. 83, 99–100.
171 *See* Social Enterprises in Colombia, pp. 191, 194.
172 Social Enterprises in the United Kingdom, p. 578 n. 1.

Under those circumstances, government actors can choose whether a specialised legal form or a certification will best suit their needs. If political conditions appear less auspicious, though, social enterprise certifications can originate with private actors seeking to educate the public about the existence of this sector or to facilitate its expansion.

Legal forms, certifications and both government and private provision can also coexist. In legal systems where multiple mechanisms for identifying social enterprises stand side-by-side, firms and their founders have a choice of visions of social enterprise with which to align themselves. Capital providers, employees, beneficiaries, regulators and the public can also select the identification mechanism that maps to the social enterprise values they wish to support.

The differing sources for social enterprise legal forms and certifications also result in quite different possible scopes of application. Specialised legal forms, along with government-led and some private certifications, apply only within a single jurisdiction. This confined scope allows for designs attuned to particular cultural, political and legal baselines, whether they be national, subnational or supranational. In the United States, for example, Delaware carefully fashioned its public benefit corporation form to coexist within its highly prized corporate law.[173] For private certifiers like Social Traders and Ākina, who seek to facilitate government procurement,[174] the single-jurisdiction approach is also particularly apt. The Shenzhen certification's choice of national application likewise makes sense given 'the national influence of the China Charity Fair', which operates it.[175] Over time, Italy has been able to build out two related social enterprise and ETS certifications that integrate its social cooperative form and together map the country's entire social economy.[176]

The special non-national reports, however, also describe regimes that reach beyond jurisdictional borders. Antonio Fici's report traces the European Union's attempts to spur social enterprise development across its member nations to the 2011 EU 'Social Business Initiative' (SBI), which was '[b]ased on the assumption that social enterprises generate several positive socio-economic effects' and 'contemplated a series of key actions in their favour.'[177] Although the SBI's intended creation and revision of EU-wide forms amenable to social enterprise did not materialise, the definition it provided was adopted as a framework for many Member States' own legislation in the area.[178] Together with EU-sponsored research on the social enterprise sector, the EU definition

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173 *See* Social Enterprises in the United States, p. 608.

174 *See* Social Enterprises in Australia, pp. 73–74; Social Enterprises in New Zealand, p. 406.

175 Social Enterprises in China, p. 172.

176 *See* Social Enterprises in Italy, pp. 329–36.

177 Fici, Social Enterprise in EU Law and Policies, pp. 662–63.

178 *See id.* at pp. 662–67.

proved highly influential in the adoption of certification or 'status-based' models for identifying social enterprises (as opposed to the creation of dedicated legal forms) across its many jurisdictions.[179]

B Lab's 'international network of organisations' today represents the most realised global vision of certification,[180] implemented in part through regional certifying bodies like Sistema B[181] and B Lab Australia and Aotearoa New Zealand.[182] Social Enterprise Mark CIC originally rolled out the SEM to the United Kingdom market,[183] but it has also certified social enterprises in Spain and the United Arab Emirates.[184] In 2020, it partnered with an Irish organisation to launch a pilot programme to expand its operations to Ireland.[185]

4.3.2. Reliance on Existing Legal Architecture

Whatever their source and scope, specialised legal forms for social enterprise trade on the familiarity of existing forms. Organising as a variant of a known legal category like a cooperative, corporation or company provides a ready framework, with only a handful of components to be changed. For example, social cooperatives preserve the democratic governance norms of the cooperative form. This recognisable quality helps potential capital providers, employees, beneficiaries and regulators conceptualise the new entity as only a variation on a familiar theme. Certifications unmoored from pre-existing legal categories present a greater design challenge.

Nevertheless, creating new social enterprises based on existing legal forms does entail risks, as it can reflect negatively on traditional forms. Carol Liao's special non-national report offering a critical perspective argues that British Columbia's benefit company form undermines the stakeholder governance norm applicable to all Canadian companies.[186] US critics have raised analogous concerns that incorporated forms for social enterprise developed there will strengthen the contested shareholder primacy view of traditional corporations.[187]

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179 *Id*. at pp. 667–70.
180 B Lab, 'Our Movement', https://www.bcorporation.net/en-us/movement/about-b-lab.
181 *See* Sistema B, 'Home Page', https://www.sistemab.org/en/welcome/.
182 *See* B Lab Australia and Aotearoa New Zealand, 'About B Lab AANZ', https://bcorporation.com.au/about/.
183 *See* Social Enterprises in the United Kingdom, pp. 591-92.
184 *See* Social Enterprise Mark CIC, 'International Applications', https://www.socialenterprisemark.org.uk/international-applications/.
185 *See* Social Enterprises in Ireland, p. 318.
186 *See* Liao, B Corporation, Benefit Corporation and Neoliberal Greenwash, pp. 680–88.
187 *See, e.g.*, J.P. Fershee, 'The End of Responsible Growth and Governance?: The Risks Posed by Social Enterprise Enabling Statutes and the Demise of Director Primacy' (2017) 19 *Transactions: Tenn. J. Bus. L.* 361, 362–63 (identifying a 'risk that traditional entities will be viewed (by both courts and directors) as pure profit vehicles, eliminating directors' ability to make choices with the public benefit in mind'); M.A. Underberg, 'Benefit Corporations vs. "Regular" Corporations: A Harmful Dichotomy', Harvard Law School Forum on Corporate

Incrementally changing pre-existing legal frameworks can also mean relatively low costs of implementation and enforcement. For example, US states adopting benefit corporation statutes simply add them to the already long list of entities available by filing with the Secretary of State.[188] No further state involvement occurs, unless shareholders invoke the assistance of courts already familiar with handling shareholder derivative suits in traditional corporations.

Some government certifications can also be administered by existing regulatory bodies. Other social enterprise certifications – particularly private ones – will need to develop capacity to assess eligibility and enforce compliance, typically on a recurring basis. B Lab appears to approach its B Impact Assessment with a vision of continuous improvement, and it reassesses individual certified B Corps every three years.[189]

As will be discussed below, jurisdictions vary tremendously in the resources they devote to regulating social enterprises, whether they use specialised forms or certifications to do so. The creation of the UK's CIC Regulator illustrates that new forms need not be slotted into existing enforcement regimes without committing extensive additional resources.[190] This level of resourcing and bespoke enforcement capacity, however, is highly unusual.

4.3.3. Potential for Dynamism

Finally, specialised legal forms and certifications differ in their potential for dynamism. The rules of the road for legal forms can be altered, but change must proceed through the requisite legislative or administrative channels. Changing governmental certifications will often follow similar bureaucratic processes. Adjusting governmentally prescribed identifiers for social enterprise is certainly possible, as experiences in Italy and Belgium illustrate.[191] It will just be infrequent and slow. Stability can be a virtue, but in an emerging field like social enterprise, it will not always be desirable.

Certifications, especially those created by private parties, can be more nimble. Two of China's local certifications made major shifts in their requirements in just a few years.[192] B Lab and SEM CIC offer certifications on

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Governance (13.05.2012) https://corpgov.law.harvard.edu/2012/05/13/benefit-corporations-vs-regular-corporations-a-harmful-dichotomy/ (similar). *But see also* J. MacLeod Heminway, 'Let's Not Give Up on Traditional For-Profit Corporations for Sustainable Social Enterprise' (2018) 86 *UMKC L. Rev*. 779, 799–803 (noting concerns like Fershee's but arguing traditional corporate law need not be detrimentally affected by the rise of specialised social enterprise forms).

[188] *See* Social Enterprises in the United States, pp. 625–26.

[189] *See* B Lab, 'About B Corp Certification', *supra* note 149.

[190] *See* Social Enterprises in the United Kingdom, pp. 585–86.

[191] *See* Social Enterprises in Belgium, p. 88; Social Enterprises in Italy, pp. 330–32.

[192] Social Enterprises in China, pp. 172–74 and tbl. 4 (describing updates made to the Shunde and Shenzhen certifications).

varying terms to companies of different ages, sizes and industries, and which evolve over time.[193]

Of course, not all change will be positive. Certifiers, especially in competitive markets, might opportunistically shift their requirements (or the enforcement of these requirements) to generate more certifications.[194] A larger network of certified entities increases a certification's recognisability and its value, so long as certification does not become so easy as to lose its meaning. Watered-down social enterprise certifications will undermine trust rather than encourage it.

The abundant landscape of specialised legal forms and certifications for social enterprise detailed in the special reports exemplify how jurisdictions are navigating the choice between these alternatives. However accomplished, identifying a class of social enterprises eases the sorting task for capital providers, employees, consumers and regulators who wish to engage with them. It also facilitates targeting incentives toward social enterprise.

5. INCENTIVISING SOCIAL ENTERPRISE

Non-profits offer a helpful baseline against which to consider the incentives governments provide to social enterprise. Non-profits face a profound disadvantage in the marketplace for capital when pitted against conventional for-profit ventures. As detailed above, comprehensive distribution constraints limit the access of those in control of a non-profit to the value it contains. These constraints encourage contributions by persuading potential donors that gifts made to a non-profit will never find their way into the hands of insiders.

Reassured, those that place sufficient value on its mission will offer financial support without additional incentives. Others, preferring to husband their wealth until a more compelling opportunity to benefit the public emerges, will wait. When governments believe distribution constraints to be insufficient to supply adequate capital to non-profits, they take further measures, including offering incentives to potential supporters. Tax breaks for donors, for example, often nudge those on the margins. Such efforts deliver support to non-profits indirectly by eliciting private contributions.

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[193] *See* B Lab, 'Standards Development & Governance', https://www.bcorporation.net/en-us/standards/development-and-governance; Social Enterprise Mark CIC, *Our Social Enterprise Certification Framework*, *supra* note 144.

[194] *See* M.K. Gugerty and A. Prakash, 'Voluntary Regulation of NGOs and Nonprofits: An Introduction to the Club Good Framework' in M.K. Gugerty and A. Prakash (eds), *Voluntary Regulation of NGOs and Nonprofits: An Accountability Club Framework*, Cambridge University Press, New York 2010, pp. 3, 19–23 (describing the challenging design questions for certification bodies selecting the standards to require for certification and the level of their enforcement).

Governments also provide direct subsidies to non-profits. They shield non-profits from tax burdens, and they do much more besides. Offering preferences in government procurement represents just one possibility. Each of these tactics can be seen as a response to non-profits' competitive disadvantage in raising capital. They can also operate to encourage the creation and maintenance of social enterprises more generally.

In truth, any benefit or burden a government can create can be turned into an indirect subsidy. Among the many options available to ensure their access to capital, tax preferences tend to loom largest.[195] Tax benefits for organisations and their donors might seem a second-best approach. In fact, tax policy offers lawmakers clear advantages over more direct support measures. For example, tax breaks eliminate the need for a dedicated bureaucracy for subsidising non-profits.

The special reports point to various ways jurisdictions subsidise non-profits and social enterprises: easing access to bond issuance,[196] loan programmes,[197] social investment,[198] and state aid.[199] It is unsurprising, though, to find that when social enterprises – whether or not organised as non-profits – attract public support they most often do so in the form of tax benefits. Like all mission-driven organisations, a social enterprise will tend to lose a head-to-head contest for private capital with a traditional for-profit venture. Unfortunately, the same will often be true when social enterprises compete against traditional non-profits for public support.

Trust offers one reason social enterprise loses both fights. Just as individuals demand reassurance before contributing to a non-profit or a social enterprise, policymakers need proof that a social enterprise will be as good as its word. For a social enterprise to secure tax breaks and other forms of public support comparable to those provided to non-profits, they must prove themselves worthy. The special reports show how this plays out across the globe.

Swiss law allows for (limited) federal and cantonal tax breaks for any 'legal entities pursuing idealistic purposes and realising low profits' – a benefit which

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[195] *See* H.B. Hansmann, 'The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation' (1981) 91 *Yale L.J.* 54, 72 (arguing income tax exemption 'serves to compensate for difficulties that nonprofits have in raising capital, and that such a capital subsidy can promote efficiency when employed in those industries in which nonprofit firms serve consumers better than their for-profit counterparts').

[196] *See, e.g.*, Social Enterprises in Belgium, pp. 102, 104 (explaining that non-profit social enterprises may be relieved of certain regulatory requirements when issuing bonds); United States Internal Revenue Service, *Tax-Exempt Bonds for 501(c)(3) Charitable Organizations*, https://www.irs.gov/pub/irs-pdf/p4077.pdf (outlining a series of bond-issuing advantages for non-profit entities qualifying as charitable under US tax law).

[197] *See* Social Enterprises in Germany, pp. 254–55.

[198] *See* Social Enterprises in the United Kingdom, pp. 594–96; Social Enterprises in Australia, pp. 78–79.

[199] *See* Social Enterprises in Romania, pp. 473–74.

clearly targets social enterprise.[200] Yet to qualify for those preferences, the legal entity must not only fit within the capacious definition of social enterprise because of its pursuit of idealistic purposes and low profits but must also demonstrate itself to be 'exclusively and irrevocably directed to such purposes.'[201] The proposed public interest company in Taiwan also contemplates a partial tax exemption for qualifying entities.[202] In Singapore, cooperatives are exempt from income tax, but are required to contribute part of their surplus to the cooperative and/or labour movements.[203]

These requirements recall the stag hunt described above. Each hunter will only commit themselves to the hunt once they know their counterpart has done the same. The struggles of the US benefit corporation forms underscore the need for trust between private investors and entrepreneurs.[204] The work of the special rapporteurs reveals that the need for trust between social enterprise and government plays no less an important role than it does with private investors.

Private investors and states differ in profound ways. Trust between governments and social enterprises could be secured by active oversight from regulators over the affairs of social enterprises. Indeed, the next section examines how some jurisdictions have done precisely that.

In the absence of affirmative regulation, the need for trust remains. The Swiss demand that a social enterprise be 'irrevocably' directed towards idealistic purposes and low profits to receive tax breaks shows how it might be achieved.[205] The same tools governments use to help direct private capital towards non-profits can be deployed to solve their own trust problem with social enterprises. Incentivising a social enterprise to make a firm commitment to pursuing its mission can deliver that trust. Distribution constraints offer social enterprises a potent means of making that commitment. Ensuring that a share of an entity's profits, assets or both will never find their way into the hands of those controlling it emboldens lawmakers just as it would private investors. Singapore's insistence that a portion of a cooperative's assets be devoted toward identified social value in order to maintain tax exemption bolsters the government's faith in their commitment in a different way.

For social enterprises organised as charities, comprehensive distribution constraints will apply as a matter of course. In Ireland, for example, social

200 Social Enterprises in Switzerland, pp. 518–19.

201 *Id*. at p. 518.

202 *See* Social Enterprises in Taiwan, p. 533.

203 *See* Social Enterprises in Singapore, p. 495.

204 *See* Brakman Reiser and Dean, *supra* note 2, at 77 (noting that such 'first-generation hybrids neither provide protection for the missions of social enterprises nor solve their capital access problem').

205 Social Enterprises in Switzerland, p. 518. The Taiwanese public interest company proposal's application of a partial distribution constraint to entities seeking to qualify for tax relief provides another example. *See* Social Enterprises in Taiwan, pp. 530, 533.

enterprises can be granted a charitable tax exemption by the Revenue Commissioners.[206] For such ventures, distribution constraints serve to reassure any sceptical policymakers. Bans on asset and profit distribution offer no guarantee that public resources delivered to a social enterprise will generate public benefits, but they do ensure that they will not line the pockets of insiders.

Distribution constraints serve as an imperfect – but potent – guarantee of good faith both private and public actors find compelling. Of course, qualifying as a charity entails much more in terms of oversight than locking in midstream profits and residual assets. So, it may mean less than it appears that Denmark,[207] Germany,[208] Peru,[209] the United Kingdom[210] and Japan[211] all make tax benefits available to social enterprises that manage to qualify as such.

In some jurisdictions, the link between distribution constraints and tax benefits stands out more distinctly. In Hungary, ventures achieving public benefit status qualify for tax benefits without achieving charitable status. To reassure lawmakers, public benefit status triggers limits on the ability of ventures to 'distribute the profits achieved in the course of its management'[212] without imposing a full measure of charitable regulation. In exchange for that and other concessions, organisations qualifying for public benefit status become entitled to entity- and contributor-level tax benefits.[213] Those tax benefits come with more strings attached than just a limitation on distributions. An array of requirements specifying everything from the purposes public benefit organisations can pursue to their governance provide policymakers with the confidence to offer incentives to these social enterprises. Even in the absence of active regulation, the reassurance delivered by those interventions unlocks public capital for social enterprises. That public support allows social enterprises to thrive without outcompeting for-profit ventures in capital markets and, no less important, without becoming charities.

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206 *See* Social Enterprises in Ireland, p. 315 ('If an organisation has been granted charitable status by the CRA it can apply to the Revenue Commissioners for charitable tax exemption status').

207 The Denmark report notes that 'tax benefits for certain non-profit charitable organisations' exist but also observes that 'most registered social enterprises will not qualify for these benefits.' Social Enterprises in Denmark, p. 220.

208 Germany offers tax benefits to non-profits, curtailing those benefits for entities that engage in a 'commercial business operation'. Social Enterprises in Germany, p. 262.

209 The Peru rapporteur observes that charities and other entities exempt from taxation enjoy that exemption on income generated through some types of business activity. Social Enterprises in Peru, pp. 423, 431–33.

210 An estimated one in 10 UK social enterprises seeks charitable tax status, thus qualifying for an exemption from corporate taxes and land tax charges. *See* Social Enterprises in the United Kingdom, p. 588.

211 A Japanese organisation that qualifies as an 'approved NPO corporation' receives tax benefits but must satisfy a 'public support test' that few social enterprises can. Social Enterprises in Japan, pp. 354–55.

212 Social Enterprises in Hungary, p. 286.

213 *See id*. at pp. 286–87.

Active regulation can also supplement a partial distribution constraint. In the UK, the dedicated CIC Regulator oversees social enterprises adopting the form. The regulator sets the limit on distributions of profits by those social enterprises not organised as charities, and their residual assets are locked in. Both actively regulated and distribution constrained (if only partially), these social enterprises become indirectly eligible for an investment subsidy. Investors can claim Social Investment Tax Relief for up to 30% of the amount they invest.[214] Further tax benefits including capital gains preferences devote additional public capital to these social enterprises.[215]

Policymakers and private investors may be alike in their need for reassurance about the commitment of social enterprises. But in other respects, they could not be more different. As the CIC Regulator demonstrates, public actors have more tools at their disposal to make a social enterprise trustworthy.

That difference becomes clear where public support for social enterprise comes in the form of procurement preferences. The relationship between an investor and a social enterprise tends to be defined purely by the contract between them. They can embed conditions directly into the investment contract, but not much more.

A government entity could likewise introduce limitations and requirements into a purchase contract. But unlike a private investor, a government's relationship with a social enterprise extends well beyond the narrow confines of a contract. In Romania, for example, public authorities have the power to designate contracts for insertion or integration social enterprises.[216] To be eligible, organisations must satisfy both the certification process applicable to all social enterprises (requiring, among other things, comprehensive distribution constraints) and must also meet additional targets ensuring that they support the inclusion of vulnerable workers.

The granting and policing of those certifications remain separate from the procurement contract. That allows the contracting agency to focus on the contract while a local office of the National Agency for Payments and Social Inspection monitors compliance with those requirements.[217] That sort of bifurcation permits governments to offer a wide range of preferences to social enterprises. Some RSVs in Denmark will qualify for preferences in procurement, though only when they satisfy the requirements of the EU Directive on public procurement, also applicable in other jurisdictions.[218] Colombian BICs benefit

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214 *See* Social Enterprises in the United Kingdom, pp. 596–97.
215 *See* Sapphire, 'Guide to SITR', https://info.sapphirecapitalpartners.co.uk/blog/sustainability-and-social-benefit-through-the-social-investment-tax-relief-sitr.
216 *See* Social Enterprises in Romania, p. 474.
217 *See id*. at p. 464.
218 *See* Social Enterprises in Denmark, pp. 220–21; Social Enterprises in Ireland, pp. 319–20.

from a suite of governmental benefits on the same terms as small and medium-sized enterprises, including special rates for copyright registration, and are also 'preferred over non-BICs with identical scores' in public procurement processes.[219] Social Traders' CSE private certification linked to government procurement constrains distributions as well.

The importance of distribution constraints and other enforcement tools in providing assurances of trustworthiness to unlock government incentives can also be gleaned from the nearly universal absence of such incentives where social enterprises lack such features. Special forms for social enterprise in the United States and Canada and certifications in China differ dramatically, but they are alike in two key respects. None includes distribution constraints or governmental enforcement capacity, and none entitles its holders to tax breaks, procurement preferences or other government benefits. Colombia is a key exception, offering some government benefits to non-asset-locked BICs, though these consist mostly of benefits also available to small and medium-sized businesses more generally and do not include tax incentives.[220]

The assurances of trust that distribution constraints or regulatory oversight can provide have not paved the way for government incentives in every jurisdiction. But while legal forms and certifications lacking these features may help brand social enterprises and encourage others to place their confidence in them, governments are largely unwilling to bear the risk of a stag hunt gone wrong.

6. REGULATING SOCIAL ENTERPRISE

Whenever a government intervenes by offering a specialised form, a certification or an incentive, it subtly shapes the evolution of social enterprise. Policymakers can also act more forcefully. The world offers an array of examples of potential regulators spanning the spectrum from transnational to local. Private certifiers can play a quasi-regulatory role too, of course. Both academic proposals and the German GmbH-gebV form advocate drafting other private players into regulatory roles.[221] Here, however, we focus on regulation of social enterprise by government actors.

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219 Social Enterprises in Colombia, p. 195.

220 *See id.* at pp. 194–95.

221 *See* Brakman Reiser and Dean, *supra* note 2, at 47–50 (describing a role for a designated charity to challenge a social enterprise's compliance with a partial asset lock, incentivised by the opportunity to receive the distribution); Sanders, *supra* note 50, at 649–50 (proposing stewardship institutions be empowered to seek a GMbH-gebV's dissolution for failures to comply with its asset lock).

That regulation can aim to achieve a variety of ends. Foremost among them stands accountability. Just as regulators police the conduct of for-profit and non-profit managers, they can monitor social entrepreneurs.

6.1. OVERSIGHT BY EXISTING REGULATORS

When social enterprises are formed using non-specialised forms and without adopting bespoke certifications, they are regulated by the existing apparatus applicable to the corporate, cooperative or non-profit forms they employ. These systems vary widely, but business regulation tends to be the most hands-off.

Cooperative law relies heavily on democratic governance by members to ensure accountability,[222] though additional government regulation can apply. In Ireland, for example, cooperatives must request listing in the Register of Friendly Societies with the same Company Registration Office that incorporates and registers companies.[223] The United Kingdom's Financial Conduct Authority holds enforcement powers for cooperatives and community benefit societies, which apply in addition to democratic control by members.[224] In Singapore, the Registrar of Co-operative Societies (a department under the Cabinet-level Ministry of Culture, Community and Youth) has extremely wide-ranging powers to regulate practically all aspects of cooperatives.[225]

Non-profit regulators, especially when tasked to protect against misapplication of tax incentives, are even more active. At a minimum, these regulators will manage any non-profit registry in their jurisdictions. Some regulators approach this task ministerially, merely accepting proffered documents, while others assess whether applicants meet non-profit or charitable obligations enshrined in organisational law or tax codes. Japan offers alternative regulatory regimes using either approach. A general incorporated association can be formed simply by presenting itself for registration, without 'authentication, authorisation or approval.'[226] A public interest incorporated association, however, may be formed only after regulators assess compliance with several 'strict criteria' including distribution constraints and trading restrictions, and is subject to continuing oversight.[227] For Japanese non-profit social enterprises seeking to obtain tax benefits, an additional level of approval and regulation applies.[228]

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[222] *See, e.g.*, Social Enterprises in Poland, p. 446 (explaining 'principle of cooperative democracy'); Social Enterprises in Switzerland, p. 512 (describing governance roles of members in Swiss cooperatives).

[223] *See* Social Enterprises in Ireland, p. 311.

[224] *See* Social Enterprises in the United Kingdom, p. 587.

[225] *See* Social Enterprises in Singapore, pp. 490, 497–500.

[226] Social Enterprises in Japan, p. 349.

[227] *See id.* at p. 350.

[228] *See id.* at p. 356.

Securing non-profit or charitable tax incentives will frequently require social enterprises to clear additional hurdles. In Brazil, for example, non-profits seeking tax advantages

> have specific accounting obligations and must draft reports aimed at rendering accounting details especially for tax purposes. In the case of foundations, these reports – which are not publicly available – must be submitted to the State Prosecutors' Office (Ministério Público Estadual) of the state in which they are headquartered.[229]

The Germany report explains that non-profit 'enforcement is undertaken solely by means of tax law',[230] including monitoring and penalising non-compliance with distribution constraints and examining required financial reporting.[231] Many other jurisdictions utilise combined enforcement regimes consisting of both non-profit or charity regulators and tax authorities.[232]

When a legal system makes a specialised form or certification available for social enterprise, it may charge existing regulators like these with ensuring accountability by firms adopting them. For example, several jurisdictions empower extant regulators to gatekeep initial access to special registries into which only qualifying social enterprises should be accepted. In France, businesses companies can obtain entry into the *économie sociale et solidaire* (ESS) registry through an administrative decision of the commercial court.[233] Firms achieving Kazakhstan's subject of social entrepreneurship designation gain registration in a new Register of Subjects of Social Entrepreneurship created and approved by the Minister of National Economy.[234] Colombia outsources maintenance of business entities to private Chambers of Commerce, which are also empowered to review BIC submissions' compliance with the social purpose requirements for Colombian BIC status, and register compliant companies as certified BICs.[235]

Some jurisdictions task existing regulators with additional supervision of social enterprises adopting specialised forms and certifications, beyond policing access to a register. In Belgium, the Federal Public Service of Economy monitors social cooperatives for continuing compliance with the certification's requirements, and can request additional documents and revoke the certification.[236]

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229 Social Enterprises in Brazil, p. 123.
230 Social Enterprises in Germany, p. 260.
231 *See id*. at pp. 260–62.
232 *See, e.g.*, Social Enterprises in China, pp. 167–68; Social Enterprises in Ireland, pp. 315–17; Social Enterprises in Singapore, pp. 500–03; Social Enterprises in the United Kingdom, pp. 588–89; Social Enterprises in the United States, pp. 622–24.
233 *See* Les entreprises sociales en France, p. 234.
234 *See* Social Enterprises in Kazakhstan, p. 381.
235 *See* Social Enterprises in Colombia, pp. 195–96. Chambers of commerce also have been historically responsible for the companies' registrar.
236 Social Enterprises in Belgium, p. 99.

'[T]he employment agencies and territorial agencies of the National Agency for Payments and Social Inspection' ensure Romania's social enterprises and insertion social enterprises comply with the requirements of their special status, combined with a unitary registry maintained at the national level.[237] The Danish Business Authority likewise both reviews the documentation provided by firms seeking to register as RSVs and is empowered to deregister RSVs who fail to maintain compliance with the certification's requirements.[238] It may also fine distributions of RSV profits beyond the statutory limits, even if undertaken after a firm's deregistration. As the Denmark report notes, though, enforcement of this perpetual asset lock will be challenging. '[T]he Business Authority would need to engage in very substantial outreach work to detect violation of these rules' and reports no such action thus far.[239]

6.2. SPECIALIST REGULATORS

Alternatively, social enterprise forms and certifications can usher in new specialist regulators. As noted above, the United Kingdom's CIC form was designed alongside the creation of a new dedicated CIC Regulator. CICs are subject to regulation by Companies House, as are other firms formed as companies,[240] but the CIC Regulator provides an additional layer of oversight. The CIC Regulator manages CIC registration, approves amendments to firms' community interest missions, and is empowered to investigate if an approved CIC's mission is jeopardised.[241] The Regulator also provides population-level supervision, setting dividend limits, maintaining a database of registered CICs, and issuing assistive guidance.[242] Although the CIC Regulator's agenda is sweeping, it 'operates a light-touch regime in terms of the intensity and extent of [its] reviews and investigations, enforcement and sanctioning.'[243]

Italy's nested system contemplates multiple relevant regulators. Social enterprises are registered 'in the special section of the business register'[244] used to register other business firms. This registration, however, also registers the entity in a new Single National Register of the Third Sector (RUNTS), 'an easily searchable computerised registry' of social enterprises and non-profits engaged

[237] Social Enterprises in Romania, p. 464.
[238] Social Enterprises in Denmark, pp. 215–18.
[239] *See id.* at p. 219.
[240] *See* Social Enterprises in the United Kingdom, p. 586.
[241] *See id.* at pp. 585–86.
[242] *See id.* at p. 585; *see also* CIC Regulator, 'About Us', https://www.gov.uk/government/organisations/office-of-the-regulator-of-community-interest-companies/about.
[243] Social Enterprises in the United Kingdom, p. 586.
[244] Social Enterprises in Italy, p. 339.

in civic, solidarity or socially useful purposes and activities that together make up the third sector.[245] Rollout of the RUNTS system is being overseen by the National Council of the Third Sector within the Ministry of Labour and Social Policy,[246] which will also engage in more general oversight and capacity building.

6.3. TRANSPARENCY REGULATION

A more modest intervention might come in the form of ensuring transparency. Regulators need not insist on any substantive outcome to protect investors, customers and the general public. Instead, they could accomplish that critical objective by shedding light on gaps between a social enterprise's statements about its impact and its actual performance.

The special reports reveal jurisdictions with new legal forms and certifications regularly incorporate periodic reporting requirements to build trust in the social enterprises they identify. The United Kingdom's CIC Regulator receives and publishes annual reports detailing CICs' community interest activities, 'asset transfers, dividend payments, directors' remuneration and stakeholder involvement.'[247] RSVs likewise must make an annual report to the Danish Business Authority addressing how they fulfilled their social purpose and cataloguing various transactions that might run afoul of partial distribution constraints.[248] The public can access both CIC and RSV reports, either through government databases or by special request.

Other jurisdictions have more limited visions of transparency. Although many US states' benefit corporation statutes require public posting of annual reports, Delaware public benefit corporations' biennial reports need to be issued only to shareholders and no US jurisdiction envisions continuing government oversight.[249] Romania takes an almost mirror-image approach. Its social enterprises and insertion social enterprises must submit annual activity and social reports only to the government employment agency, though these reports can be accessed by others on request.[250]

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245 Social Enterprises in Italy, p. 337.

246 *See id.* at pp. 340–41; *see also* Press Release, Ministry of Labor and Social Policy, 'Third Sector: The National Council Met in the Presence of Minister Orlando' (29.03.2022) https://www.lavoro.gov.it/stampa-e-media/comunicati/pagine/terzo-settore-riunito-il-consiglio-nazionale-alla-presenza-del-ministro-orlando.aspx/ (describing, inter alia, the progress of the rollout of the RUNTS system).

247 Social Enterprises in the United Kingdom, p. 586.

248 *See* Social Enterprises in Denmark, pp. 217–18.

249 *See* Social Enterprises in the United States, pp. 625, 627.

250 *See* Social Enterprises in Romania, pp. 464–65 (noting this and other employment-specific reporting obligations).

Whether it forms only part or nearly all of the social enterprise regulation agenda, transparency is a touchstone across many jurisdictions. As such, the reliability of social enterprise reporting is especially important. Perhaps the most troubling concern raised by the special rapporteurs is whether required annual reports are actually being produced. Disclosure mandates often proceed without clear penalties and motivated enforcers; they might be easily ignored. The Danish Business Authority conducted a survey of all certified RSVs in 2016 and found 'just under half failed to comply' with the certification's annual reporting requirement.[251] Early empirical data on benefit corporations in the United States also showed disappointing rates of annual reporting compliance under 15%.[252] Colombia's BIC legislation does empower the Superintendence of Companies to revoke the certification for 'reiterated and gross breach' of the disclosure requirements,[253] but most of its certified BICs were required to make their first reports in 2022, so compliance and enforcement rates are still uncertain.

Even when annual reporting is completed, the results it imparts can be difficult to verify or compare. Social impact metrics are highly contested and impacts in different fields of social concern may well be incommensurable.[254] Some disclosure regimes address relevant metrics. For example, firms holding Colombia's BIC certification must report on their social impact using specific independent standards accepted by the Superintendence of Companies.[255] Benefit corporations in various US states and benefit companies in Canada are required to self-report their achievements in relation to a standard developed by an independent third party. These are still self-assessments, though, not outside reviews by independent experts. Reporting mandates also typically envision narrative reports without specified metrics or auditing,[256] further frustrating benchmarking and comparisons.

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251 Social Enterprises in Denmark, p. 218.

252 *See* E. Berrey, 'Social Enterprise Law in Action: Organizational Characteristics of U.S. Benefit Corporations' (2018) 20 *Transactions: Tenn. J. Bus. L.* 21, 85–86 (finding a 6% compliance rate); Murray, *supra* note 127, at 42–47 and tbl. A (finding 8% compliance rate); *cf.* Verheyden, *supra* note 127, at 37, 86–94 (reporting results of four-state study of compliance rates: Delaware (8%), Colorado (11%), Oregon (14%), Minnesota, where the statute unusually penalises non-compliance (100%)).

253 Social Enterprises in Colombia, p. 196 and n. 103 (quoting Law 1901 (2018), Article 7).

254 *See* Brakman Reiser and Dean, *supra* note 2, at 126–31.

255 *See* Social Enterprises in Colombia, p. 193.

256 *See, e.g.*, Social Enterprises in Belgium, p. 99 (social enterprise 'certification requirements do not specifically mandate the auditing of the social enterprise's annual report and special report. Neither do they mandate use of certain standards or metrics; they can be fulfilled through a simple narrative overview'); Social Enterprises in Denmark, p. 218 ('There is no requirement for the report to be audited').

6.4. REGULATION THROUGH FINANCE

A government might exercise even more restraint by focusing only on deregulating financing tools appropriate for social enterprises. Reducing prescriptive regulation or disclosure requirements applicable to capital markets likely to finance social enterprises ensures that regulation will not unduly stifle the creativity and growth of a social enterprise sector. Allowing social enterprises to flourish free of heavy-handed oversight while limiting the potential systemic impact of deregulation could strike an appropriate balance between openness and vigilance.

The best example of this theory of regulatory change pertains to crowdfunding. Many jurisdictions are experimenting with reducing the regulatory hurdles to capital formation for small and medium-sized enterprises. The overlap between crowdfunding and social enterprise is far from perfect, but worth tracking.[257] The New Zealand report identifies a positive impact of crowdfunding initiatives on the social enterprise sector. In a country where the 'equity crowdfunding landscape is over-developed', it also displays 'a significant lean towards social enterprises – about one third of companies that succeed in raising capital are social enterprises.'[258] Romanian social enterprises formed as non-profit associations and foundations have also found crowdfunding to be an 'important form of financing.'[259]

Whether the potential for crowdfunding regulation to boost the social enterprise sector will be realised in other jurisdictions is less clear. In Turkey, the impact thus far is mixed. Although a Turkish autism social enterprise ran a highly successful crowdfunding campaign[260] and a crowdfunding platform specifically for social enterprises has been developed there, '[f]ield research shows that crowdfunding is not very often used as a funding model by social enterprises.'[261] The reports from Australia and the United States also take note of innovative crowdfunding regulation but decline to predict its potential effects.[262]

257 *See* J. MacLeod Heminway, 'Financing Social Enterprise: Is the Crowd the Answer?' in B. Means and J.W. Yockey (eds), *The Cambridge Handbook of Social Enterprise Law*, Cambridge University Press, Cambridge 2018, pp. 196–200 (exploring the '[p]arallels in the [d]evelopment of [s]ocial [e]nterprise and [c]rowdfunding').

258 Social Enterprises in New Zealand, p. 408.

259 Social Enterprises in Romania, p. 475.

260 Social Enterprises in Turkey, p. 550.

261 *Id*. at p. 550 n. 63.

262 *See* Social Enterprises in Australia, pp. 79–80; Social Enterprises in the United States, pp. 614–15; Heminway, *supra* note 257, at 203–08 (assessing the potential for crowdfunding to aid in US social enterprise capital formation); *see also* Brakman Reiser and Dean, *supra* note 2, at 111–22 (noting the concern that trust will remain an obstacle between social entrepreneurs and crowdfund social investors, and offering a proposal for tax law to help them secure each other's trust).

The project of regulating social enterprise is at its earliest stages. While it is difficult to predict its future development, if more jurisdictions design legal forms or certifications to identify social enterprises, and especially if they offer tax or other incentives, some will likely experiment with new regulatory approaches as well. The special reports provide early insights into how they may do so.

7. CONCLUSION

This report and volume were commissioned to answer the question whether social enterprise is 'a new form of the business enterprise?' Social enterprise is certainly an innovative global phenomenon, but grasping its significance requires engagement with an extensive set of business law concepts, from corporations to cooperatives, as well as other important areas of law. Understanding non-profit law is also critical, along with features of tax law and procurement law. This report describes and analyses social enterprise law around the world with this more fulsome agenda at its core.

The spectrum of approaches revealed by the special reports reflect both important differences and notable similarities. Jurisdictions take opposing positions on whether some form of distribution constraint is an essential feature of social enterprise. Some define and understand social enterprise to include at least partial constraints as essential to legitimate their claimed public purposes. Others dispense with these constraints altogether, freeing social enterprises to take on equity investment to scale their social impact. Regardless of their positions on this key issue, analogous efforts to identify social enterprises are taking root around the globe, created by governments at various levels as well as private certification providers. Each social enterprise identifier represents an attempt to signal the trustworthiness of firms adopting it to various constituencies.

Key among these constituencies are governments, who have the power and position to both offer incentives and impose regulation. The special reports provide early support for a link between defining social enterprise to require at least partial constraints on distribution and the availability of incentives. Non-profit social enterprises – nearly universally subject to comprehensive distribution constraints – also have the greatest access to tax and other benefits. Specialised legal forms and government certifications that include distribution constraints are also frequently accompanied by public incentives. Social enterprise identifiers without distribution constraints, at least among the jurisdictions described by the special reports, are not. Regulatory choices sometimes follow a similar pattern.

As the concept of social enterprise – contested as it may be – continues to take hold of the imaginations of entrepreneurs around the globe, legal developments have followed. The shape of these emerging innovations varies widely across jurisdictions. Like all legal evolutions, social enterprise law responds to the broader cultural, political and jurisprudential systems into which it will fit. The resulting tapestry of approaches illuminates the diverse ways business methods can be deployed in service of social good and can inspire future legal developments to promote social enterprise.

PART I

SPECIAL NATIONAL REPORTS

SOCIAL ENTERPRISES IN AUSTRALIA

Victoria Schnure BAUMFIELD*

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The Commonwealth of Australia is a federal system with power split between the Commonwealth government and its eight states and territories (jointly, 'states').[1] This report considers the status of social enterprise within those jurisdictions.

1. WHAT IS A SOCIAL ENTERPRISE?

1.1. DEFINITIONS

While there is no single, legally binding definition of 'social enterprise' in Australia,[2] a prevalent definition derives from the influential *Finding Australia's Social Enterprise Sector 2016: Final Report* (FASES 2016 Report). It requires social enterprises to satisfy four elements:

a) Are led by an economic, social, cultural, or environmental mission consistent with a public or community benefit;
b) Trade to fulfil their mission;
c) Derive a substantial portion of their income from trade; and
d) Reinvest the majority of their profit/surplus in the fulfilment of their mission.[3]

This definition has been endorsed by Social Traders,[4] a prominent Australian social enterprise certifier and procurement intermediary, as well as the three

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[1] These are: the Australian Capital Territory, Queensland, New South Wales, Victoria, Tasmania, South Australia, Western Australia and the Northern Territory.

[2] KPMG, *Social Enterprise in Queensland: Final Report* (Report prepared for Jobs Queensland, September 2019), p. 18.

[3] J. Barraket, C. Mason and B. Blain, *Finding Australia's Social Enterprise Sector 2016: Final Report* (Joint Initiative of Social Traders and the Centre for Social Impact, Swinburne University of Technology, 2016), p. 3.

[4] Social Traders, *Finding Australia's Social Enterprise Sector 2016: Analysis* (2016), p. 5. Social Traders Ltd is a not-for-profit company and registered charity created in 2008 and based in Melbourne, in the Australian state of Victoria. See Australian Securities and Investments Commission Company Register, connectonline.asic.gov.au, searched online 04.08.2022. In a 2017 submission to the Australian Treasury, Social Traders claimed to be 'the only Australian organisation specialised in supporting the social enterprise sector'. See Social Traders, 'Social Impact Investing Discussion Paper, Social Traders' Submission' (24.02.2017) socialtraders.com.au/new/impact-investing-discussion-paper. In its 2021 Annual Information Statement

largest Australian states by population (representing 76% of the population) in their procurement policies.[5]

Simpler definitions describe 'commercially viable businesses driven by making a positive social impact'.[6] A South Australian study took a middle ground, defining social enterprises as 'for-profit or not-for-profit businesses that primarily seek to fulfil a public or community benefit, to provide benefits to members or to support the mission of a non-profit auspice'.[7]

Several aspects of the FASES definition merit comment. Despite the critical role of mission in the FASES definition (element one), mission lock in the business's constitution or other foundational documentation is not required. Furthermore, the fourth element of the FASES definition imposes a moderate non-distribution constraint (setting the threshold at >50%) in order to meet the 'social enterprise' definition. However, only social enterprises operating through not-for-profit corporate forms are subject to binding non-distribution constraints or asset locks. The benefit for social enterprises in complying with the FASES definition requirements is the ability to access benefits, as described later in this report.

1.2. SIZE OF SECTOR AND TYPICAL INDUSTRIES

1.2.1. Traditional Examples of Mission-Oriented Businesses

No particular social enterprise is acknowledged as the oldest, most prominent or largest in Australia. However, Australian community organisations have long used trading entities to support themselves. For example, the surf lifesaving

filed with the Australian Charities and Not-for-profits Commission, Social Traders describes its mission as follows:

> The purpose of the Company is to facilitate the development of a sustainable social enterprise sector that delivers social and economic inclusion. Social Traders is the trailblazer of Social Enterprise Procurement in Australia. We connect Certified Social Enterprises with Business and Government Members. By activating the power of Social Enterprise Procurement, we create positive impact through jobs, community services and support for the most marginalised.

See 'Social Traders Ltd' listing in the Charity Register, Australian Charities and Not-for-profits Commission, acnc.gov.au, searched online 04.08.2022. This listing contains links, in the 'Financials & Documents' tabs, to Social Traders' annual filings going back to 2013. (2013 was the first year for which filing was required, following the ACNC's creation in December 2012.)

5 See section 3.1, referring to New South Wales, Victoria and Queensland.

6 Australian Institute of Company Directors, 'Social Enterprise: Role of the Board' (NFP Director Tools) https://aicd.companydirectors.com.au/-/media/cd2/resources/director-resources/nfp/pdf/05446-7-5-9-nfp-director-tools-social-enterprise_a4_v6.ashx.

7 A. Cebulla, *Stretton Fellowship – The Value of Social Enterprise: Two Case Studies* (2018), p. 5.

clubs that patrol local beaches have for decades supported their missions through bar/restaurants open to the public. Australia also has traditionally had a strong cooperative or mutual ownership sector, spanning areas as diverse as agriculture to financial services, which businesses may potentially qualify as social enterprises.[8]

1.2.2. Demographics

Australian social enterprises operate in every state and territory.[9] Data as to the number, type and size of social enterprises in Australia is fractured, incomplete and not always like-to-like as there is no uniform or global reporting mechanism.

The FASES 2016 Report estimated that at least 20,000 social enterprises existed in Australia in 2016,[10] 'accounting for up to 3% of GDP and employing an estimated 300,000 Australians'.[11] For context, the Australian population then was approximately 24 million people.[12]

In 2021, the Victorian government reported that Victoria had the largest social enterprise sector in Australia, 'with over 3,500 social enterprises employing around 60,000 people and generating $5.2 billion [Australian dollars] to our economy every year.'[13] The Victorian population as of June 2021 was approximately 6,649,200.[14]

A discussion in the 2019 Queensland Social Enterprise Strategy (QSES) illustrates the complexities that can arise in developing accurate data as to the size of the sector. The QSES identified 229 social enterprises, based on a Jobs Queensland-sponsored mapping exercise.[15] (Queensland's 2019 population was

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8 See e.g. A. Cain, 'Governing Social Enterprise' (Company Director, August 2015) http://www.companydirectors.com.au/director-resource-centre/publications/company-director-magazine/2015-back-editions/august/small-business-governing-social-enterprise; Western Australia Social Enterprise Council, 'FAQ' (2020) https://www.wasec.org.au/faq/.

9 J. Barraket, C. Mason and B. Blain, *FASES 2016 Report*, pp. 4, 13.

10 Ibid., p. 3.

11 City of Sydney, *Strengthening Our Social Enterprise Sector: Literature Review and Engagement Report* (January 2020), p. 2.

12 Australian Bureau of Statistics, 'Historical Population Reference Period 2016' (18.04.2019) https://www.abs.gov.au/statistics/people/population/historical-population/latest-release. By 30 June 2021, the Australian population had increased to 25,739,256. See Australian Bureau of Statistics, 'National, State and Territory Population Reference Period June 2021' (16.12.2021) https://www.abs.gov.au/statistics/people/population/national-state-and-territory-population/latest-release.

13 Department of Jobs, Precincts and Regions, *Victorian Social Enterprise Strategy 2021–2025* (State Government of Victoria, October 2021), p. 6.

14 Australian Bureau of Statistics, 'National, State and Territory Population Reference Period June 2021' (16.12.2021).

15 KPMG, *Social Enterprise in Queensland: Final Report* (2019). See generally Jobs Queensland, 'Social Enterprise Project' (Queensland Government, Department of Employment, Small Business and Training, 03.06.2021) https://jobsqueensland.qld.gov.au/projects/social-enterprise/.

approximately 4.9 million.)[16] However, the Queensland mapping undertaken by KPMG used a narrower definition of 'social enterprise' than the Victorian figures cited above.[17] KPMG contrasted its treatment of several classes of organisation with Victoria's classifications. In particular, the Victorian figures included entities that receive significant direct or indirect government funding, including childcare centres, aged care providers, private schools and universities, private hospitals, and community recreation organisations such as the YMCA and Scouting groups.[18] KPMG considered that these entities might not qualify as true social enterprises even if they self-identify as such because many of them 'receive more than 50% of their revenue from the Australian Government' even where they technically earn revenue from trade.[19]

KPMG also excluded entities that technically meet the FASES definition, including childcare, aged care, schools and medical clinics, where they were not established to function as social enterprises.[20] KPMG's narrower approach even excluded entities like Goodstart Early Learning, a Certified B Corporation (B Corp) under US non-profit B Lab's scheme, that operates not-for-profit daycare centres, which KPMG specifically acknowledged self-identifies as a social enterprise.[21] Goodstart's problem, like daycare generally in Australia, is that almost all families in Australia receive government subsidies towards their daycare fees – in many cases quite generous subsidies of well over 50%. Although its rationale is not explained clearly, KPMG appears to have excluded daycares because even though their income comes from trade, the real payer of a large proportion of the fees is the Commonwealth government. KPMG here seems to be eliding the distinction between earned income and charitable donations – a choice that seems open to challenge.

More problematically, KPMG excluded 'corporations' on the grounds that corporations (i) seek profits for shareholders, while social enterprises under its definition must reinvest at least 50% of profits into the business;[22] and (ii) are not created to act as social enterprises, even though many now pursue socially responsible agendas.[23] Even if KPMG only excluded for-profit corporations, which is unclear, this choice is problematic because many social enterprises are organised as for-profit businesses.[24] For example, KPMG's choice inevitably

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[16] KPMG, *Social Enterprise in Queensland: Final Report* (2019), p. 177.
[17] Ibid., p. 22.
[18] Ibid.
[19] Ibid., p. 21.
[20] Ibid., pp. 21–23.
[21] Ibid., p. 21. B Corps are discussed in greater detail later in this section and in section 3.2.
[22] Interestingly, the FASES 2016 Report reported that approximately 5% of social enterprises surveyed reinvested less than 50% of their surplus/profit in fulfilment of their mission. The vast majority (81%) reported reinvesting all profits/surplus: ibid.
[23] Ibid., p. 23.
[24] See section 2.2.

excluded many B Corps. This choice also ignores that fact that larger not-for-profit organisations in Australia are organised as public companies.[25]

As a result, KPMG likely underestimated the number of social enterprises in Queensland. The QSES claims that under the broader Victorian approach, Queensland likely has 3,590 social enterprises.[26] This figure, however, is likely overinflated for the same reasons as the Victorian data. The true number of social enterprises is likely somewhere in the middle.

1.2.3. Industries of Operation

Australian social enterprises span a wide variety of industry sectors and serve a variety of missions.[27] The FASES 2016 Report identified retail trading (24.5%) and health and social assistance (22.2%) as the largest sectors. In total, 68% of the sample operated in the service economy. Besides health and social assistance, other service categories, in order of size, included accommodation, cafes and restaurants; education; property and business services; cultural and recreation services; personal and other services; communication services; transport and storage; finance and insurance; construction; and electricity, gas and water supply.

A 2020 survey produced similar results: the top two industries for social enterprises were health and social assistance (28%) and retail trade (25%).[28] The remaining categories, in order, were: cultural and recreation services (24%); education (17%); property and business services (14%); accommodation, cafes and restaurants (13%); personal and other services (13%); manufacturing (8%); wholesale trade (7%); communication services (7%); transport and storage (7%); agriculture, forestry and fishing (6%); finance and insurance (4%); construction (2%); mining (2%); electricity, gas and water supply (1%); and government administration and defence (1%).[29]

1.2.4. Missions and Beneficiaries

Many social enterprises exist to train and employ individuals who have faced barriers to employment such as homelessness, disability, race/indigenous status

[25] See section 2.
[26] Department of Employment, Small Business and Training, *Queensland Social Enterprise Strategy* (Queensland Government, 10.06.2021) https://desbt.qld.gov.au/small-business/strategic-documents/social-enterprise-strategy, p. 5. Note that if this figure is correct, then Queensland has a larger social enterprise sector than Victoria.
[27] J. Barraket, C. Mason and B. Blain, *FASES 2016 Report*, p. 4.
[28] Centre for Social Impact, *Pulse of the For-Purpose Sector: Social Enterprise* (November 2020), p. 3.
[29] Ibid.

or lack of education (these entities are sometimes known as WISEs – Work Integration Social Enterprises).[30] A 2019 study reported that over one-third of social enterprises in Australia 'have employment-based support or employment creation as their main focus'.[31] Illustrating this, in 2021, the Victorian government noted that of the 60,000 jobs created by its social enterprise sector, 12,000 went to people with disabilities, 4,000 went to long-term unemployed people, and 985 went to Aboriginal Australians.[32]

Other commonly cited missions in the FASES 2016 Report (each listed by over 20% of respondents) included: 'create opportunities for people to participate in their community'; 'provide needed goods or services to a specific group'; 'provide training opportunities for people from a specific group'; and 'generate income to reinvest in charitable services or community'.[33] The most commonly cited beneficiaries of social enterprises' activities were, in descending order: people with disabilities; young people; disadvantaged women; unemployed people; people with mental illness; disadvantaged men; and a particular geographic community. Less commonly cited beneficiaries included migrants, refugees or asylum seekers; Aboriginal and Torres Strait Islander people; people with substance use issues; older people; families; the environment; homeless people; and remote or rural communities.[34]

1.2.5. What about B Corps?

There appears to be something of a dichotomy, at least at the institutional level, between the Social Traders-led ecosystem (keeping in mind Social Traders' outsized role in the Australian social enterprise space, including both its partnerships with various state governments and its sponsorship of key standard-setting reports such as the FASES 2016 Report) and the B Lab/B Corp ecosystem. Significant studies, like the FASES 2016 Report, say nothing about B Corps. B Corps also might not self-identify as social enterprises even where they meet the FASES definition.[35]

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30 See e.g. Department of Employment, Small Business and Training, *Queensland Social Enterprise Strategy* (Queensland Government, 10.06.2021), pp. 7–10, 14; Department of Jobs, Precincts and Regions, *Victorian Social Enterprise Strategy 2021–2025* (State Government of Victoria, October 2021), p. 20.

31 J. Barraket, J. Qian and E. Riseley, *Social Enterprise: A People-Centred Approach to Employment Services* (Report for Westpac Foundation Australia: Westpac Foundation and the Centre for Social Impact Swinburne University of Technology, 2019).

32 Department of Jobs, Precincts and Regions, *Victorian Social Enterprise Strategy 2021–2025* (State Government of Victoria, October 2021), p. 12.

33 J. Barraket, C. Mason and B. Blain, *FASES 2016 Report*, p. 19.

34 Ibid., p. 20.

35 E.I. Castellas et al., *Map for Impact: The Victorian Social Enterprise Mapping Project* (Centre for Social Impact Swinburne, 2017), p. 15.

Nevertheless, B Lab currently lists 366 Australian B Corps in its global B Corp directory, the fourth-highest number after the United States, the UK and Canada.[36] An empirical analysis of Australian B Corps found that 'the sectors with the most B Corps are: Financial Services, Marketing & Communication Services, IT Software & Services/Web Design, and Food & Beverage (in descending order).'[37]

Not all B Corps meet the prevailing Australian 'social enterprise' definition, for example because they do not reinvest the majority of their profits. That limits the comparability of this data to the statistical data presented earlier.

1.2.6. Entity Size

Entity size estimates are consistent across the available sources. Most enterprises in the FASES 2016 Report (73%) were small, 23% were medium sized, and only 4% were large.[38] In a 2020 survey, 47% of social enterprises studied were micro businesses (0–4 employees); 29% were small (5–19 employees); 19% were medium (20–199 employees); and 5% were large businesses (200 or more employees).[39] Using the categories of small (0–19 employees), medium (20–200 employees) and large (more than 200 employees), 2021 Victorian data found that 73% of Victorian social enterprises are small, 22% are medium and 5% are large.[40]

1.2.7. Examples of Australian Social Enterprises

The following examples were taken from the Social Traders and B Lab directories.

- *Parliament on King:* a Social Traders-certified WISE offering catering by asylum seekers and refugee chefs.[41]
- *Green Island Creative:* a Social Traders-certified brand marketing agency that helps clients 'build purpose-driven brands, launch products, share stories

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[36] B Lab, 'Find a B Corp – Filter by Country' (2022) https://www.bcorporation.net/en-us/find-a-b-corp/search.

[37] I. Ramsay and M. Upadhyaya, 'The Failed Attempt to Enact Benefit Company Legislation in Australia and the Rise of B Corps' in H. Peter, C. Vargas Vasserot and J. Alcalde Silva (eds), *The International Handbook of Social Enterprise Law: Benefit Corporations and Other Purpose-Driven Companies*, Springer, Cham 2023, p. 418.

[38] J. Barraket, C. Mason and B. Blain, *FASES 2016 Report*, p. 14; Social Traders, *Finding Australia's Social Enterprise Sector 2016: Analysis* (2016), p. 9.

[39] Centre for Social Impact, *Pulse of the For-Purpose Sector: Social Enterprise* (November 2020), p. 2.

[40] Department of Jobs, Precincts and Regions, *Victorian Social Enterprise Strategy 2021–2025* (State Government of Victoria, October 2021), p. 13.

[41] Social Traders, 'Social Enterprise Finder' (2022) https://www.socialtraders.com.au/find-a-social-enterprise/.

and engage their audiences.'[42] Its social impact arises from various donations and using other social enterprises as suppliers.[43]

- *Who Gives a Crap:* a B Corp and Social Traders-certified business that 'makes eco-friendly toilet paper out of 100% recycled materials and 100% bamboo. We donate 50% of profits to help build toilets for the 2 billion who live without them.'[44]
- *Hepburn Energy:* a Victoria cooperative that owns and operates 'Australia's first community-owned wind farm'.[45] A B Corp, it produces 'enough clean energy for over 2000 homes'[46] and is now developing a solar and battery farm.[47]
- *Outland Denim:* Queensland-based Outland Denim Pty Ltd, a B Lab 2019 Best for the World Honoree,[48] was created to provide employment for sexually trafficked women in Cambodia, and now employs other vulnerable and exploited people, too.[49] It is notable for its ethical supply chain, including not only paying a fair wage but also achieving 100% traceability for its fabric.[50]

1.3. FUNDING SOURCES

Under the prevailing definition, Australian social enterprises must raise a substantial portion of their funds from trade rather than donations or grants. The FASES 2016 Report found that 81% of respondents' income came from trade, including 64.84% from the sale of goods and services directly to consumers and 16.71% representing sales to government through competitively sourced contracts.[51] By contrast, 55% of Victorian social enterprises' income comes from trade.[52] However, the broader definition of 'social enterprise' used in the Victorian count, as discussed in section 1.2, should be kept in mind, particularly as regards government subsidies.

42 Ibid.
43 Green Island Creative, 'How We Give Back' (2021) https://www.greenislandcreative.com.au/impact.
44 Who Gives a Crap, 'Talking Crap' (2020) https://blog.whogivesacrap.org/about; Who Gives a Crap, 'Wholesale Portal' https://try.au.whogivesacrap.org/wholesale/.
45 B Lab Global, 'Hepburn Energy' (2022) https://www.bcorporation.net/en-us/find-a-b-corp/company/hepburn-wind.
46 Hepburn Wind, 'About' https://www.hepburnwind.com.au/about/.
47 Hepburn Energy, *Annual Report 2021* (2021).
48 Outland Denim, *Sustainability Report 1 July 2019–30 June 2020* (2020), p. 14.
49 Outland Denim, 'Our Origins' https://www.outlanddenim.com.au/pages/our-origins.
50 Outland Denim, *2021 Impact Report July 2020 – June 2021* (2021), p. 35.
51 J. Barraket, C. Mason and B. Blain, *FASES 2016 Report*, p. 22.
52 Department of Jobs, Precincts and Regions, *Victorian Social Enterprise Strategy 2021–2025* (State Government of Victoria, October 2021), p. 12.

Twelve percent of FASES 2016 respondents received philanthropic grants or bequests, rising to 17% for entities less than five years old.[53] Interestingly, in a November 2020 report, reflecting the first year of the COVID-19 pandemic, 69% of survey respondents indicated that grants would be an option if they needed to raise funds in the next 12 months, followed by impact investment funds (31%), and bank loans (17%), with equity capital raising and overdrafts tied at 9%.[54]

2. ORGANISATIONAL FORMS FOR SOCIAL ENTERPRISES

2.1. ABORTED EFFORT TO ADOPT BENEFIT COMPANY LEGISLATION

Australia does not have any legal form specifically designed for social enterprise. In recent years, B Lab lobbied for the adoption of a US-style benefit corporation form to be known as a 'benefit company'.[55] B Lab argued that this form would remove the risk of directors' duty liability that might arise from the diversion of corporate funds to social purposes.[56] Reception from the academic community was mixed. A number of commentators, including this rapporteur,[57] argued that the form was not necessary because existing law already allows companies to benefit multiple stakeholders and to adopt other features provided by the proposed new form. Supporters of the legislation highlighted the signalling effect to the market, including potential funders, about benefit companies' trustworthiness and social bona fides,[58] even though many acknowledged that a new legal form was not strictly necessary.[59] B Lab dropped its efforts to enact

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[53] J. Barraket, C. Mason and B. Blain, *FASES 2016 Report*, p. 23.

[54] Centre for Social Impact, *Pulse of the For-Purpose Sector: Social Enterprise* (November 2020), p. 6.

[55] See e.g. B Lab Australia & New Zealand, *Building a Prosperous, Impact-Driven Economy* (Pre-Budget Submission to The Treasury 2020, December 2019) https://treasury.gov.au/sites/default/files/2020-09/115786_B_LAB_AUSTRALIA_NEW_ZEALAND.pdf.

[56] I. Ramsay and M. Upadhyaya, 'The Failed Attempt to Enact Benefit Company Legislation in Australia and the Rise of B Corps' in H. Peter, C. Vargas Vasserot and J. Alcalde Silva (eds), *The International Handbook of Social Enterprise Law: Benefit Corporations and Other Purpose-Driven Companies*, Springer, Cham 2023, pp. 399–400.

[57] Ibid., pp. 410–12; V.S. Baumfield, 'How Change Happens: The Benefit Corporation in the United States and Considerations for Australia' in B. Sjafjell and I. Lynch Fannon (eds), *Creating Corporate Sustainability: Gender as an Agent for Change*, Cambridge University Press, Cambridge 2018.

[58] E.g. A. Kamalnath, 'Social Enterprise and Equity Crowdfunding – A Proposal to Share Legal Infrastructure' (2020) 48 *Aust. Bus. LR* 444, 445.

[59] E.g. A. Klettner, 'Finding the Balance Between Profit and Purpose: Should Australia Create a Legal Structure for Social Enterprise?' (2019) 47 *Aust. Bus. LR* 335, 346.

benefit company legislation in 2020, agreeing that a new corporate form was not necessary for interested companies in Australia to lock in for-purpose features.[60]

2.2. FORMS CURRENTLY USED BY AUSTRALIAN SOCIAL ENTERPRISES

Australian social enterprises use the same organisational forms as other Australian businesses.[61] They may be for-profit or not-for-profit. Although the complexities can make them harder to manage, some social enterprises use hybrid group structures to capture the benefits of both entity types (for example, having a not-for-profit with the ability to attract charitable donations own shares in a for-profit company that may receive outside investment and pay dividends).[62]

2.2.1. For-Profit Entity Types

For profit businesses may operate as sole traders, partnerships, or various corporate forms, including companies and cooperatives.

2.2.1.1. Companies

All companies (for- or not-for-profit) are registered and regulated by a federal regulator, the Australian Securities and Investments Commission (ASIC), under the Commonwealth-level Corporations Act 2001 (Cth) (CA). The main for-profit company forms are public or proprietary (private/closely held).[63] Australia does not offer a flexible limited liability company (LLC) form as seen in the United States.

Australian companies enjoy the typical benefits of the corporate form, including separate legal entity status, limited liability for investors and perpetual succession. The management power is presumptively vested in the board of directors, not the general meeting of shareholders,[64] and this is

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[60] S. Khisty, 'The Evolution of Benefit Company Reform in Australia' (B Lab Australia & New Zealand, 01.09.2020) https://www.bcorporation.com.au/post/benefit-company-australia.

[61] See e.g. M. Nehme and F. Martin, 'Social Entrepreneurs: An Evaluation of the Pty Ltd Company from a Corporation's Law and Taxation Law Perspective' (2019) 93 *Aust. LJ* 126, 126–27.

[62] See examples in Justice Connect, *Social Enterprise Guide (Cth): Legal Issues to Consider When Setting Up a Social Enterprise* (2021), pp. 25–27.

[63] There are also two specialist forms: the no liability (NL) form – available solely for mining companies – and unlimited liability companies, which are rare.

[64] CA s. 198A.

interpreted strictly. For example, shareholders have no power to put advisory, 'non-binding resolutions which express an opinion' at general meetings.[65] Shareholder rights are limited to such matters as electing directors (subject to the ability of proprietary companies to change how directors are removed),[66] amending corporate constitutions, asking questions and making comments at annual general meetings,[67] participating in 'say on pay' resolutions (for listed companies only),[68] approving variations of shareholder class rights,[69] and voting to wind up a solvent company.[70] Other stakeholders generally have no right to participation in company management other than certain creditors' rights in the insolvency context. The CA does not contain a corporate constituency statute either permitting (as is common in the US) or requiring (as in the UK under section 172 of the Companies Act 2006) consideration of other stakeholder interests.

Directors and officers owe fiduciary duties to the company to act in good faith in the best interests of the company, act for proper purposes, avoid conflicts of interest, and exercise care, skill and diligence under the general law as well as corresponding statutory duties under the CA.[71] ASIC is empowered – unlike regulators in many other jurisdictions – to enforce statutory directors' duties by suing directors and officers for breach.[72] Breaches of duty may not only attract civil liability in the form of damages and relinquishment of gains, civil monetary penalties and disqualification to act as a director, but may even (except for duty of care claims under section 180) attract criminal liability.[73]

Most companies are no longer required to have an objects clause or any other provision specifying a corporate purpose.[74] The default assumption under the best interests of the company is that 'the company' equates to the shareholders as a whole, and that their interests are in maximising corporate financial value.[75]

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65 See e.g. *Australasian Centre for Corporate Responsibility v. Commonwealth Bank of Australia* [2015] FCA 785; 325 ALR 736.

66 CA s. 203C.

67 CA s. 250S.

68 CA s. 250R(2).

69 CA s. 246B.

70 CA s. 491.

71 E.g. CA ss. 180 (duty of care and diligence), 181 (duties to act in good faith in the best interests of the company and for a proper purpose), 182 (duty not to misuse position), 183 (duty not to misuse information), 191 (duty to disclose conflicts), and 588G (duty to prevent insolvent trading).

72 The company itself, including derivatively, by members or officers, may sue to enforce the general law and statutory duties, but in relation to the statutory duties is limited to seeking compensation rather than the other civil penalties available to ASIC. See CA ss. 236–37, 1317J(2).

73 CA s. 184.

74 CA s. 125(2).

75 See e.g. V.S. Baumfield, 'Stakeholder Theory from a Management Perspective: Bridging the Shareholder/Stakeholder Divide' (2016) 31 *Aust. J. Corp. L.* 187; V.S. Baumfield, 'The

But Australian law has added significant nuance to the proposition. A growing body of case law indicates that directors are certainly allowed and most likely expected to focus on the company's long-term survival. Conversely, there is no case law explicitly requiring shareholder wealth maximisation to the exclusion of other corporate objectives. Companies may devote resources to social objectives where some benefit to the company is likely.[76] As Langford argues, defining a social enterprise's social purpose in its constitution may help clarify what conduct is in the company's best interests.[77]

Companies are taxed at a flat rate.[78] The general corporate tax rate is 30%; however, for-profit companies with revenue below certain thresholds pay tax at a reduced rate, which has just decreased from 27.5% to 25%.[79] There is no double taxation of corporate profits as shareholders receive tax credits under the dividend imputation scheme.

Public (Ltd) companies may raise funds from the general public and may, additionally, choose to list on a securities exchange such as the Australian Securities Exchange (ASX), but face expensive administrative requirements, including significant public disclosure, audit requirements and the obligation to hold annual general meetings.[80] Listed public companies face heightened disclosure obligations compared to other public companies,[81] plus additional restrictions depending on the listing rules of the relevant exchange (e.g. the ASX Listing Rules). Approximately 5% of the social enterprises studied in the FASES 2016 Report were listed public companies.[82] One prominent example of a listed company social enterprise is Australian Ethical Investment Ltd, a B Corp that provides ethical investment options, particularly in the superannuation (retirement) and managed fund areas.[83]

Australian Paradox: Conservative Corporate Law in a Progressive Culture' in B. Sjåfjell and C.M. Bruner (eds), *Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, Cambridge University Press, Cambridge 2019; R. Teele Langford, 'Purpose-Based Governance: A New Paradigm' (2020) 43 *UNSW LJ* 954.

[76] In addition to sources in the previous footnote, see e.g. *Parke v. Daily News Ltd* [1962] Ch 927; *Miles v. Sydney Meat-Preserving Co Ltd* (1912) 16 CLR 50; Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations* (2006); Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value* (2006).

[77] R. Teele Langford, 'Purpose-Based Governance: A New Paradigm' (2020) 43 *UNSW LJ* 954, 975.

[78] See M. Nehme and F. Martin, 'Social Entrepreneurs: An Evaluation of the Pty Ltd Company from a Corporation's Law and Taxation Law Perspective' (2019) 93 *Aust. LJ* 126.

[79] Australian Taxation Office, 'Changes to Company Tax Rates' (28.10.2021) https://www.ato.gov.au/rates/changes-to-company-tax-rates/#Companytaxrates.

[80] See CA Parts 2M.3 (general disclosure), 6D.2 (fundraising disclosure).

[81] CA s. 300A.

[82] J. Barraket, C. Mason and B. Blain, *FASES 2016 Report*, p. 15.

[83] Australian Ethical Investment Ltd, 'Who We Are' (2021) https://www.australianethical.com.au/about/.

Proprietary (Pty Ltd) companies face fundraising restrictions, and share transfers are subject to board approval,[84] but small proprietary companies[85] – most companies in Australia – are generally exempt from the burdensome reporting and audit requirements to which public companies and large proprietary companies are subject.[86] The FASES 2016 Report unsurprisingly indicates that proprietary companies are the most common for-profit entity type at 18% of entities studied.[87]

2.2.1.2. Other For-Profit Forms

For-profit businesses may also operate as partnerships, sole traders, cooperatives or indigenous corporations.

The *cooperative* is a specialist corporate form that has the potential to be a good fit for some social enterprises. Uniform legislation creating a national cooperative law regime, the Co-operatives National Law (CNL), which interacts with the Corporations Act 2001, was introduced in 2014 and has since been adopted in all Australian states.[88] The structure gives effect to the seven 'cooperative principles', namely: voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training and information; cooperation among cooperatives; and, most aptly, concern for the community.[89] As with other corporations, management is vested in the board of directors, while members have limited liability.[90] Cooperatives may be organised as either for-profit or not-for-profit ('distributing' or 'non-distributing co-operatives') with relaxed disclosure rules for smaller businesses similar to the distinction applying to companies under the CA.[91]

Partnerships are the relationship created when two or more persons carry on business in common with a view of profit.[92] They are not separate legal entities. They are contractual relationships and partners by agreement can accordingly overrule the default rules in the relevant state Partnership Act.[93]

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84 CA s. 1072G. Unreasonable refusals to register share transfers may be challenged as oppressive, however.

85 Defined in CA s. 45A(2) as satisfying two of the following: having revenue below $25 million; gross assets worth less than $12.5 million; and fewer than 50 employees.

86 See e.g. CA s. 292(2).

87 J. Barraket, C. Mason and B. Blain, *FASES 2016 Report*, p. 15; Social Traders, *Finding Australia's Social Enterprise Sector 2016: Analysis* (2016), p. 9.

88 Co-operatives National Law (Qld) (CNL) s. 28.

89 CNL ss. 10, 11.

90 CNL ss. 121, 172.

91 CNL ss. 18, 19, 270.

92 See e.g. Partnership Act 1891 (Qld) s. 5.

93 See e.g. Partnership Act 1891 (Qld) s. 22.

As such, although profit-seeking is a fundamental requirement of partnerships, it appears that partnership agreements may recognise social objectives along with profit-seeking. All partners may normally participate in management, and all owe joint and several liability for partnership debts. To mitigate this risk, partners owe each other fiduciary duties. Australian law also allows limited partnerships, under which limited partners sacrifice management rights in exchange for limited liability. Partnerships are flow-through tax entities with tax paid by individual partners at their personal tax rates. Only a small percentage of social enterprises operate as partnerships.[94]

Sole traders have complete control over their businesses and accordingly have complete control to pursue social objectives, but the individual owner is fully liable for any debts. They pay tax at the personal tax rate, and the business dissolves upon death. They may have difficulties raising funds due to the lack of equity investors. Accordingly, the form is used by only around 5% of social enterprises.[95]

Indigenous entities also have the option of organising as an *Aboriginal and Torres Strait Islander corporation* (ATSI corporation) under the Corporations (Aboriginal and Torres Strait Islander) Act 2006 (Cth), regulated by a separate regulator, the Office of the Registrar of Indigenous Corporations (ORIC).[96] Benefits of using this form include:

- when they register, the members can choose not to be liable for debts of the corporation
- the corporation's rule book can accommodate Aboriginal or Torres Strait Islander customs and traditions
- Aboriginal and Torres Strait Islander corporations can operate nationally – they are not limited to the state or territory in which they are registered
- it is free to register as an Aboriginal and Torres Strait Islander corporation – unlike alternative regimes that may charge a fee
- in some cases, corporations may be exempted from annual reporting
- the corporation's profits can be distributed to members – if the rule book allows for that
- registered corporations can access ORIC's advice and support, and services.[97]

It is unclear how many social enterprises are ATSI corporations.

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94 J. Barraket, C. Mason and B. Blain, *FASES 2016 Report*, p. 15.
95 Ibid.
96 Corporations (Aboriginal and Torres Strait Islander) Act 2006 (Cth).
97 Office of the Registrar of Indigenous Corporations, 'Registration Options' https://www.oric.gov.au/start-corporation/registration-options.

2.2.2. Not-for-Profit Entity Types

Approximately 55% of social enterprises use not-for-profit structures.[98] Not-for-profit social enterprises may organise as companies or associations, as well as non-distributing cooperatives (discussed in section 2.2.1.2).

The only company form available to not-for-profits is the *company limited by guarantee* (CLG), a type of public company. In 2016, 32% of entities studied used this structure.[99] The form is suitable for larger entities because they can transact business nationwide and fundraise from the public at large, subject to the reporting and audit requirements applicable to all public companies.[100] CLGs have members, but no shareholders, and are forbidden from distributing profits to members. Members' liability is limited to the amount set in the company constitution (normally a nominal amount).

The association form is also available for not-for-profits. Not-for-profits that take no steps to formally organise are de facto considered *unincorporated associations*. This form is problematic because there is no legal structure to hold the social enterprise's assets, and members may be personally liable for enterprise activities, particularly members involved in enterprise decision-making.

Alternatively, not-for-profits with at least seven members may register (at the state rather than federal level) as an *incorporated association* under the relevant state's Incorporated Associations Act.[101] This was the most common structure in the FASES 2016 Report, used by 33% of respondents.[102] Incorporated associations enjoy separate legal entity status and limited liability, but face reporting and insurance requirements.[103] These entities must use the suffix 'Inc'.[104]

All not-for-profits are entitled to a lower income tax rate, but only a subset of not-for-profits that meet certain requirements as charities may be fully tax-exempt.[105] There are many complexities involved in whether a social enterprise will be entitled or find it beneficial to seek tax-exempt status.[106] Social enterprises as a discrete class, however – as opposed to charities or not-for-profits – receive no particular tax benefits in Australia.

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98 Social Traders, *Finding Australia's Social Enterprise Sector 2016: Analysis* (2016), p. 9.

99 Ibid.

100 For a discussion of the differences between CLGs and incorporated associations, see Justice Connect, *Incorporated Association or Company Limited by Guarantee? (ACT)* (2021).

101 E.g. Associations Incorporation Act 1981 (Qld) s. 5 (eligibility for incorporation) (AIA Qld).

102 J. Barraket, C. Mason and B. Blain, *FASES 2016 Report*, p. 15.

103 AIA Qld ss. 58–59E, 70, 70A.

104 AIA Qld s. 29. In Australia, 'Inc' never designates a company or other for-profit entity.

105 See Australian Taxation Office, *Tax Basics for Non-Profit Organisations* (2014), p. 10.

106 See Justice Connect, *Social Enterprise Guide (Cth): Legal Issues to Consider When Setting Up a Social Enterprise* (2021), pp. 27–34.

2.3. LIFECYCLE

Because they do not have special legal status, social enterprises face no special steps in their formation compared to other businesses.

3. STATE/PRIVATE CERTIFICTIONS AND METRICS

While the government does not certify social enterprises, various private social enterprise certifications are available including, most prominently, Social Traders' 'Certified Social Enterprise' (CSE) designation and B Lab's 'Certified B Corporation' (B Corp). Indigenous entities may also be certified as such. These certifications may assist in attracting not only business but also investors and employees.

3.1. SOCIAL TRADERS CERTIFICATION

Social Traders was created in 2008 as an independent not-for-profit company with the support of the Victoria state government for the explicit purpose of connecting social enterprises with social procurement opportunities and helping them deliver on their contracts.[107] CSE certification is available to organisations that evidence their adherence to the FASES 2016 'social enterprise' definition.[108] To recap, the FASES definition entails a public or community benefit mission requirement; fulfilling that mission through trade; deriving a substantial portion of their income from trade; and reinvesting the majority of their profit/surplus in fulfilment of the mission. Businesses must recertify and pay a membership fee every 12 months.[109] As of January 2023, 352 businesses appear on the Social Traders CSE directory.[110]

KPMG noted that 'accreditation is likely to only be successful if it is linked to a benefit for the enterprise (beyond validity as a social enterprise)'.[111] Beyond verifying a social enterprise's social bona fides and giving them access to a

[107] KPMG, *Social Enterprise in Queensland: Final Report* (2019), p. 127.

[108] Social Traders, 'Social Enterprise Certification: Guidance Notes and Standards' https://assets.socialtraders.com.au/downloads/FINAL-Full-guidance-notes-17Aug21.pdf; Social Traders, 'For Social Enterprise: Certification' (2022) https://www.socialtraders.com.au/for-social-enterprise/certification; Social Traders, 'For Social Enterprise: Social Enterprise FAQs' (2022) https://www.socialtraders.com.au/for-social-enterprise/social-enterprise-faqs/.

[109] Social Traders, 'Certified Social Enterprise Terms and Conditions' (12.10.2021) https://www.socialtraders.com.au/certified-social-enterprise-terms-and-conditions/, [9].

[110] See Social Traders, 'Social Enterprise Finder' (2023) https://www.socialtraders.com.au/find-a-social-enterprise/.

[111] KPMG, *Social Enterprise in Queensland: Final Report* (2019), p. 126.

network of other social enterprises, CSE designation has a major substantive benefit: it entitles organisations to participate in government social procurement schemes in New South Wales, Queensland and Victoria.[112]

Because Australia's largest states' social procurement regimes are linked to Social Traders' CSE certification, Social Traders is arguably akin to a private regulator. It is notable that Social Traders controls the key definition, which it can presumably change since it is not bound to align its definition with any statutory definition. It is a key gatekeeper as to who can participate in government procurement programmes, making its policy choices a form of soft law. It is an open question if the states that currently recognise CSE certification for procurement purposes would follow Social Traders' lead if Social Traders were to materially change the requirements to qualify as a CSE.

3.2. B CORPS

B Lab awards this designation to qualifying Australian businesses that have operated for at least 12 months, including not only for- and not-for-profit companies but also sole traders, partnerships and cooperatives, the main restriction being that revenue must derive from business activity, not donations (entities with deductible gift recipient tax status are ineligible).[113] Associations are apparently not eligible. The first certification was awarded in June 2012.[114] To qualify, businesses must attain a sufficient score on their 'B Impact Assessment', which assesses the company's impact on its workers, customers, community and environment.[115] B Corps must recertify every three years and are subject to audit; they also must pay an annual fee and publish their Impact Report on B Lab's website.[116]

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112 Social Traders, 'For Government: Unlock Social Enterprise Procurement' (2022) https://www.socialtraders.com.au/for-government; NSW Government, *Procurement Policy Framework* (August 2021), p. 132; Department of Employment, Small Business and Training, *Queensland Social Enterprise Strategy* (Queensland Government, 10.06.2021), p. 4; Department of Jobs, Precincts and Regions, *Victorian Social Enterprise Strategy 2021–2025* (State Government of Victoria, October 2021), p. 8.

113 B Lab Australia & Aotearoa New Zealand, 'Guide to Becoming a B Corp: What Organisations Are Eligible?' (2023) https://bcorporation.com.au/become-bcorp/guide/eligibility/.

114 I. Ramsay and M. Upadhyaya, 'The Failed Attempt to Enact Benefit Company Legislation in Australia and the Rise of B Corps' in H. Peter, C. Vargas Vasserot and J. Alcalde Silva (eds), *The International Handbook of Social Enterprise Law: Benefit Corporations and Other Purpose-Driven Companies*, Springer, Cham 2023, p. 417.

115 B Lab, 'FAQS: What Topics Are Covered in the B Impact Assessment?' (2022) https://www.bcorporation.net/en-us/faqs/what-topics-are-covered-b-impact-assessment/.

116 B Lab Australia & Aotearoa New Zealand, 'Guide to Becoming a B Corp: What Organisations Are Eligible' (2023) https://bcorporation.com.au/become-bcorp/guide/eligibility/. See I. Ramsay and M. Upadhyaya, 'The Failed Attempt to Enact Benefit Company Legislation in Australia and the Rise of B Corps' in H. Peter, C. Vargas Vasserot and J. Alcalde Silva (eds),

In 2020, B Lab announced that Australian B Corps are required to amend their constitution or other governing document to include the following 'purpose clause': 'The purpose of the Company is to deliver returns to shareholders whilst having an overall positive impact on society and the environment'. They must also implement stakeholder governance by adopting a 'stakeholder clause' requiring corporate directors and officers to consider a list of enumerated stakeholders in their corporate decision-making.[117]

B Corp status is available to some businesses that may not qualify for CSE certification,[118] and has the benefit of international recognition. It provides no particular procurement benefits but the constitutional amendments required for certification may help companies protect their mission, particularly in the face of capital raisings, and signal as much to investors and potential employees. Certified B Corp status may also assist with marketing to socially conscious consumers. The constitutional changes also clarify directors' obligations and minimise any legal risk associated with directors prioritising purpose along with profits.

3.3. COMPARING CERTIFICATIONS

CSE and B Corp certifications are not mutually exclusive and a number of qualifying social enterprises have both.[119] The certifications, to a certain extent, provide different benefits. Because of their slightly different focuses and requirements to qualify, they also seem to target different businesses, although both certifications require social enterprises to make money from trading.

In a previous piece, this rapporteur classified social enterprises as Type A quasi-non-profits, which seek profits specifically to finance the social mission, and, using a broad conception of social enterprise, Type B classic 'mission-driven companies' more focused on earning profits for their own sake, albeit in a socially beneficial manner with a strong focus on the double- or triple-bottom line.[120] Klettner applied this typology to empirical data on Australian

The International Handbook of Social Enterprise Law: Benefit Corporations and Other Purpose-Driven Companies, Springer, Cham 2023, pp. 418–19 for additional discussion of the process.

117 B Lab Australia & Aotearoa New Zealand, 'The B Corp Legal Requirement' (2021) https://www.bcorporation.com.au/legal-requirement; B Lab Australia & Aotearoa New Zealand, *How to Meet the B Corporation Legal Requirement: Australia & Aotearoa New Zealand* (September 2022) https://bcorporation.com.au/wp-content/uploads/2022/09/B-Corp-Legal-Requirement-How-to-Guide-AUNZ-September-2022.pdf.

118 E.g. because insufficient profits are reinvested in their mission.

119 E.g. toilet paper manufacturer Who Gives a Crap.

120 V.S. Baumfield, 'How Change Happens: The Benefit Corporation in the United States and Considerations for Australia' in B. Sjåfjell and I. Lynch Fannon (eds), *Creating Corporate*

social enterprise and found that B Corps are 'more oriented to profit-making – Type B organisations', while CSEs are more tailored to the Type A social activist.[121] That is consistent with the requirement that CSEs reinvest most profits (i.e. they are more asset locked), while B Corps have more flexibility in this area despite being mission locked through their constitutional amendments. On the other hand, Stubbs reported that B Corp founders or directors viewed profit as a means to achieve their social purposes, sought B Corp certification to align their business with their values, and did not seek to maximise profits even while viewing profits as a key measure of the business's success.[122]

3.4. SUPPLY NATION CERTIFICATION OF INDIGENOUS OWNERSHIP

ATSI businesses are treated as social enterprises for some purposes, based on their ability to benefit their local community.[123] They may be certified as indigenously owned by their own certifier, Supply Nation.[124] This enables ATSI businesses not registered with ORIC as ATSI corporations to prove their indigenous status.[125]

Supply Nation certification allows qualifying businesses to tender for indigenous set-asides under the Commonwealth Government Indigenous Procurement Policy,[126] as well as various state policies preferencing procurement from ATSI businesses.[127]

Sustainability: Gender as an Agent for Change, Cambridge University Press, Cambridge 2018, pp. 190–93.

121 A. Klettner, 'Finding the Balance Between Profit and Purpose: Should Australia Create a Legal Structure for Social Enterprise?' (2019) 47 *Aust. Bus. LR* 335, 345.

122 I. Ramsay and M. Upadhyaya, 'The Failed Attempt to Enact Benefit Company Legislation in Australia and the Rise of B Corps' in H. Peter, C. Vargas Vasserot and J. Alcalde Silva (eds), *The International Handbook of Social Enterprise Law: Benefit Corporations and Other Purpose-Driven Companies*, Springer, Cham 2023, pp. 420–21, citing W. Stubbs, 'Sustainable Entrepreneurship and B Corps' (2017) 26 *Bus. Strat. and the Environment* 331.

123 See e.g. Department of Jobs, Precincts and Regions, *Victorian Social Enterprise Strategy 2021–2025* (2021), p. 25; see also Department of the Prime Minister and Cabinet, *Closing the Gap: Prime Minister's Report 2017* (Australian Government, 2017), pp. 71–72, 77. For example, see Burrunju Aboriginal Corporation, 'About Us' (2014) http://aboriginal-arts.com.au/about.htm.

124 Supply Nation, 'How We Verify Aboriginal and Torres Strait Islander Businesses' (2021) https://supplynation.org.au/benefits/indigenous-business/.

125 See National Indigenous Australians Agency, *Indigenous Procurement Policy* (Australian Government, December 2020), p. 10.

126 Ibid.

127 E.g. NSW Treasury, *Aboriginal Procurement Policy* (January 2021), p. 2.

4. GOVERNMENT SUBSIDIES/BENEFITS

While federal and state entities have expressed support for the social enterprise sector, there is no cohesive or comprehensive national scheme. Instead, a patchwork of relatively modest Commonwealth and state programmes have been attempted by various government agencies. Some programmes provide grants or other financial support directly to qualifying enterprises. For example, the Queensland Inclusive Social Enterprise Project provided $2 million to create employment opportunities for people with serious mental health issues.

Other programmes, such as the Commonwealth Department of Education, Employment and Workplace Relations' (DEEWR) Social Enterprise and Development and Investment Funds (SEDIF), have focused on developing investment capacity.[128]

A third category of programmes is intended to support the growth of the 'social enterprise ecosystem', such as through the provision of information and networking opportunities.[129]

4.1. ENTERPRISE LEVEL

Over time, governments' focus has expanded or indeed shifted from modest financial support programmes, sometimes in partnership with private organisations, to increasing markets for social enterprises through changes to government procurement programmes at the federal, state and local level.[130]

Procurement strategies include set-asides for qualifying businesses[131] and adjustments to the value-for-money principle applicable to government procurement programmes to give credit for non-financial/social outcomes.[132] Social Traders offers government memberships designed to facilitate social enterprise procurement.[133]

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128 Department of Education, Skills and Employment, *Social Enterprise Development & Investment Funds (SEDIF) Evaluation Report* (Australian Government, 2016).

129 See e.g. Department of Employment, Small Business and Training, *Queensland Social Enterprise Strategy* (2021); Department of Jobs, Precincts and Regions, *Victorian Social Enterprise Strategy 2021–2025* (2021).

130 KPMG, *Social Enterprise in Queensland: Final Report* (2019), p. 106; NSW Government, *Procurement Policy Framework* (2021); Victorian Government, 'Social Procurement Framework and Guides' (27.09.2021) https://www.buyingfor.vic.gov.au/social-procurement-framework-and-guides.

131 E.g. National Indigenous Australians Agency, *Indigenous Procurement Policy* (2020).

132 S. Easton, 'Australia's First Social Procurement Policy Redefines Value for Money' (*The Mandarin*, 27.04.2018) https://www.themandarin.com.au/91835-australias-first-social-procurement-policy-redefines-value-for-money/.

133 Social Traders, 'For Government: Unlock Social Enterprise Procurement' https://www.socialtraders.com.au/for-government.

There is evidence that social enterprises support the shift to procurement because developing markets for relevant businesses is a concrete way to help them grow and make them more sustainable.[134] Grants-based programmes may be more appropriate for start-ups that require capital to commence operations and do not have the assets or track record to obtain loans.[135] However, grants programmes may exclude for-profit businesses and some social enterprises viewed them as stigmatising because they could create a perception that the business's products could not stand on their own merit.[136]

4.2. INVESTOR LEVEL

Government funding has also been made available to encourage social enterprise investment. Under the SEDIF programme, for example, which operated from 2011–2016, the Commonwealth government provided $20 million in seed funding to three fund managers chosen under a competitive tender process (Social Enterprise Finance Australia Ltd (SEFA), an unlisted (for-profit) public company and B Corp; Foresters Community Finance Ltd, an 'ethical lender' and investment manager; and Social Ventures Australia, a not-for-profit that provides both equity investments and loans).[137] The fund managers were required to match the government's seed funding and provide finance to later-stage start-ups. The programme had mixed results because only slightly more than half of the $41 million in funds raised was invested (mainly through loans at relatively high interest rates), but is said to have revealed key insights about how to improve future programmes, including offering finance with longer time horizons (so-called 'patient capital') and focusing on investments with a higher risk profile, since the lower-risk projects that the lenders were willing to finance could often find better terms from commercial lenders.[138]

In another example, from 2015–2022, Impact Investing Australia (IIA) has offered 'Impact Investment Ready Growth Grants' (IIRGG), supported by a $7 million grant from the Commonwealth Department of Social Services.[139] IIRGG provides grants of up to $100,000 to for- and not-for-profit social enterprises 'to secure investment capital to scale their social impact.'[140] The grants

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[134] Department of Education, Skills and Employment, *SEDIF Evaluation Report* (2016), p. 45.
[135] KPMG, *Social Enterprise in Queensland: Final Report* (2019), p. 107.
[136] Ibid., p. 106.
[137] Social Ventures Australia, 'Impact Investing' (2022) https://www.socialventures.com.au/impact-investing/.
[138] Department of Education, Skills and Employment, *SEDIF Evaluation Report* (2016).
[139] Impact Investing Australia, *Paving Further Pathways to Impact: Insights and Analysis From Six Years of the Impact Investment Ready Growth Grant* (2021).
[140] Impact Investing Australia, 'Applying for a Growth Grant' https://impactinvestingaustralia.com/application-guidelines/.

enable the purchase of professional advice and preparation of documentation necessary to attract outside investors. As of June 2021, $6.8 million disbursed under the scheme had generated $143.1 million in funding to 69 organisations.[141]

5. THE INVESTMENT LANDSCAPE FOR PRIVATE CAPITAL

5.1. IMPACT INVESTORS (INSTITUTIONAL INVESTORS)

The pool of both Australian and international impact investors operating in Australia has increased dramatically over the past decade yet is said to remain undercapitalised.[142] Consequently, IIA is seeking a $200 million investment by the federal government (to be matched by private investors) to form an impact investment wholesaler.

Impact investors make both equity and debt investments in social enterprises, often via blended funding models incorporating funding from both government and private investors. For example, in addition to section 4.2's examples, the Indigenous Social Enterprise Fund provided financial support in the form of grants and loans to 15 Aboriginal social enterprises.[143] ISEF is a collaboration between not-for-profits SVA and Reconciliation Australia in conjunction with federal agency Indigenous Business Australia.

5.2. INDIVIDUAL INVESTORS

Individual investors may invest either through ethical fund managers such as SEFA, or directly. The handful of social enterprises that are listed companies are subject to the same securities regulation regime, with its focus on disclosure of material information, as other listed companies.[144]

A recent innovation that may benefit social enterprise is Australia's 2017 legalisation of crowd equity funding, or 'crowd-sourced funding' (CSF).[145] The CSF rules allow unlisted public companies and, significantly, proprietary companies with assets and annual turnover of less than $25 million to raise

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141 Impact Investing Australia, *Paving Further Pathways to Impact: Insights and Analysis From Six Years of the Impact Investment Ready Growth Grant* (2021), p. 10.

142 See e.g. KPMG, *Social Enterprise in Queensland: Final Report* (2019), p. 104; Impact Investing Australia, *Pre-Budget Submission 2021–22* (Submission to Commonwealth Government, December 2020), p. 6.

143 KPMG, *Social Enterprise in Queensland: Final Report* (2019), p. 105.

144 See CA Ch. 6CA (continuous disclosure), Ch. 6D (fundraising).

145 See CA Part 6D.3A.

up to $5 million via online platforms (CSF intermediaries) in numerous small investments from the general public. CSF companies enjoy streamlined disclosure obligations compared to the general fundraising rules.[146]

6. OTHER CONSTITUENCIES

As a general matter, social enterprise investors have no particular right to preserve an entity's mission, although this could theoretically be changed in an organisation's governing documents. Nor do other stakeholders (e.g. employees and customers).

The situation might be different for B Corp shareholders because of the required constitutional amendments. Corporate constitutions have legal effect as a statutory contract between the company, its directors and its members.[147] This entitles shareholders to sue the company to enforce the constitution. However, the clauses that B Lab requires B Corps to adopt are so vague that it is unclear how a member might prove they have been breached, or what specific remedy a member could successfully require. Where B Corps – or other enterprises – have adopted detailed purpose clauses in addition to the minimum language required by B Lab, however, then members might have a greater ability to enforce those commitments.

7. LOOKING AHEAD

There are no particular law changes currently under discussion. Within the sector, a movement is now underway to implement a social enterprise national strategy to help the sector grow, increase its impact and increase its influence on mainstream business practices.[148] However, the movement is in its infancy and it is unclear what real outcomes might follow.

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146 CA ss. 738J, 738K; see also A. Kamalnath, 'Social Enterprise and Equity Crowdfunding – A Proposal to Share Legal Infrastructure' (2020) 48 *Aust. Bus. LR* 444, 447.

147 CA s. 140.

148 See e.g. A. Hannant et al., *Directions Part 1: Perspectives, Provocations and Sense-Making for Strategy* (Social Enterprise National Strategy (SENS) Project, The Yunus Centre, Griffith University, 2021).

SOCIAL ENTERPRISES IN BELGIUM

Sofie Cools and Maxime Verheyden*

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1. WHAT IS A SOCIAL ENTERPRISE?

1.1. DEFINITION

Despite the burgeoning attention given to social enterprises in recent decades, there is no generally accepted definition of social enterprises among Belgian policymakers and academics. Usually, however, the term 'social enterprise' is employed to describe businesses that engage in market activities primarily in order to serve a social purpose. An older notion often used in this context is that of the 'social economy', which to a large extent overlaps with the sector of social enterprises.[1] Social enterprises are not limited to a specific organisational form. They are commonly organised as a non-profit organisation or as a company with a limited profit distribution purpose (hereafter 'non-profit social enterprises' and 'for-profit social enterprises' respectively).[2]

The aforementioned definition of social enterprises is in line with the one used by the European Commission, which features a similar 'entrepreneurial/economic', 'social' and 'inclusive governance-ownership' dimension.[3] It is further supported by recent corporate law and regulation in other fields. With regard to

[1] See e.g. J. Defourny and M. Nyssens, 'Belgium. Social enterprises in community services' in C. Borzaga and J. Defourny (eds), *The Emergence of Social Enterprise*, Routledge, New York 2001, pp. 47–48.

[2] See e.g. M. Denef and B. Van Baelen, 'Sociaal ondernemerschap in vergelijkend perspectief: juridische variaties van een ontluikende paradigmashift?' [2020] *TRV-RPS* 944 and 948–55.

[3] European Commission, *Social enterprises and their ecosystems in Europe. Comparative synthesis report*, Publications Office of the European Union, Luxembourg 2020, pp. 28–31.

corporate law, the Code of Companies and Associations of 2019 (CCA) created the possibility for cooperative companies to be certified as a social enterprise, if they satisfy conditions consistent with the aforementioned conception of social enterprise, except for the required engagement in market activities (see below section 4.1).[4] The CCA does not offer a corresponding certification for non-profit organisations. A proposed provision that would have created such a certification for non-profit associations (*verenigingen zonder winstoogmerk/associations sans but lucratif*) was deleted during the parliamentary process, because non-profit associations were deemed social enterprises by nature in light of their non-distribution constraint.[5] Finally, regional regulatory initiatives, such as the certification as a social enterprise administered by the Brussels-Capital Region, which provides a framework for subsidisation and other support for social enterprises, use a similar conception of social enterprise (see below section 4.2).[6]

In its definition of a company, the CCA of 2019 explicitly allows companies to include in their articles of association other purposes besides profit distribution even if they are not certified as a social enterprise.[7] However, such companies are not subject to further specific organisational law requirements like an obligation to *primarily* serve a social purpose or a statutory cap on profit distributions. As a consequence, dual-purpose companies may – but do not necessarily – fall under the definition of social enterprises sketched above.

1.2. INDUSTRIES AND SIZE

Social enterprises operate across a multitude of industries using diverse business models. Over time, non-profit organisations have achieved a substantial concentration in industries such as health care, community works, education, culture and sports, as well as other subsidised industries such as social housing and work integration.[8] Their activities are typically less capital intensive and more labour intensive than the rest of the Belgian economy.[9] For-profit social enterprises often operate in industries where the adoption of a social enterprise form is required by the regulator in order to be eligible for subsidies, such as social housing (see below section 1.4).

[4] Article 8:5 CCA.

[5] Article 9:27 of the Draft Law initially submitted to the Belgian Chamber of Representatives and amendment no. 40 (Parl. St. Kamer, nr. 3119/002, 496–97 and nr. 3119/004, 56).

[6] Articles 3–6 of the Brussels-Capital Region Ordinance of 23 July 2019 concerning the certification of and the support to social enterprises, *BOJ* 18 September 2018.

[7] Article 1:1 last sentence *juncto* 2:8, §2, 11° CCA.

[8] See M. De Gols and E. Leurquin, 'Het gewicht van sociale ondernemingen in België in kaart gebracht' [2020] *TRV-RPS* 805.

[9] Koning Boudewijnstichting and Nationale Bank van België, *Het economische gewicht van instellingen zonder winstoogmerk in België,* Koning Boudewijnstichting, Brussels 2020, p. 30.

Although the lack of uniform definition of social enterprise complicates the estimation of industry size,[10] the social enterprise sector is generally considered to significantly contribute to the Belgian economy. For instance, the share of jobs created by social enterprises was estimated at 11.9% of all paid jobs in Belgium in 2014.[11] As a clearly delineated category responsible for by far most of the jobs created by social enterprises,[12] non-profit organisations lend themselves better to reliable data gathering. Their contribution to the Belgian economy was estimated to amount to approximately 4.9% of gross domestic product and 12.6% of paid jobs in 2017.[13] On 30 April 2019, the Crossroads Bank for Enterprises contained 138,229 non-profit associations (of which 24,518 were subject to VAT) and 1,513 foundations (of which 140 were subject to VAT).[14] This dwarfs the number of cooperatives certified as social enterprises, which we currently estimate at between 700 and 1,000.[15]

1.3. EXAMPLES

Although social enterprises have garnered increased academic and policy interest in the last decades, they are far from new. The 19th century witnessed the emergence of the cooperative movement. In 1873, the legislator introduced the cooperative company into Belgian company law.[16] A well-known example

[10] Estimates based on legal form range from 18,074 social enterprises in 2014 (Académie des Entrepreneurs Sociaux, *Baromètre des entreprises sociales en Belgique*, Académie des Entrepreneurs Sociaux @HEC Liège – Université de Liège, Liège 2016, p. 26) to 17,830 social enterprises in 2015 (M. De Gols and E. Leurquin, 'Het gewicht van sociale ondernemingen in België in kaart gebracht' [2020] *TRV-RPS* 806).

[11] Académie des Entrepreneurs Sociaux, *Baromètre des entreprises sociales en Belgique*, Académie des Entrepreneurs Sociaux @HEC Liège – Université de Liège, Liège 2016, p. 27 (calculated in full-time equivalents).

[12] Ibid., p. 30 (stating that the share of full-time equivalent jobs created by (regular and international) non-profit associations amounted to 90.1% of all jobs in social enterprises, with foundations representing 2.4%).

[13] Koning Boudewijnstichting and Nationale Bank van België, *Het economische gewicht van instellingen zonder winstoogmerk in België,* Koning Boudewijnstichting, Brussels 2020, p. 16.

[14] E. Van den Broele, 'Het ondernemingslandschap bij de inwerkingtreding van het Wetboek van vennootschappen en verenigingen' [2019] *TRV-RPS* 460–61.

[15] We counted 972 cooperatives certified as social enterprises by adding the newly certified social enterprises (based on the Ministerial Decrees published in the Belgian Official Journal until 3 September 2021) to the list of companies which, upon enactment of the CCA, are legally presumed to be certified as a social enterprise pursuant to annex I to the Ministerial Decree of 27 August 2019 concerning the lists of companies presumed to be certified as a social enterprise or as an agricultural enterprise, *BOJ* 4 September 2019. Since the publication of this Ministerial Decree, an unknown, but seemingly non-negligible, number of the companies listed have converted to another legal form or have been dissolved, which explains the lower bound of this estimate.

[16] Law of 18 May 1873 regarding Title IX, Book I of the Commercial Code, with regard to companies, *BOJ* 25 May 1873.

is the Ghent-based cooperative Vooruit, which was founded in the 1880s and catered to the needs of workers before the introduction of the social security system at the height of the second Industrial Revolution.[17] The non-profit association was introduced in the early 20th century. Nowadays, non-profit social enterprises operating in the health care industry, such as large hospitals, have the most prominent impact of the social enterprise sector, in terms of employment created, funds invested and added value generated.[18] Recently, several social enterprises have also been making headlines in a negative way, due to alleged abuse of stakeholders' trust (and subsidies) by social entrepreneurs.[19]

There are currently no listed companies that satisfy the aforementioned definition of social enterprises. Social enterprises in a non-profit or cooperative form cannot have shares listed on a stock exchange. However, as mentioned above, companies are now explicitly permitted to adopt a dual purpose. Two listed companies have since enshrined an additional, social purpose in their articles of association in the context of their certification as a B Corporation (see below section 4.3), without, however, committing to a cap on profit distributions.[20]

1.4. FINANCING

The sources of Belgian social enterprises' financing vary greatly, partially depending on the type of legal entity. Non-profit social enterprises cannot attract equity financing. They traditionally rely to a significant extent on government financing and donations[21] and seek less debt financing than their for-profit counterparts.[22] In the past decades, they increasingly also derive income from market activities.[23] Less is known about the financing of for-profit social enterprises. By their nature as companies and in contrast with non-profit

[17] See S. Lateur, 'Voo?uit [sic] Geschiedenis', https://www.vooruit.be/en/pQ0j4CM/history.

[18] See Académie des Entrepreneurs Sociaux, *Baromètre des entreprises sociales en Belgique,* Académie des Entrepreneurs Sociaux @HEC Liège – Université de Liège, Liège 2016, p. 31; Koning Boudewijnstichting and Nationale Bank van België, *Het economische gewicht van instellingen zonder winstoogmerk in België,* Koning Boudewijnstichting, Brussels 2020, pp. 24 and 31.

[19] E.g. the case of LGU Academy VZW (A. Hope, 'Judicial net closes around Let's Go Urban founder' *The Brussels Times* 31 March 2021).

[20] See article 3, fourth and fifth alinea, articles of association of Ion Beam Applications SA, as amended on 10 March 2020; article 3.6 of the articles of association of Inclusio SA, as amended on 11 December 2020.

[21] See e.g. Koning Boudewijnstichting and Nationale Bank van België, *Het economische gewicht van instellingen zonder winstoogmerk in België,* Koning Boudewijnstichting, Brussels 2020, p. 31.

[22] Ibid., p. 27.

[23] J. Defourny and M. Nyssens, 'Conceptions of Social Enterprise and Social Entrepreneurship in Europe and the United States: Convergences and Divergences' [2010] *Journal of Social Entrepreneurship* 35.

social enterprises, they benefit from equity financing. A review of the list of cooperatives certified as social enterprises indicates that they often operate in highly publicly subsidised industries, such as social housing.[24]

2. FORMS OF ORGANISATION FOR SOCIAL ENTERPRISES

2.1. NON-PROFIT ORGANISATIONS VS. COMPANIES

2.1.1. Non-Profit Organisations

On the non-profit side, social enterprises can choose between the de facto association without legal personality (*feitelijke vereniging/association de fait*), the non-profit association (*vereniging zonder winstoogmerk/association sans but lucratif*), the international non-profit association (*internationale vereniging zonder winstoogmerk/association internationale sans but lucratif*), the private foundation (*private stichting/fondation privée*) and the public interest foundation (*stichting van openbaar nut/fondation d'utilité public*).[25] Both among non-profit organisations and among social enterprises in general, the non-profit association is the most widely used form (see above section 1.2). The second-most popular form of non-profit organisation, but remaining far behind the non-profit association, is the private foundation (hereafter referred to in short as 'foundation').

Under the CCA, all non-profit organisations must pursue a disinterested purpose (*belangeloos doel/but désintéressé*)[26] and precisely describe this purpose in their articles of association.[27] According to the parliamentary preparations, disinterested purposes may be scientific, cultural, social, humanitarian or sports-related, as well as related to the protection of the environment or the interests of consumers or of a certain industry,[28] but the precise definition of a disinterested purpose is subject to some debate. Most authors argue that this term simply mandates the pursuit of a purpose that is not aimed at yielding (economic) benefits for the members.[29] It does not, therefore, mandate the pursuit of a truly

[24] Based on the list mentioned in footnote 15.
[25] See Articles 1:2–1:3 and 1:6–1:7 CCA.
[26] Articles 1:2, second sentence, and 1:3 CCA. Prior to the entry into force of the CCA, this requirement only (explicitly) applied to foundations under the law of 27 June 1921, concerning non-profit associations, foundations and European political parties and foundations.
[27] Articles 2:9, §2, 4°, 2:10, §2, 3° and 2:11, §2, 3° CCA.
[28] Explanatory Memorandum to the CCA, Parl. St. Kamer, nr. 3119/001, 27.
[29] P. Bossard, *CSA – Examen systématique du nouveau droit des sociétés non cotées et des associations*, Anthemis, Limal 2020, p. 41; M. Denef and B. Van Baelen, 'De VZW op maat van de vennootschap gesneden of toch een eigen leest?' in S. Cools (ed.), *Lessen na twee*

'social' purpose,[30] even though many (if not most) non-profit organisations do in fact pursue a social purpose.

Non-profit forms are prohibited from (directly or indirectly)[31] distributing profits to their owners, directors or other persons (the 'non-distribution constraint'), except to serve their disinterested purpose.[32] Before entry into force of the CCA of 2019, non-profit associations were also severely limited by law in their ability to engage in market activities, as these were only permitted when 'incidental' to their non-profit activities. The CCA abolished this restriction,[33] but the unbridled engagement in commercial activities can have negative consequences in other areas of law. In particular, it can lead to the imposition of (often less advantageous – see below section 2.8) corporate income tax.[34]

2.1.2. Companies

On the for-profit side, social enterprises can choose between the general partnership (*maatschap/société de droit commun*), the unlimited partnership (*vennootschap onder firma/société en nom collectif*), the limited partnership (*commanditaire vennootschap/société en commandite*), the private limited liability company (*besloten vennootschap/société à responsabilité limitée*), the public limited liability company (*naamloze vennootschap/société anonyme*) and finally the cooperative company (*coöperatieve vennootschap/société coopérative*). In this report, we refer to all these forms together as 'companies'. In Belgium, both in Dutch and in French, the term 'companies' is used in a broad sense that includes corporations and partnerships. In this report, 'corporations' are to be understood as companies with limited liability (see below section 2.3), i.e. private limited liability companies, public limited liability companies and

jaar WVV, Roularta, Roeselare 2022, pp. 18–19; D. Van Gerven, *Handboek vennootschappen*, Larcier, Brussels 2020, p. 547.

30 J. Vananroye, 'Over trans-vennootschappen en cis-verenigingen', https://corporatefinancelab.org/2019/11/26/over-trans-vennootschappen-en-cis-verenigingen/; R. Van Boven, *De Belgische stichting*, Larcier, Brussels 2020, pp. 27–31.

31 See Articles 1:2–1:4 CCA and Explanatory Memorandum to CCA, Parl. St. Kamer, nr. 3119/001, 28.

32 Articles 1:2–1:3 CCA, which also state that infringements can lead to nullity of the infringing operation, while Articles 9:4, 5°, 10:4, 5°, 11:5, 4°, 2:113, §1, 3° and 2:114, §1, 4° CCA state that (international) non-profit associations and foundations can be annulled or be dissolved judicially if they are formed with a profit distribution purpose or infringe the non-distribution constraint.

33 Article 1:2 CCA. Non-profit associations incorporated before 1 May 2019 remain subject to the old restrictions as long as they do not amend their objects and at the latest until 1 January 2029 (see Article 39, §4 Law of 23 March 2019 concerning the introduction of the Code of Companies and Associations and relating to diverse provisions, *BOJ* 4 April 2019).

34 S. Garroy, 'Entreprise sociale et fiscalité directe en Belgique' [2020] *TRV-RPS* 939–40.

cooperative companies. The term 'partnerships' refers to general partnerships, unlimited partnerships and limited partnerships.

For-profit social enterprises formed as cooperative companies may be certified as social enterprises. This new certification was created in the 2019 CCA as the successor of the social purpose company (*vennootschap met een sociaal oogmerk/société à finalité sociale*), which had received limited uptake and rather negative assessments. The certification as a social enterprise is discussed below in section 4.1.

For-profit social enterprises need not necessarily to pursue this certification (or adopt the cooperative form). Indeed, as mentioned above in section 1.1, the CCA allows all companies to include in their articles of association other purposes in addition to the distribution of profits to (or the reduction of costs for) shareholders.[35] Accordingly, every type of company can be tailored to social enterprises' needs and the shareholders can set their own limits on profit distribution in the articles of association.[36]

It is still uncertain how the enshrinement of a social purpose in the articles of association or the certification as a social enterprise impacts the corporate interest. The corporate interest had been defined in 2013 by the Supreme Court as the 'collective profit interest of the company's current and future shareholders'.[37] Commentators agree that this definition allows companies to consider stakeholders' interests as a means of safeguarding the profit interest of the current and (especially) the future shareholders.[38] Some argue that the reference to future shareholders makes the definition sufficiently broad to accommodate the possibility to include a social purpose in the articles of association, while others state that the possibility of dual-purpose companies requires a modification of the definition of the corporate interest.[39]

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35 Articles 1:1, last sentence, *juncto* 2:8, §2, 11° CCA.

36 See S. Cools and B. Van Baelen, 'Sociaal ondernemerschap en de nieuwe gedaante van de VZW, de CV en de andere vennootschapsvormen' in *Themis Vennootschapsrecht*, die Keure, Bruges 2021, p. 59.

37 Cass. 28 November 2013 [2014] *TRV-RPS* 286.

38 X. Dieux, 'L'intérêt social: pour une approche pragmatique' [2018] *JT* 599; A. François, 'Eng is niet steeds eng: het vennootschapsbelang eindelijk gedefinieerd!' in E. Alofs, H. Casman and A. Van Den Bossche (eds), *Liber Amicorum Andre Michielsens*, Kluwer, Antwerp 2015, p. 354; D. Willermain, 'L'intérêt social selon la Cour de cassation: "The Social Responsibility of Business is to Increase its Profits"?' [2014] *RDC-TBH* 861.

39 Compare M. Verheyden and A. François, 'Quand il pleut à Paris et aux États-Unis… ? Analyse du Code des sociétés et des associations à la lumière de la loi PACTE française et des benefit corporations américaines' in T. Tilquin (ed.), *Les instruments de droit des sociétés et de droit financier de l'économie durable*, Larcier, Brussels 2021, pp. 335–36 and D. Willermain and É.-J. Navez, 'L'évolution de la gouvernance des sociétés au 21e siècle' in *La gouvernance des sociétés au 21e siècle*, Anthemis, Limal 2020, pp. 85–86.

The enforcement of the corporate interest and corporate purpose(s) is to a large extent in the hands of insiders (i.e. shareholders and directors). While some case law recognised employees' or creditors' standing, stakeholder standing to file a nullity claim is uncertain.[40] Further, the risk of (successful) director's liability claims initiated by external stakeholders is rather theoretical, except for bankruptcy suits initiated by the government, the bankruptcy trustee or creditors.[41] Therefore, in dual-purpose companies, the preservation, monitoring and enforcement of the company's social purpose will largely depend on the presence of a strong stakeholder with sufficient bargaining power (e.g. the subsidising government or shareholders with a strong commitment to the social purpose, such as impact investors), or monitoring by other interested parties or organisations in the wider market (e.g. non-governmental organisations, consumer protection organisations or other activists).

2.2. APPLICABLE LAW

All the legal forms discussed above are regulated by national organisational law, namely the CCA, as organisational law is an exclusive federal competence.[42]

2.3. LEGAL PERSONALITY AND LIMITED LIABILITY

All the legal forms discussed above are incorporated forms (i.e. have legal personality), except for the de facto association or the general partnership. Nevertheless, the general partnership's assets are shielded from direct claims by shareholders' or members' creditors.[43] The unlimited partnership and the limited partnership do have legal personality, but the partners (except the limited partners in a limited partnership) do not enjoy limited liability.[44]

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[40] Article 2:44, first alinea CCA reserves standing to the legal entity itself and any person with an interest in compliance with the infringed rule. See Explanatory Memorandum to the CCA, Parl. St. Kamer, nr. 3119/001, pp. 54–55.

[41] See M. Wyckaert and R. Foriers, 'Bestuurdersaansprakelijkheid in vennootschappen: een veldonderzoek' in B. Tilleman (ed.), *Curatoren en vereffenaars: actuele ontwikkelingen VI*, Intersentia, Brussels 2021, pp. 337 and 370–71.

[42] Article 6, §1, VI, fourth alinea, 5° of the special law regarding the reform of institutions of 8 August 1980, *BOJ* 15 August 1980, expressly attributes company law to the federal government. The law of non-profit organisations is a 'residuary competence' of the federal government (J. Vanpraet, 'Kunnen de gemeenschappen en gewesten afwijken van het federale vennootschaps- en verenigingsrecht?' [2008] *CDPK* 884).

[43] See Articles 1:1 and 4:13–4:15 CCA.

[44] See Articles 1:5, §2 and 4:22 et seq. CCA.

2.4. PERMISSIBLE OBJECTS

The CCA mandates that all incorporated legal forms state their objects in their articles of association.[45] The objects may in principle be set freely, as long as they are not 'unlawful or contravening the public order (*openbare orde/ordre public*)', in which case the organisation could be nullified.[46]

2.5. GOVERNANCE

The central touchstone of director behaviour is the organisation's interest ('corporate interest'), as directors are required to act in the corporate interest and its infringement can therefore lead to director's liability or nullity of the act.[47] Unlike for companies (section 2.1.2), the definition of the corporate interest of non-profit associations and foundations has not been set by case law.[48]

Directors of organisations with legal personality must also disclose conflicts of interests and may not participate in the deliberations regarding the decision for which they are conflicted.[49] Only listed companies[50] and some companies subject to specific (industry) regulations[51] are required to appoint a minimum number of independent directors.

2.6. VOTING AND GOVERNANCE RIGHTS

Corporations and non-profit associations have a general meeting, in which, by default, shareholders have one vote per share and members each have one vote. The articles of association may provide for multiple voting rights.[52] However, listed companies can only provide for double ('loyalty') voting rights for shareholders who have held registered shares for at least two years

45 Articles 2:8, §2, 12°, 2:9, §2, 4° and 2:11, §2, 3° CCA.
46 See Articles 5:13, 3°, 6:14, 3°, 7:15, 3°, 9:4, 4° and 11:5, 3° CCA.
47 D. Van Gerven, *Handboek vennootschappen*, Larcier, Brussels 2020, pp. 628, 700 and 709–10; M. Verheyden and A. François, 'De schijnwerpers op een onderbelicht fundament: de rol en invulling van het verenigingsbelang' [2020] *TRV-RPS* 840 and 842; D. Van Gerven, *Handboek stichtingen*, Biblo, Kalmthout 2004, p. 120.
48 See M. Verheyden and A. François, 'De schijnwerpers op een onderbelicht fundament: de rol en invulling van het verenigingsbelang' [2020] *TRV-RPS* 856–58; D. Van Gerven, *Handboek stichtingen*, Biblo, Kalmthout 2004, p. 127.
49 Articles 5:76, 6:64, 7:96, 7:102, 7:115, 7:117, 9:8 and 11:8 CCA.
50 Articles 7:99, §2 and 7:100, §2, second alinea CCA; Article 3:4 Belgian Corporate Governance Code 2020.
51 See e.g. Article 4.39/5, §3, second alinea Flemish Housing Code 2021.
52 Articles 5:42, first alinea, 6:41, first alinea, 7:52 and 9:17 CCA.

uninterruptedly[53] and shareholders' voting power is capped in certified social enterprises (see below section 4.1). The general meeting has a number of default rights, such as the modification of the articles of association and the dissolution of the company, as well as, crucially, the appointment and dismissal of directors.[54] Other stakeholders are not by default granted representation on the board, but employees must be informed and consulted with under labour law[55] and powerful stakeholders can be granted the right to propose a candidate for a director's mandate.

In partnerships, decisions are in principle made with the unanimous consent of all partners. Unless the articles of association provide otherwise, each partner thus has one vote, irrespective of the size of his or her contribution.[56] By default, partnerships do not feature a general shareholders' meeting that decides by majority. Yet partnership agreements can stipulate majority instead of unanimity requirements.[57]

2.7. TRANSFERABILITY OF OWNERSHIP

The transferability of company shares depends on the legal form and the arrangement in the articles of association. At one end of the spectrum, shares of a public limited liability company can be freely traded and their tradability can only be restricted under certain conditions.[58] At the other end, partnership shares cannot be transferred without the unanimous agreement of the partners, unless agreed otherwise (as the case may be in the articles of association).[59] Private limited liability companies and cooperative companies operate in between those extremes, with the transfer of the former's shares being subject to the approval of a qualified majority of shareholders unless stated otherwise in the articles of association.[60] In addition, for the transfer of shares in cooperative companies to third parties, the acquiror must satisfy the conditions set in the

[53] Article 7:53 CCA.

[54] Articles 5:70, §2, 5:100, 6:58, §2, 6:85, 7:85, §2, 7:105, §3 and 9:12, 1° and 2° CCA, as well as Articles 2:71, §1 and 2:110, §1, first alinea CCA.

[55] In undertakings with a certain number of employees, such concertation happens through the works council. See e.g. C. Engels, 'Collectief ontslag en sluiting van onderneming' in F. Hendrickx and C. Engels (eds), *Arbeidsrecht – Deel 3*, die Keure, Bruges 2020, pp. 557–66.

[56] J. Malherbe et al., *Droit des sociétés*, 5th ed., Larcier, Brussels 2020, p. 442.

[57] Article 4:12 CCA.

[58] Articles 7:73 and 7:78 CCA.

[59] Article 4:6, first alinea CCA.

[60] Article 5:63 CCA, which dispenses the transfers to other shareholders, to the shareholder's spouse or civil partner or to his or her lineal ascendants or descendants from the compliance with these requirements.

articles of association and the transfer must be approved by the board (or the general shareholders' meeting).[61]

The membership of non-profit associations cannot be transferred,[62] but members can resign and can be excluded by the general members' meeting.[63]

2.8. ENTITY AND OWNER TAXATION

Under Belgian tax law, organisations with legal personality are in principle subject either to corporate income tax (*vennootschapsbelasting/impôt des sociétés*) or to 'legal entity tax' (*rechtspersonenbelasting/impôt des personnes morales*), each with different tax base and tax rates. Non-profit associations and foundations are subject to legal entity tax, unless they regularly or structurally engage in 'profit-making' activities or operations.[64] The vast majority of non-profit associations are subject to legal entity tax,[65] which is mostly considered the more attractive option. Corporations are in principle subject to corporate income tax,[66] with potentially an exception for certified social enterprises that do not distribute dividends.[67]

General partnerships (but not unlimited or limited partnerships)[68] enjoy tax transparency. Each partner is taxed on the annual income of the partnership in proportion to his or her share in the distributed profits.[69] De facto associations are in principle not taxed at entity level either.[70]

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61 Article 6:54 CCA. Shares can be transferred freely to other shareholders, unless stated otherwise in the articles of association (Article 6:52 CCA).

62 K. Geens, 'De VZW in haar afbakening tegenover andere rechtsvormen' in *1921–1996. 75 jaar Belgisch VZW-recht*, Procura, Brussels 1996, p. 68.

63 Article 9:23 CCA.

64 S. Garroy, 'Entreprise sociale et fiscalité directe en Belgique' [2020] *TRV-RPS* 928–33; D. Deschrijver, *Verenigingen, Stichtingen & Belastingen*, Roularta, Schoten 2019, pp. 122–275.

65 See E. Schiepers, 'Mist de fiscale wetgever de trein van het moderne verenigingsrecht? De gevolgen van de liberalisering van economische activiteiten voor het fiscaal statuut van de vzw', unpublished Master's thesis on file with the rapporteurs, 2020.

66 Articles 179 and 2, §1, 5°, a) and b) Income Tax Code 1992.

67 Compare L. De Broe and D. Garabedian, 'Aspect de droit fiscal' in *Le nouveau droit des sociétés et des associations*, Anthemis, Waver 2019, p. 570 and S. Garroy and X. Gérard, 'Variations autour des coopératives en Belgique: aspects fiscaux et non fiscaux, propos rétrospectifs, dynamiques actuelles et réflexions prospectives' [2021] *Rev. Dr. Ulg.* 472–73.

68 Articles 2, §1, 5° *juncto* 179 Income Tax Code. See, however, Article 29, §2, 2° Income Tax Code, with regard to limited and unlimited partnerships certified as agricultural enterprises and Article 29, §2, 4° Income Tax Code, with regard to unlimited partnerships formed by conversion of an economic interest grouping.

69 Articles 29, § 1 *juncto* 183 Income Tax Code.

70 D. Deschrijver, *Verenigingen, Stichtingen & Belastingen*, Roularta, Schoten 2019, pp. 975–87; A. Haelterman, 'De feitelijke (on)belastbaarheid van de feitelijke vereniging en de "kaaimantaks"' in *Liber Amicorum Rik Deblauwe*, Knops, Herentals 2018, pp. 397–410.

2.9. CONTINUITY OF EXISTENCE

All the legal forms discussed endure for an indefinite period by default, but their articles of association may set a limited duration.[71] The incorporated forms, except foundations, can be dissolved by a decision of the general shareholders' meeting or the general members' meeting subject to certain formalities and special majorities.[72] All the legal forms discussed can be dissolved by a judge, under specific circumstances set by statute and varying from one legal form to another.[73]

3. LIFECYCLE

3.1. FORMATION

Depending on their legal form, social enterprises can be formed orally (de facto associations and general partnerships), may be formed through a private deed (non-profit associations and partnerships) or must be formed through a notarial deed (public and private limited liability companies, cooperative companies and foundations).[74]

A specific registration for social enterprises only applies to companies that apply for certification as a social enterprise (see below sections 4.1 and 4.2).

Public and private limited liability companies and cooperative companies must have adequate starting capital and must justify this in a financial plan that they file with the notary public.[75] In every company form, shareholders must also make a contribution (*inbreng/apport*).[76]

3.2. CONVERSION

On the for-profit side, corporations and partnerships with legal personality can convert to other types of corporations and partnerships with legal personality on the basis of a statement of assets and liabilities, a directors' report and a decision

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[71] Articles 4:3, 5:157, 6:125, 7:230, 2:9, §2, 10° CCA; D. Van Gerven, *Handboek stichtingen*, Biblo, Kalmthout 2004, p. 76; D. Van Gerven, *Handboek verenigingen*, Biblo, Kalmthout 2004, p. 56.

[72] Articles 2:71 and 2:110, §1, first alinea CCA.

[73] Articles 4:17, §2, 2:73–2:74, 2:113 and 2:114 CCA. For de facto associations, such dissolution can be demanded on the basis of Article 1184 Civil Code (Supreme Court 2 May 2002 [2002] *NjW* 24–25).

[74] Article 2:5, §1, first and second alinea, §2, first alinea and §3, first alinea CCA.

[75] Article 5:3–5:4, 6:4–6:5 and 7:3 CCA.

[76] Article 1:1 and 1:8, §1 CCA.

of the general shareholders' meeting taken with an 80% majority or unanimity.[77] The amendment of the articles of association to anchor, modify or remove a social purpose or several social purposes (even while remaining the same type of company) requires a general shareholders' meeting decision with a qualified majority of 80%.[78]

Corporations and partnerships with legal personality can be converted to non-profit associations by a unanimous decision of the shareholders.[79]

The certification of a cooperative company as a social enterprise is granted by a federal minister and does not formally require a conversion, unless the company was not formed as a cooperative company (see below section 4.1). Inserting (or removing) the clauses necessary for certification in principle requires a majority of 75% of the votes cast, except for the amendment of the objects and the purpose, which require an 80% majority.[80] Although the certification requirements no longer explicitly state so, a cooperative company that loses its certification as a social enterprise must, upon loss of its certification, earmark its net assets for allocation in line with the social impact purpose (or immediately disburse it for that purpose).[81]

Non-profit associations can convert into an international non-profit association (and vice versa), whilst foundations can convert to public interest foundations.[82] The conversion of a non-profit association to a foundation (and vice versa) is not possible, as they are two very different organisations.

A non-profit association cannot convert directly into a company, except into a cooperative company certified as a social enterprise. This requires an 80% majority.[83] The conversion procedure protects the non-distribution constraint by mandating the earmarking of the 'net assets' for allocation to the social purpose anchored in the new cooperative company's articles of association.[84] The distribution of these earmarked net assets to the new company's shareholders is strictly prohibited and can lead to liability of directors, liquidators or bankruptcy trustees, as well as to clawbacks if the beneficiaries knew or should have known of the irregularity of the payments.[85]

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77 Articles 14:1–14:14 CCA.

78 Articles 5:101 and 7:154 CCA. Compare Article 6:86 CCA: cooperative companies may lower this majority threshold in their articles of association.

79 Article 14:34, §1 CCA.

80 The articles of association can deviate from these majority requirements. See Articles 6:85, fourth alinea and 6:86, fifth alinea CCA; S. Cools and M. Verheyden, 'Doelwijzigingen en omzettingen die het doel wijzigen: meerderheidsvereisten en vermogensbescherming' [2022] *TRV-RPS* 364.

81 S. Cools, 'Asset lock bij verlies van erkenning als sociale onderneming' [2021] *TRV-RPS* 970–74.

82 See Articles 14:46–14:50 and 14:67 CCA respectively.

83 Article 14:39, first alinea *juncto* 9:21, third and fourth alineas CCA.

84 Articles 14:42 and 14:43 CCA.

85 Articles 14:43 and 14:44 CCA.

3.3. ACCOUNTABILITY

3.3.1. Reporting and Disclosure

The periodic financial and ad hoc corporate reporting obligations of social enterprises are determined by their legal form and size and not affected by their nature as social enterprises, unless they are cooperative companies certified as a social enterprise (see below section 4.1).

First, corporations and partnerships with legal personality, non-profit associations and foundations must establish annual accounts.[86] With the exception of small, non-listed companies, non-profit associations and foundations and certain (unlimited and limited) partnerships, they must complement these with an annual report.[87] These financial documents are accessible to the public at the registrar of the enterprise court or on the website of the Belgian National Bank.[88] Certain (unlimited and limited) partnerships, as well as 'small non-profit associations' and 'small foundations' that (in addition to being 'small') do not exceed certain thresholds in terms of personnel, turnover, assets and liabilities, are not obliged to file their annual accounts with the Belgian National Bank.[89]

Second, forms with legal personality must disclose certain corporate decisions, such as the appointment of directors or modifications to the articles of association, in the Annexes to the Belgian Official Journal.[90] These are available online,[91] as are the consolidated articles of association of companies established or having modified their articles of association after 1 May 2019.[92]

3.3.2. Auditing

All corporations and partnerships with legal personality, except for certain partnerships and non-listed small corporations, and all non-profit associations and foundations that are not small must appoint one or more statutory auditors (*commissaris/commissaire*).[93] The appointment of a statutory auditor may also be done voluntarily or be imposed by specific industry regulations.[94]

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86 Articles 3:1, 3:47 and 3:51 CCA.
87 Articles 3:4, 3:5, 3:48 and 3:52 CCA.
88 The 'Consult' database is available at https://cri.nbb.be/bc9/web/catalog?execution=e2s1.
89 Articles 3:9, 3:47, §7 and 3:51, §7 CCA.
90 Articles 2:8–2:14 CCA.
91 The 'Reference Database Legal Entities' is available at http://www.ejustice.just.fgov.be/tsv/tsvn.htm.
92 Article 2:7, §2 CCA. The 'Costa' database is available at https://statuten.notaris.be/costa_v1/enterprises/search.
93 Articles 3:72–3:73, 3:47, §6 and 3:51, §6 CCA.
94 E.g. Article 4, 6° of annexes 10 and 11 of the Decision Flemish Housing Code 2021.

3.3.3. (Third-Party) Assessment of the Social Impact

The annual report must include non-financial performance indicators when this is 'necessary for the comprehension of the development, results or position of the company'.[95] Besides that, there is little statutory guidance on how an organisation is to report on the pursuit of its social purpose.[96] Of course, specific industry (e.g. subsidy) regulations often include other reporting requirements.

Since statutory auditors are required to verify the conformity of the transactions featured in the annual accounts with the articles of association, they must at least theoretically check whether the incurred expenses have indeed been made to pursue the organisation's purposes and objects. Moreover, for companies that must include non-financial information in their annual report, statutory auditors must verify that the report indeed includes the required information.[97] Other than that, the application of a third-party standard, the verification of social impact by a third party and the quantification of social impact remain matters of voluntary action by social enterprises (and their directors), except in cases of pressure by powerful stakeholders or industry (e.g. subsidy) requirements. Further, a few Belgian dual-purpose companies (although not necessarily social enterprises) have committed to third-party standards and review under the umbrella (and with the marketing value) of the B Corporation certification (see below section 4.3).

3.3.4. Government Supervision

There is no centralised regulator or supervisor for social enterprises in Belgium. The only social enterprises with a dedicated supervisor are those that have been certified as such by the competent minister (see below sections 4.1 and 4.2) or which operate in regulated industries with government supervision.[98] Of course, social enterprises are subject to criminal law and the public prosecutor's office may therefore from time to time target social enterprises (or its controllers), for alleged breach of trust, misappropriation of corporate assets or other criminal investigations.

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[95] Article 3:6, §1, second alinea, 3:48, §2, 1° and 3:52, second alinea CCA.

[96] Regarding for-profit social enterprises, see M. Verheyden and A. François, 'Quand il pleut à Paris et aux États-Unis… ? Analyse du Code des sociétés et des associations à la lumière de la loi PACTE française et des benefit corporations américaines' in T. Tilquin (ed.), *Les instruments de droit des sociétés et de droit financier de l'économie durable*, Larcier, Brussels 2021, pp. 321–23. Regarding non-profit social enterprises, see e.g. the mandatory content of the annual report (Article 3:48 CCA) and compare to Article 3:6, §1 CCA (regarding corporations and partnerships with legal personality).

[97] Regarding the non-financial performance indicators, see above section 3.3.3. Regarding the 'non-financial statement' mandated by Article 3:6, §4 CCA for large 'public-interest entities', see Article 3:75, §1, 6° CCA.

[98] See e.g. Articles 4.79 et seq. Flemish Housing Code 2021.

3.4. EXIT

The typical lifecycle of a social enterprise formed as an organisation ends with its dissolution and liquidation, conversion to another organisational form, or the loss of its certification (see above section 3.2).

As mentioned above in section 2.9, the dissolution can occur either pursuant to a shareholder decision or as a consequence of a court decision. Such judicial dissolution can be demanded by every interested third party (including employees or other stakeholders). It can only be ordered in a specific set of circumstances set in the CCA, including the infringement of the non-distribution constraint by non-profit organisations[99] and the non-deposition of annual accounts by corporations and partnerships with legal personality.[100] After repayment of shareholder contributions and, under specific circumstances,[101] of member or founder contributions, the net assets of a non-profit association, a foundation and a certified social enterprise are 'locked' and can only be allocated to the social enterprise's social purpose.[102]

4. STATE/PRIVATE CERTIFICATIONS AND METRICS

4.1. FEDERALLY CERTIFIED SOCIAL ENTERPRISE

The certification as a social enterprise, granted by the federal Minister of Economy, is available only to cooperative companies.[103] The CCA seeks to reserve the cooperative company form for 'true cooperatives' in the sense of the cooperative principles of the International Cooperative Alliance.[104] In line with the importance of democratic decision-making in cooperatives,[105] the articles of association of a certified social enterprise must forbid that shareholders vote for more than one-tenth of the total number of votes represented at the general shareholders' meeting.[106]

The certification requirements further include a social purpose requirement and a profit distribution constraint, as well as a disclosure requirement. These

99 Articles 9:4, 5°, 11:5, 4°, 2:113, §1, 3° and 2:114, §1, 4° CCA.
100 Article 2:74, §1 CCA.
101 See Article 9:23, third alinea and 11:2, second alinea CCA.
102 Article 2:11, §2, 6° CCA, 2:135, second alinea and 8:5, §1, 3° CCA.
103 Article 8:5 CCA.
104 Explanatory Memorandum to the CCA, Parl. St. Kamer, nr. 3119/001, 11 and 191.
105 'Democratic member control' is the second cooperative principle.
106 Article 6, §1, fist alinea Royal Decree of 28 June 2019 establishing the conditions for certification as an agricultural enterprise and as a social enterprise (RD 28 June 2019), *BOJ* 11 July 2019.

certification requirements must be anchored in the articles of association and complied with in practice.[107]

Certified social enterprises must 'subscribe to the social impact approach',[108] by having as their main purpose to 'generate, in the general interest, a positive social impact on man, environment or society' (hereinafter 'social impact purpose').[109] This relatively new provision has not yet been tested and interpreted in (published) case law, but leaves room for very diverse social impact purposes, as long as they are not seeking to serve the shareholders' financial interests.[110]

Moreover, although all corporations must be formed with a profit distribution purpose, certified social enterprises may only distribute profits, by dividend or otherwise,[111] up to a particular rate of return on the amount actually paid by the shareholders on the shares, currently set at 6% per year.[112] Upon liquidation, if a balance remains after payment of debts, shareholders are only entitled to the payment of their historical contribution; the remainder, if any, must be allocated to a cause as close as possible to the certified social enterprise's objects.[113] Shareholders withdrawing in exchange for a payment by the company, thereby in effect causing a partial liquidation, are only entitled to the nominal value of their actual contribution.[114] Logically, the same applies to shareholders who are excluded.[115] The commitment of the social enterprise's assets to its social impact purpose is further protected by the default rule of gratuity of the director's mandate (although the general shareholders' meeting may grant a limited expense allowance or attendance fee) and the need to determine, before paying a dividend, the amount that will be allocated to projects necessary or useful to the realisation of its objects.[116] Furthermore, as mentioned above in section 3.2, certified social enterprises must allocate their net assets to their social impact purpose when losing their certification.

107 Ibid.

108 Explanatory Memorandum to the CCA, Parl. St. Kamer, nr. 3119/001, 279.

109 Article 8:5, §1, 1° CCA. Article 6, §1, first alinea, 2° RD 28 June 2019 mandates that the company's objects are described in the articles of association in a way that clearly indicates that it serves such social impact purpose.

110 B. Van Baelen, 'Artikel 8:5 WVV' in *Vennootschappen en verenigingen. Artikelsgewijze commentaar met overzicht van rechtspraak en rechtsleer*, Kluwer, Mechelen 2020, pp. 399–400.

111 Article 8:5, §1, 2° CCA; Article 6, first alinea, §1, 7° RD 28 June 2019.

112 Article 8:5, §1, 2° CCA; Article 1, §1, 5° Royal Decree of 8 January 1962 establishing the conditions for certifications of groupings of cooperative companies and of cooperative companies, *BOJ* 19 January 1962.

113 Article 8:5, §1, 3° CCA; Article 6, first alinea, §1, 8° RD 28 June 2019; Explanatory Memorandum to the CCA, Parl. St. Kamer, nr. 3119/001, 279.

114 Article 6, §1, first alinea, 3° CCA.

115 S. Cools and B. Van Baelen, 'Sociaal ondernemerschap en de nieuwe gedaante van de VZW, de CV en de andere vennootschapsvormen' in *Themis Vennootschapsrecht*, die Keure, Bruges 2021, p. 54.

116 Article 6, §1, 4° and 6° CCA.

Certified social enterprises must establish an annual special report detailing the way in which the board supervised the compliance with the certification requirements, the activities performed by the company to realise its objects and the resources deployed to that end.[117] If the company must establish an annual report, the special report is to be inserted in that annual report; if the company does not have to establish an annual report, the board must send it to the Federal Public Service of Economy.[118] While the appointment of a statutory auditor may be required based on the rules governing all corporations (see section 3.3.2), the certification requirements do not specifically mandate the auditing of the social enterprise's annual report and special report. Nor do they mandate the use of certain standards or metrics; they can be fulfilled through a simple narrative overview. The use of (third-party) standards and metrics can hence happen on a voluntary basis, but, like other corporations and partnerships with legal personality, certified social enterprises that must publish an annual report must include non-financial performance indicators (including environment or staff matters), when this is 'necessary for the comprehension of the development, results or position of the company'.[119]

The Federal Public Service of Economy is tasked with monitoring the continued compliance of certified social enterprises with the certification requirements and can request additional information and documents from the company.[120] Non-compliance with the certification requirements or failure to provide the requested information or documents is sanctioned with revocation of the certification.[121]

The 'certified social enterprise brand' is further protected by the capacity of the enterprise court to dissolve a company that presents itself as a certified social enterprise, without being certified. Such judicial dissolution can be requested by the Minister of Economy, the public prosecutor's office or any interested party.[122]

4.2. BRUSSELS-CAPITAL REGION CERTIFIED SOCIAL ENTERPRISE

One year before the federal government created the certification as a social enterprise, the Brussels-Capital Region introduced a certification with the same name. This certification is granted by the Brussels-Capital Region Minister of Employment to private or public organisations which are located in the Brussels-Capital Region and, besides satisfying a number of formal requirements, pursue

[117] Article 6, §2, first alinea, 2°–4° RD 28 June 2019.
[118] Article 6, §2 RD 28 June 2019.
[119] Article 3:6, §1, second alinea CCA.
[120] Article 8 RD 28 June 2019.
[121] Article 9 RD 28 June 2019.
[122] Article 8:7, second alinea CCA.

an economic project that is primarily for a social purpose and with democratic governance.[123] The certification does not detract from the certified organisation's obligations under (federal) organisational law. Of the 148 private certified social enterprises, the vast majority take the form of a non-profit association.[124] Given the limited geographical scope of this certification, the remainder of this report only discusses the federally certified social enterprise.

4.3. PRIVATE CERTIFICATIONS

In addition to government-issued certifications, companies are free to apply for private certifications, the most renowned being the B Corporation, administered by B Lab. Certification as a B Corporation requires, among other things, obtaining a minimum score on an impact assessment, payment of certification fees and compliance with legal requirements relating to the transition to a B Corporation.[125] In Belgium, the latter requirements consist of a set of clauses that must be inserted in the company's articles of association. They include a social purpose clause, a clause mandating the consideration of stakeholders' interests in board decisions and a clause stressing that this mandated consideration does not confer any right on these stakeholders or other third parties vis-à-vis the board, its directors or the company.[126] In September 2021, the B Lab listed 20 B Corporations located in Belgium.[127] Two of these (Ion Beam Applications and Inclusio, see above section 1.3) are listed on Euronext Brussels.

The government-issued and private certifications can be alternative options, but can also be complementary. The certification as a B Corporation does not require that companies primarily pursue a social purpose. Hence, B Corporations are not necessarily social enterprises and often do not qualify for either of the government-issued certifications as social enterprises. The combination of certification requirements is possible and does not create conflicts,[128] but does not seem to occur in practice.[129]

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[123] Articles 4–6 Brussels-Capital Region Ordinance of 23 July 2019 concerning the certification of and the support to social enterprises, *BOJ* 18 September 2018.

[124] Analysis based on the list of certified social enterprises of 2 August 2021, as published on https://economie-werk.brussels/sociale-onderneming-erkenning#verplichtingen.

[125] B Lab, 'Certification', https://bcorporation.net/certification, and B Lab, 'Certification Requirements', https://bcorporation.net/certification/meet-the-requirements.

[126] B Lab, 'Legal Requirements', https://bcorporation.net/certification/legal-requirements.

[127] List on file with the rapporteurs. Compiled using B Lab, 'B Corp Directory', https://bcorporation.net/directory (searched 1 September 2021). As of 3 January 2023, the number of B Corporations listed by the B Lab as located in Belgium had increased to 50.

[128] See M. Verheyden and A. François, 'Quand il pleut à Paris et aux États-Unis… ? Analyse du Code des sociétés et des associations à la lumière de la loi PACTE française et des benefit corporations américaines' in T. Tilquin (ed.), *Les instruments de droit des sociétés et de droit financier de l'économie durable*, Larcier, Brussels 2021, p. 345 (with respect to the federal certification).

[129] Comparing the lists mentioned in footnotes 15, 124 and 127.

5. SUBSIDIES/BENEFITS

5.1. AT THE LEVEL OF THE ENTERPRISE

5.1.1. Taxation

Belgium does not offer a specific tax regime for social enterprises. However, certified social enterprises that do not distribute dividends could potentially be taxed under legal entity tax instead of corporate income tax.[130]

In addition, cooperative companies that are certified as such (i.e. as cooperative companies) by the federal Minister of Economy ('certified cooperative companies') benefit from tax advantages regarding corporate income tax. Although this certification is different from certification as a social enterprise, several certification conditions are similar.[131] Some cooperative companies combine both certifications.[132] Cooperative companies that are certified as such are exempted from corporate income tax on the first tranche of dividends distributed to shareholders who are natural persons,[133] do not risk requalification of the interests paid on debts to shareholders at above-market rates or for debts exceeding the sum of the taxed reserve and the paid-up capital as dividends,[134] and are not subject to the exclusion grounds for the lower tax rate applicable to the first tranche of income of small corporations.[135]

5.1.2. Subsidies

Despite the absence of a subsidy regime that automatically applies to all social enterprises, many social enterprises partially rely on subsidies, as different governments often fund social enterprises to execute public interest missions.

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130 Compare L. De Broe and D. Garabedian, 'Aspect de droit fiscal' in *Le nouveau droit des sociétés et des associations*, Anthemis, Waver 2019, p. 570 and S. Garroy and X. Gérard, 'L'impact du Code des sociétés et des associations sur le régime de fiscalisation des revenus des ASBL: lorsque l'un part et l'autre reste' in L. Hervé and I. Richelle (eds), *Incidences fiscales de la réforme du droit des sociétés*, Larcier, Brussels 2019, pp. 230–40 and 258–62.

131 For instance, both the dividend cap and the limit on voting powers for certified social enterprises (see above section 4.1) are almost identical transplants of two of the certification requirements stated in Royal Decree of 8 January 1962 establishing the conditions for certifications of groupings of cooperative companies and of cooperative companies, *BOJ* 19 January 1962. See, however, V. Simonart, 'Double agrément des sociétés coopératives' [2022] *TRV-RPS* 59–61 on the differences between the (standard) purposes of both types of certified companies.

132 Comparing our list of 972 certified social enterprises mentioned above in footnote 15 and the list of 719 certified cooperative companies of 16 September 2021 published on the website of the Federal Public Service of Economy (on file with the rapporteurs), we find that 186 companies combine both certifications.

133 Article 185, §1, first alinea Income Tax Code 1992, which caps the exemption at €200 per person for taxation year 2022.

134 Article 18, alinea 1, 4° and alinea 8 Income Tax Code 1992.

135 Article 215, alineas 2 and 3, 1°, 2° and 4° Income Tax Code 1992.

Belgian subsidy law is a dispersed patchwork of regulations at many different levels, from the national level, via the regional and community level, to the local level.[136] Many such regulations expressly reserve subsidies to non-profit organisations that pursue a social purpose.[137] Some of these regulations also[138] (or only)[139] allow for-profit social enterprises to be granted a subsidy, often on the condition that they take the form of a social purpose company.[140] As explained above (section 2.1.2), the latter no longer exist in the CCA of 2019. As most of the aforementioned subsidy regulations were issued at the regional level, it remains to be seen whether the Regions will replace the legal form requirement by a requirement of certification granted by a federal minister, or will instead design a separate set of conditions, as in the case of the Brussels-Capital Region's certification discussed above in section 4.2.[141]

5.1.3. Public Financing

Non-profit associations are exempted from the obligation to publish a prospectus for the issuance of investment instruments (such as bonds), provided that the funds raised are necessary to realise the organisation's non-profit purposes.[142] This exemption is not applicable to for-profit social enterprises, even if they are certified social enterprises.[143]

5.1.4. Workers

An important advantage for non-profit social enterprises is that they can rely on 'volunteers' (*vrijwilligers/volontaires*) who are unpaid or merely receive reimbursement of expenses without triggering taxation (under certain

136 See D. Coeckelbergh, *De VZW & haar financiering*, Intersentia, Mortsel 2021, pp. 58–60 (focusing on Flanders).

137 E.g. Article 3, first alinea Participation Decree of 18 January 2008, *BOJ* 4 April 2008 (Flanders).

138 E.g. Article 2, §1, 1° Decision of 3 April 2014 of the Walloon Government concerning the certification and the subsidisation of non-profit associations and social purpose companies active in the industry of (preparation of) recycling, *BOJ* 29 April 2014.

139 A relatively rare example is that of Flemish social housing companies (Articles 4.39 et seq. Flemish Housing Code 2021).

140 See e.g. Articles 3, §1, 1° *juncto* 7, §1, 2° *juncto* 15, §1, 1° Flemish Decree of 20 October 2016 concerning the certification of social economy initiatives and subsidisation of integration enterprises, *BOJ* 7 November 2016.

141 See also e.g. Articles 4.39 et seq. Flemish Housing Code 2021.

142 Article 10, §2, 5° Law of 11 July 2018 on public offers of investment instruments and on the admission of investment instruments to trading on regulated markets, *BOJ* 20 July 2018.

143 Financial Services and Market Authority in its Opinion of 29 June 2021, https://www.fsma.be/fr/opinion/applicabilite-aux-asbl-et-aux-entreprises-sociales-de-lexception-lobligation-de-prospectus.

conditions).[144] The law only provides for the hiring of such volunteers by non-profit (and public) organisations,[145] but it has been argued that it also allows social purpose companies to hire volunteers if they exclude the distribution of dividends.[146] It is highly uncertain whether the tax administration will accept this for certified social enterprises.[147]

5.2. AT THE LEVEL OF INVESTORS AND DONORS

Belgian law does not feature a generally applicable system of subsidies or tax preferences for investments or donations to social enterprises. However, investors in and donors to social enterprises may benefit from one of the following two measures.

A first tax incentive exists for donations to non-profit organisations. Donors can enjoy a tax reduction covering part of their charitable contributions provided that the non-profit organisation is named in the tax code or certified by the competent minister.[148] Donors can be physical or legal persons. Specifically, they can deduct an amount of 45% of donations (provided that these exceed €40) from their income taxes[149] until a ceiling is reached.[150]

Second, the first tranche of €200 of interest paid by certified social enterprises which are also certified by the Minister of Finance are not considered taxable income of investors for income tax purposes.[151] This second certification requires, among other things, that certified social enterprises pursue one of the purposes enumerated in the tax code and that their articles of association state that the remaining balance upon liquidation, if any, is entirely allocated to another social enterprise.[152]

5.3. PUBLIC PROCUREMENT

Under certain circumstances, social enterprises may also benefit from the growing tendency to consider social and environmental aspects in public

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144 Articles 3, 1° and 10 Law of 3 July 2005 concerning the rights of volunteers, *BOJ* 29 August 2005.

145 Ibid., Article 3, 3°.

146 J. Goyvaerts, 'De vzw en haar vrijwilliger' in *De VZW*, die Keure, Bruges 2015, p. 560; D. Deschrijver, *Verenigingen, Stichtingen & Belastingen*, Roularta, Schoten 2019, p. 1090.

147 See M. Davagle, *Le volontariat dans tous ses états*, Kluwer, Mechelen 2019, p. 13.

148 Article 145[33] Income Tax Code.

149 See M. Davagle, *Mémento des ASBL*, Kluwer, Mechelen 2021, pp. 980–92; D. Deschrijver, *Verenigingen, Stichtingen & Belastingen*, Roularta, Schoten 2019, pp. 1119–75.

150 Namely 10% of net income and €392,200 for taxation year 2022 for natural persons and 5% and €500,000 for corporate income tax.

151 Article 21, first alinea, 10° Income Tax Code (€125; subject to yearly indexation).

152 Ibid.

procurement. Even though the law only provides possibilities and not obligations for contracting authorities,[153] a recent report concluded that the use of these tools is 'well developed in Belgium and leads to public authorities being an important client for social enterprises'.[154]

6. PRIVATE CAPITAL

Some non-profit social enterprises (partly) rely on private funding, instead of (or in addition to) government financing and income from market activities. Such private funding can be provided without the expectation of direct consideration, in the form of membership contributions, donations and philanthropy, by individuals, by other non-profit organisations (e.g. the King Baudouin Foundation) or by corporations, with examples of the latter being non-profit organisations ('philanthropic arms') formed and funded by large corporations.[155] Private funding can also take the form of a repayable credit offered by financial institutions, factoring or sponsoring.[156] Some non-profit organisations target the general public as a source of financing, via crowdfunding,[157] or sometimes by issuing bonds (often without the need to publish a prospectus; see above section 5.1.3).[158]

For-profit social enterprises will often, at least to some extent, rely on capital provided by 'impact investors' who seek a blend of financial and social return.[159] A particular type of impact investor, which can hardly be considered as providing 'private capital', is (national, regional or local) governments. These often (directly or indirectly) provide for-profit social enterprises with equity, sometimes combined with subsidies and payments for goods or services.[160] Some for-profit social enterprises resort to public financing through the public

[153] E.g. Articles 54, 81, §2, 3°, 91 and recital 97 of the Public Procurement Law of 17 June 2016.

[154] European Commission, *Social enterprises and their ecosystems in Europe. Updated country report: Belgium*, Publications Office of the European Union, Luxembourg 2020, p. 68.

[155] E.g. the Collibri Foundation, founded by Etablissementen Franz Colruyt (Colruyt), a large retail company listed on Euronext Brussels (https://www.collibrifoundation.org/en).

[156] See D. Coeckelbergh, *De VZW & haar financiering,* Intersentia, Mortsel 2021, pp. 41–42 and 46–53; V. Simonart, *Associations sans but lucratif, associations internationales sans but lucratif et fondations,* Larcier, Brussels 2016, pp. 405–40.

[157] See V. Simonart, *Associations sans but lucratif, associations internationales sans but lucratif et fondations,* Larcier, Brussels 2016, pp. 436–40.

[158] Ibid., p. 424; R. Galle, 'De uitgifte van obligaties door de VZW' in *De obligatielening*, Intersentia, Mortsel 2017, pp. 497–502.

[159] See iPropeller and King Baudouin Foundation, 'Study on Belgian impact investing for development: 2018–2019 edition', https://kbfafrica.org/wp-content/uploads/2021/04/BelgianImpactInvesting-Study2018–2019.pdf.

[160] The Flemish social housing companies discussed above being a typical example (see Article 4.39/2 Flemish Housing Code 2021).

placement of bonds or shares. However, as discussed above in section 1.3, no Belgian social enterprise currently has its shares listed on a stock exchange.

7. OTHER CONSTITUENCIES

This section outlines the extent to which investors and other stakeholders have an influence on the protection, monitoring and enforcement of the pursuit of social enterprises' social purpose.

7.1. FOR-PROFIT CORPORATIONS AND NON-PROFIT ASSOCIATIONS

7.1.1. Insiders (Shareholders, Members and Directors)

In for-profit corporations and non-profit associations, shareholders and members can play an important role in protecting, monitoring and enforcing the effective pursuit of the social purpose. Although corporations and non-profit associations are in the first instance governed by their boards (which have 'residual powers'),[161] shareholders and members can exert significant influence through the default rights allocated to them by the CCA. Unless provided otherwise by the articles of association, a simple majority of shareholders or members can effectively replace directors through a general meeting decision (see above section 2.6). In addition, if they represent sufficient voting power and follow the appropriate formalities, shareholders and members can decide to modify a social enterprise's purpose or even to dissolve the organisation (see above sections 2.6 and 2.9).[162]

However, shareholders and members are imperfect 'guardians' of the social purpose when decisions (directly or indirectly) impact their own (especially financial) interests. The potential conflict is most acute for shareholders of for-profit social enterprises who also seek a return on investment. While presumably less regularly and less acutely, comparable conflicts can also arise in non-profit

[161] The board is competent for all the matters that have not been allocated to the general meeting by the law or the articles of association. See Articles 5:73, §1, 6:61, §1, 7:93, §1 and 9:7, §1 CCA.

[162] General meetings also have other default rights, such as the approval of annual accounts and the granting of discharge to directors (Articles 5:98, 6:83, 7:149 and 9:12, 4° and 5° CCA) and, in companies, the decision on the allocation of profits (Articles 5:141, 6:114 and 7:211 CCA), though the right to pay dividends may be granted to the board in the articles of association, with certain limits (Articles 5:141, 6:114 and 7:213 CCA).

associations when yearly contributions or cost savings may be impacted by decisions required to pursue the social purpose to the fullest.[163]

Further, corporations and non-profit associations must pursue their social purpose and must be governed in their corporate interest, which (at least) requires the consideration of the interests of stakeholders who can impact the pursuit of the organisation's long-term objectives (see above section 2.1.2). Directors are required and empowered to play a crucial role in the pursuit of the social purpose. Their freedom to act as guardians of the social purpose will however often be constrained by the risk of dismissal by a majority of members or shareholders. Moreover, they may at times face their own (direct or indirect) conflicts of interest.

Finally, social enterprise insiders are often driven by a genuine intrinsic motivation to support and pursue the organisation's social purpose. This intrinsic motivation undoubtedly plays a crucial role in explaining the many social enterprise success stories, as it may sufficiently dampen the risk that they will prioritise their own interests over those of the social enterprise.

7.1.2. External Stakeholders

External stakeholders, such as donors, subsidising governments, employees, consumers or the beneficiaries of the social enterprise's social purpose in general have limited organisational law[164] rights to monitor and enforce the pursuit of the social purpose, unless they are also shareholders or members. Monitoring requires information, but the minimum reporting and disclosure requirements are rather weak, especially if the social enterprise is not certified as a social enterprise (sections 3.3 and 4.1). A notable exception is employees, who are entitled to some information (see above section 2.5). Legal enforcement through annulment proceedings requires standing, which is uncertain for many stakeholders, and director liability suits are more of a theoretical solution than a realistic one (section 2.1.2).[165]

While not all stakeholders are legally entitled to information, monitoring and enforcement, some are effectively granted such rights beyond the legal minimum. This is regularly the case for subsidising governments or major donors, who sometimes have the right to nominate one or more directors.

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[163] See M. Verheyden and A. François, 'De schijnwerpers op een onderbelicht fundament: de rol en invulling van het verenigingsbelang' [2020] *TRV-RPS* 855.

[164] In exceptional cases, the social purpose may sometimes be sanctioned through other bodies of law, like criminal law or consumer protection law.

[165] See above section 2.1.2 and the references cited there. Regarding stakeholder standing in non-profit organisations, see S. De Dier, 'Nietigheid van besluiten van een rechtspersoon: zijn outsiders vorderingsgerechtigd?' in *De vennootschaps- en verenigingsrechter*, Larcier, Brussels 2017, pp. 186–88.

Moreover, the pursuit of the social purpose by certified social enterprises will to some extent be supervised by the Federal Public Service of Economy (section 4.1). However, the results of this supervision will depend on its resources and may therefore be mostly limited to flagrant cases of non-compliance with the certification conditions.

7.2. FOUNDATION

Foundations are, by definition,[166] memberless organisations and therefore differ starkly from the organisations discussed above. In foundations, power rests more firmly in the hands of the board, which has a relatively wide margin to run the foundation. Foundation directors' power is not entirely unchecked, however. First, directors must remain within the boundaries set by the founder in the articles of association and by the foundation's interest. The latter obliges directors to consider the impact of their decisions on stakeholders, who can impact the realisation of the foundation's disinterested purpose. Second, a specific procedure applies in the event of directors' conflicts of interest.[167] Third, directors can be replaced by court decision if they manage the foundation in a manifestly negligent manner, infringe their obligations under the law or the articles of association or use the foundation's assets for a purpose contrary to the purpose stated in the articles of association, the CCA or the public order.[168]

Stakeholders, such as employees or customers, have the same relatively weak rights to information and legal enforcement of the pursuit of the social purpose as their counterparts in corporations and non-profit associations. However, they can benefit from the protection of the non-distribution constraint, sometimes from bargained information or enforcement rights, and often from the intrinsic motivation of insiders (founders and directors) (see above sections 2.1.1, 7.1.1 and 7.1.2).

8. CONCLUDING REMARKS

Belgian law does not have a single specific legal form for social enterprises. Instead, social enterprises resort to non-profit forms, such as non-profit associations and foundations, or to regular corporate forms, especially cooperatives, for which a certification as a social enterprise is available. However, the 'social enterprise brand' of such certification is somewhat diluted by the existence of several

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166 Article 1:3 CCA.

167 Articles 11:8–11:9 CCA.

168 Article 11:13 CCA.

(in some cases even identically named) social enterprise certifications granted by different governments and with different certification conditions (see above section 4).

Although cooperative companies have been crucial for the development of the Belgian social economy, the reservation of the sole organisational social enterprise regime[169] to cooperative companies (and the related limitation of shareholder voting power) diverges from recent European and global developments. Indeed, other jurisdictions have recently enacted social enterprise laws that are not restricted to cooperative companies. Given the diversity of the social enterprise industry (see above section 1.2) in size and business as well as organisational model, social enterprises could benefit from access to non-cooperative company forms.

169 As discussed above in section 1.1, dual-purpose companies are not subject to specific organisational law requirements ensuring that they are indeed social enterprises.

SOCIAL ENTERPRISES IN BRAZIL

Luciana Dias and Rafael Andrade*

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1. INTRODUCTION

It is not an easy task to talk about social enterprises in Brazil – which are locally known as impact businesses (*negócios de impacto*) – because the local debate on the topic is still incipient. However, discussions on the social effects of economic activity are gaining momentum in domestic corporate, legislative and academic circles, especially due to the growing importance of the ESG (environmental, social and governance) agenda.

This early stage of development is evidenced in two ways. First, Brazil has no specific legal form covering impact businesses, a circumstance that leads to the constant use of traditional corporate forms for the incorporation of these businesses, even though they are typically associated with the exclusive pursuit of profits.

Furthermore, the Federal Decree No. 9,977, dated 19 August 2019 (2019 Decree), is the only law concerning impact business. The 2019 Decree replaced Federal Decree No. 9,244, dated 19 December 2017 (2017 Decree), which has

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almost identical content. The 2019 Decree establishes the National Strategy for Business and Impact Investing (Estratégia Nacional de Investimentos e Negócios de Impacto, ENIMPACTO), an initiative that aims at fostering businesses with a double bottom line in Brazil. Notwithstanding this goal, neither the 2019 Decree nor other legal rules provide for any special taxation, exemptions, incentives or subsidies designed to benefit impact businesses as a specific category of business. Thus, despite constant progress observed over the past few years, currently there is no comprehensive legal framework for social enterprises.

In this scenario of relative legislative scarcity, non-state actors play an important role in the development of the impact business industry in Brazil. The coordinated action of private players and state representatives has gradually intensified and grown in scale, giving rise to what has been commonly referred to as the 'Brazilian ecosystem of impact businesses'. The term 'ecosystem' emphasises that coordination among different players is needed to develop an environment suitable for impact businesses.[1]

Second, the very absence of an accurate definition of impact businesses – or, in fact, the existence of multiple concepts that are not always consistent – also demonstrates the lack of maturity of the subject at the national level. For example, according to the definition provided by Article 2 of the 2019 Decree, impact businesses are 'enterprises aimed at generating a social and environmental impact and a positive financial result in a sustainable way'.[2] Thus, the law highlights three elements that could be regarded as determining characteristics of this type of activity, namely: (i) the objective of generating a positive social and environmental impact; (ii) the pursuit of a positive economic result; and (iii) the sustainability of these business models.

However, no matter how straightforward the concept set out in 2019 Decree seems to be, it is not free from criticism and, according to institutions that are part of the Brazilian ecosystem, at the very least it should be supplemented. For these institutions, impact businesses should not be understood as only one of the categories outlined above. They argue that the characteristics of an impact business established by the 2019 Decree could be confused with other

[1] As explained by the Brazilian Social Finance Task Force (Força Tarefa de Finanças Sociais, FTFS), 'the Social Finance ecosystem is composed of players on the supply side (those who donate, invest or lend financial resources), players on the demand side (the Impact Businesses), financial mechanisms and intermediary organizations (responsible for connecting the players and facilitating the circulation of capital, as well as qualifying and monitoring the performance of the businesses)'. FTFS, *Finanças Sociais: Soluções Para Desafios Sociais e Ambientais – Uma nova mentalidade para gerenciar recursos e necessidades da sociedade*, São Paulo 2015, https://aliancapeloimpacto.org.br/wp-content/uploads/2020/02/financas-sociais-solucoes.pdf.

[2] The concepts provided by the 2017 and 2019 Decrees are identical.

types of conceptually close ventures, which despite having, to some extent, a positive social and environmental impact, constitute meaningfully different types of ventures, ranging from inclusive businesses or sustainable businesses to philanthropies and charities.

There are countless impressions that institutions involved in the impact business ecosystem have on this topic. Therefore, in 2019, a group of Brazilian non-state agents assessed several jurisdictions in order to gather elements to achieve a more comprehensive, accurate concept of impact business. This exercise resulted in a concept formed by four fundamental elements: (i) the intent to solve a social and/or environmental issue; (ii) the impact solution being the core activity of the business; (iii) the search for financial return by operating according to market logic; and (iv) commitment to monitoring the impact generated.[3]

In other words, the criteria identified by these non-state players would generate a definition that is more specific than that provided for in the 2019 Decree. But these definitions are only supplementary. As acknowledged by the non-state players that are part of the Brazilian ecosystem of impact businesses, the legislative definition, although less accurate, is important for at least two reasons. First, because it has actively sought not to restrict the concept to the point of preventing a diversity of models. Second, because it is not excessively vague, which would otherwise facilitate the use and misappropriation of the concept (i.e. greenwashing).[4]

Despite their respective merits, the conceptual differences found between the preferred definition of impact business accepted in the public and private sectors, together with the absence of specific legal regimes, demonstrate that the debate on impact businesses in Brazil is still at a very early stage.

This report aims at contributing to this discussion and describing both the Brazilian ecosystem of impact businesses and the economic and legal environments currently encountered by companies with a double bottom line in Brazil. It is divided into four sections, in addition to this introduction. Section 2 will explore the origins of the Brazilian ecosystem of impact business and explain the reasons why it is so important to promote this sector in Brazil. Section 3, in turn, will provide data on the economic environment encountered by entrepreneurs who seek to develop impact businesses in Brazil. Section 4 will describe the legal aspects of the corporate forms most commonly used to set up impact businesses in Brazil. Finally, section 5 will summarise the conclusions of this report.

[3] Alliance, *O que são Negócios de Impacto: Características que definem empreendimentos como negócios de impacto*, São Paulo 2019, p. 29, https://aliancapeloimpacto.org.br/wp-content/uploads/2020/03/ice-estudo-negocios-de-impacto-2019-web.pdf.

[4] Ibid., p. 21.

2. THE BRAZILIAN ECOSYSTEM OF IMPACT BUSINESSES

The Brazilian ecosystem of impact businesses is made up of the coordination of institutions of different natures and from different sectors. The origins of a formal network to support impact businesses dates back to 2014, when the Brazilian Social Finance Task Force (Força Tarefa de Finanças Sociais, FTFS) was created. In 2017, the FTFS was transformed into the Brazilian Alliance for Impact Investment and Impact Businesses (Aliança pelos Investimentos e Negócios de Impacto, Alliance). The FTFS drew inspiration from similar initiatives that were emerging at that time in other countries (especially in the United Kingdom) and was created via the joint efforts and mobilisation of a multidisciplinary working group formed by dozens of organisations and players with varied backgrounds with the objective of driving innovative, decentralised solutions aimed at leveraging the domestic industry of impact businesses.

During the FTFS formation process, the roles of the Getulio Vargas Foundation's São Paulo School of Business Administration (Escola de Administração de Empresas de São Paulo da Fundação Getulio Vargas, FGV-EAESP), a traditional Brazilian higher education institution and think tank, and the Corporate Citizenship Institute (Instituto de Cidadania Empresarial, ICE), an entity dedicated to promoting positive social impact, were particularly important. These organisations coordinated the task force until it was capable of performing its roles independently. The ICE acted as the executive board of the FTFS and continues to hold this position even after the task force's conversion into the Alliance.

The studies and discussions undertaken by FTFS resulted in a list of 15 recommendations for the period between 2015 and 2020. These recommendations made up an agenda that sought to advance capital formation, as well as entrepreneurship and innovation, with the objective of solving complex social and environmental issues, combined with the possibility of generating a financial return for impact entrepreneurs and investors.[5]

This engagement of organised civil society produced initial results in 2016 when the FTFS entered into partnerships with governmental agencies, allowing a joint discussion of public policies and projects at municipal, state and federal levels.[6] This joint effort by state agents, with non-state actors taking a leadership role, gave rise to the enactment of the 2017 Decree. Since its initial

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5 FTFS, *Finanças Sociais: Soluções Para Desafios Sociais e Ambientais – Uma nova mentalidade para gerenciar recursos e necessidades da sociedade*, São Paulo 2015, https://aliancapeloimpacto.org.br/wp-content/uploads/2020/02/financas-sociais-solucoes.pdf.

6 It is worth mentioning, in particular, the execution of a Technical Cooperation Agreement with the former Ministry of Industry, Foreign Trade and Services, which is currently integrated into the Ministry of Economy. The agreement gave rise to a closer relationship between representatives of the Brazilian state and impact businesses.

version, the Decree has introduced two initiatives to the Brazilian public policy framework, both seeking to strengthen cooperation between the public and private sectors to promote impact businesses in Brazil.

The first of these innovations was the creation of ENIMPACTO, which is organised into five strategic axes, four vertical (i–iv) and one transversal (v), namely: (i) expansion of capital offering for impact businesses; (ii) increase in the number of impact businesses; (iii) strengthening of intermediary organisations, such as 'accelerators' and 'incubators'; (iv) establishment of an institutional and regulatory environment favourable to impact businesses; and (v) strengthening the generation of data on these companies.[7]

In practice, ENIMPACTO is executed through another innovation introduced by the 2017 Decree: the creation of the Committee for Impact Investments and Businesses (Comitê de Investimentos e Negócios de Impacto). Although the Committee is not considered to be a public regulator for impact businesses – no such entity currently exists in Brazil – it is responsible for proposing, monitoring, assessing and articulating the implementation of ENIMPACTO. The Committee's structure reflects the intention to gather representatives from the public and private sectors in a single body formed by a group of 26 members, 10 of which from the impact business industry, and the others appointed by various ministries, agencies and others government authorities. The plenary of the Committee, which comprises all 26 members, assemble every three months or whenever necessary.

The Committee has currently four working groups, which comprise not only members of the Committee but also other guest institutions, such as banks, asset managers and law firms. Each working group focuses on one of ENIMPACTO's four vertical axes. Therefore, the activities of the Committee occur mainly through the working groups. In 2021, for example, the working group responsible for fostering the number of impact businesses in Brazil offered training courses to entrepreneurs, together with private partners, some of them free of charge. In addition, the working group responsible for expansion of capital concluded a partnership with the National Bank for Economic and Social Development (Banco Nacional de Desenvolvimento Econômico e Social, BNDES), through which BNDES has committed to invest up to R$200 million (US$35.8 million)[8] in three private equity funds targeting impact businesses (as defined by the 2019 Decree).[9]

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7 A detailed explanation of ENIMPACTO's activities may be found in its 'base text' available at https://www.gov.br/produtividade-e-comercio-exterior/pt-br/images/Nationala_Strategya_fora_Businessa_anda_Impacta_Investinga_-a_finala_versiona_posta_publica_consultationa_28.02.pdf.

8 Unless otherwise stated, amounts in Brazilian reais (R$) were converted into US dollars (US$) using the exchange rate as of 31 December 2021, as provided by the Brazilian Central Bank (Banco Central do Brasil).

9 ENIMPACTO, *Relatório anual de atividades do Comitê de Investimentos e Negócios de Impacto*, 2021, pp. 7–10, https://www.gov.br/produtividade-e-comercio-exterior/pt-br/assuntos/inovacao/enimpacto/RelatrioAnualdeAtividades202115.12.2021.pdf.

Before turning to the next section, it is important to highlight that the Alliance recently launched a new set of nine recommendations for the 2020–2025 cycle. These nine proposals address dissemination, training and boosting of impact businesses, opening up more sources of financing, communication, innovation and compatibility between the social vulnerability and the climate and environmental crisis agendas.[10]

3. MAPPING IMPACT BUSINESSES

Intermediary organisations, such as start-up incubators and accelerators or university labs, have been gathering data regarding Brazilian impact businesses. One of the most significant entities in this context is Pipe.Social (Pipe), a private institution founded in 2016 for the purpose of mapping businesses aligned with the 17 United Nations Sustainable Development Goals (UN SDGs) and connecting impact entrepreneurs with potential investors. Pipe has an extensive database that allows for comprehensively mapping the ecosystem and further enables drafting periodic publications, the 'Impact Businesses Maps' (*Mapas dos Negócios de Impacto*, hereinafter 'Maps'), with the institutional support of ENIMPACTO and the Alliance, among other collaborators.

Another organisation actively engaged in mapping the ecosystem is the Group of Institutes, Foundations and Enterprises (Grupo de Institutos, Fundações e Empresas, GIFE), a non-profit organisation formed by foundations and institutes engaged in social investments. Since 2001, GIFE has published a biennial study on the Brazilian social investment environment, called the GIFE Census. The Census focuses on investors willing to make social investments. Together, the data collected by Pipe and GIFE identify and provide the context of the businesses, entrepreneurs, investors and other players in this ecosystem, allowing for relatively comprehensive analysis of impact businesses in Brazil.

3.1. THE BUSINESSES AND THEIR ACTIVITIES

The Brazilian sector of impact businesses stands out as one of the three largest in Latin America, alongside Colombia and Mexico.[11] However, estimates on the total number of impact businesses in Brazil vary. For example, while Pipe, in

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[10] According to Alliance, *Visões de Futuro para a Agenda de Impacto no Brasil – Recomendações para o avanço dos investimentos e negócios de impacto até 2025*, São Paulo 2021, https://aliancapeloimpacto.org.br/wp-content/uploads/2021/03/alianca-interativo.pdf.

[11] ANDE, *Investimentos de Impacto na América Latina – Tendências 2018 & 2019*, 2020, p. 5, https://www.gov.br/produtividade-e-comercio-exterior/pt-br/assuntos/inovacao/enimpacto/RelatrioANDE2020.pdf.

a Map published in 2017, accounted for 579 impact businesses, another study conducted in the same year by the United Nations Development Programme (UNDP) in partnership with the Brazilian Micro and Small Business Support Service (Serviço Brasileiro de Apoio às Micro e Pequenas Empresas, Sebrae) identified 857 businesses aiming at generating positive social impact through their core activities.[12]

Despite these divergences, there is a consensus that the number of impact businesses has grown substantially in recent years, showing an upward trend. For example, the latest Pipe Map – published in 2021 – reports that the total number of impact businesses more than doubled in the period since the publication began: from 579 in 2017 to 1,272 in 2021.[13] Although the majority (71%) of impact businesses are duly registered and organised, the bureaucracy for making these businesses formal is an issue faced by most impact entrepreneurs in the early stages of their journeys and many remain part of the informal economy.[14]

In addition, according to the 2021 Map, domestic impact businesses are primarily distributed among the areas of green technologies, citizenship, education, health, cities and financial services, and companies usually operate concurrently in two or more of these fields.[15] More precisely, the fields of green or sustainable technologies (green tech) and the civic agenda (civic tech) related to issues of social inclusion, diversity, gender and the rights and duties of citizens comprise respectively 49% and 40% of the fields of business activity.[16] The industries of education (ed tech) and health (health tech) come next, corresponding to 28% and 27% of the fields of activity.[17] In general, Brazilian impact businesses have been experiencing greater diversification in their fields of activity over time.

The methodology adopted by Pipe also assesses the activities of impact businesses in accordance with the 17 SDGs. From that perspective, the primary segments of impact businesses are those of responsible consumption and production (39%); good health and well-being (36%); and decent work and economic growth (35%).[18] Some of the industries with the lowest share are clean water and sanitation (8%); peace, justice and strong institutions (6%); and affordable and clean energy (6%).[19]

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12 PNUD/Sebrae, *Retrato dos Pequenos Negócios Inclusivos e de Impacto no Brasil*, Brasília 2017, p. 7, https://www.sebrae.com.br/Sebrae/Portal%20Sebrae/Anexos/3._mapeamento_negocios_de_impacto.pdf.

13 Pipe, *Mapa de Negócios de Impacto Socioambiental*, 2021, pp. 1 and 26, https://mapa2021.pipelabo.com/downloads/3_Mapa_de_Impacto_Relatorio_Nacional.pdf.

14 Ibid., p. 6.

15 Ibid., p. 18.

16 Ibid.

17 Ibid.

18 Ibid.

19 Ibid.

Impact businesses operating for up to five years account for 64% of the sample, with 34% operating for less than two years.[20] However, there are cases of companies that have been operating for longer periods in the market, such as Mãe Terra, a natural and organic products company that has been operating in the market since 1979 and is considered the longest-running impact business in Brazil.[21] Another exception is Natura, a cosmetics manufacturer listed on the local stock exchange and which, in terms of both number of employees and revenue, is considered to be the largest impact business in Brazil – and one of the largest in the world.[22]

Regarding geographic location, the 2021 Map reveals that impact businesses are primarily located in Brazil's south-eastern region, which is home to 58% of them, and 40% of all Brazilian impact businesses are located in the State of São Paulo, Brazil's most populous state.[23] The north-eastern region accounts for 16%, closely followed by the southern region, with 15%. In turn, the northern and central/western regions each account for 5% of the total.[24]

3.2. ENTREPRENEUR PROFILE

The social and demographic profiles of Brazilian impact entrepreneurs is varied, but some general trends may be highlighted. According to the 2021 Map, most impact businesses are formed by small teams and were founded approximately over the last five years.[25] More than half of them (55%) have between two and five members, 14% have only one entrepreneur, and 27% have six or more members.[26] 69% use freelance teams providing specific services.[27]

Women are present in 67% of businesses.[28] However, despite the apparent gender equality, there are more businesses run exclusively by men (27%) than exclusively by women (23%).[29] In addition, the Pipe survey shows that more gender-equitable businesses face greater difficulties in accessing financing and other forms of support. Maintaining gender equality levels is even more challenging in advanced stages of development of Brazilian impact businesses.[30]

20 Ibid., p. 6.
21 https://www.maeterra.com.br/sobre-mae-terra.html.
22 https://www.sistemab.org/empresasb/natura/.
23 Pipe, *Mapa de Negócios de Impacto Socioambiental*, 2021, p. 6, https://mapa2021.pipelabo.com/downloads/3_Mapa_de_Impacto_Relatorio_Nacional.pdf.
24 Ibid.
25 Ibid., pp. 3 and 6.
26 Ibid., p. 3.
27 Ibid.
28 Ibid.
29 Ibid.
30 Ibid.

The social and demographic imbalance is not restricted to gender aspects: it also affects racial issues. The leadership or management of the impact businesses surveyed is predominantly comprised of white people (66%), while Black, Asian and Indigenous people, together, account for 12% of entrepreneurs (9%, 2% and 1%, respectively).[31] Although there are regional variations, the overall proportions remain relatively close.

Data on the age and the level of education of entrepreneurs also reveal the predominance of certain attributes: 49% of businesses are formed by entrepreneurs between 30 and 44 years of age, 22% by people from 18 to 29 years of age, and 17% by people from 45 to 54 years of age.[32] Most entrepreneurs (53%) hold a postgraduate degree (i.e. they have a master's, doctorate or post-doctorate degree), and 25% hold a graduate degree. 50% of entrepreneurs who hold graduate or postgraduate degrees have majors in the fields of management, economics, accounting and/or computer science, engineering, physics or chemistry.[33]

3.3. INVESTOR DATA

The 10th issue of the GIFE Census, with data from 2020 – published in 2021 – gathered data from 131 corporate, family and independent or community associations, foundations or philanthropic funds operating in Brazil, which points to a growing trend in the number of organisations engaged in providing capital to social and impact investments.[34] By comparison, GIFE's first Census, published in 2001, included only 48 participating organisations.[35]

Total social investments made by organisations participating in the 2020 Census amounted to approximately R$5.3 billion (US$950 million) in 2020.[36] This figure is considerably higher than in previous years, particularly due to

[31] Ibid., p. 4.
[32] Ibid.
[33] Ibid.
[34] GIFE, *Censo GIFE 2020*, São Paulo 2021, p. 7, https://sinapse.gife.org.br/download/censo-gife-2020.
[35] Ibid., p. 9.
[36] As explained by GIFE, the Census gathers data from 'corporate, family, and independent or community associations, foundations, or philanthropic funds operating in Brazil. GIFE conducts this biannual census with its members to better understand their characteristics and social investment priorities. This overview presents the main results obtained from 131 organizations (81% of GIFE's 161 members at the time of the survey) that responded to questions regarding their activities and structure in 2020. All census data, unless explicitly stated, refer to 2020 and are based on the 131 responses. The amounts are presented in Brazilian reais (R$) and were adjusted for inflation to December 2020 values using the Brazilian index IPCA.' GIFE, *2020 GIFE Census Key Facts*, São Paulo 2020, p. 1, https://sinapse.gife.org.br/download/key-facts-censo-gife-2020.

contributions to initiatives aimed at dealing with the effects of the COVID-19 pandemic.[37]

Among the 131 organisations mapped in the 2021 Census, 11% are companies engaged in impact business; approximately 35% are family or independent foundations, institutes and philanthropic funds; and more than half (54%) are business philanthropic organisations (organisations engaged in investing in impact business).[38] Most of these organisations use the UN SDGs as a reference to guide their agendas and actions, in particular SDGs 4 (quality education) and 10 (reduced inequalities).[39]

Although team sizes vary considerably depending on the type of organisation, organisations participating in the Census employ approximately 100 people.[40] All together, organisations participating in the study employ more than 13,000 people.[41]

The 2021 Census also shows that there are discrepancies concerning the number of men and women in management and on the boards of directors of participating organisations. The study shows that 67% of all directors are men, while 32% are women.[42] However, the study shows a growing trend towards balance in recent years, with a gradual reduction in the number of men and a simultaneous increase in the number of women.[43] On the other hand, in racial terms, the proportion of members and the trend of imbalance is significantly more serious, since 58% of the entities surveyed are formed exclusively of white people, and 32% are formed by Black, Asian and Indigenous people, but still with a predominance of white people.[44]

Regarding the regions in which the organisations participating in the Census focus their attention, impact businesses and the ecosystem in general substantially focus on initiatives in the south-eastern region. Of the total number of initiatives, 73% are located there, and 38% of those are specifically located in the State of São Paulo.[45]

In addition to the investors targeting impact businesses, there is growing interest from other types of organisations, such as private equity and venture capital funds in these types of businesses. According to a survey on impact investment in Latin America published in 2020 by Aspen Network of Development Entrepreneurs (ANDE), 47% of investors that answered the

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37 Ibid., pp. 28 and 29.
38 Ibid., p. 4.
39 Ibid., pp. 102 and 104.
40 Ibid., p. 161.
41 Ibid.
42 Ibid., p. 151.
43 Ibid., p. 150.
44 Ibid., p. 152.
45 Ibid., p. 100.

survey,[46] corresponding to 63% of assets under management (AUM), are fund managers with for-profit purposes, followed by managers of non-profit funds, with 17% of participants and 8% of AUM. Commercial banks and other financial institutions hold the most significant positions after private equity and venture capital funds, with 14% of the surveyed AUM.[47]

3.4. FINANCING ALTERNATIVES

Access to credit under favourable conditions and public fundraising through financial and capital markets could improve the development of impact businesses. However, as mentioned, there are no subsidies, tax benefits or even special tax rules in Brazil specifically designed for impact businesses, entrepreneurs or investors. There are also no special regimes for raising funds from banks or the capital markets. For this reason, impact businesses must be active in a field that is covered by other public policies to take advantage of special mechanisms, such as those aimed at promoting culture, science and technology, and sports.[48]

Perhaps for these reasons, among impact entrepreneurs there is a strong preference or need for non-reimbursable funds; 67% of them fund their businesses mainly through this type of funding.[49] Concerning new investment rounds, the 2021 Pipe Map reported that 69% of Brazilian impact businesses were seeking donations as the primary modality of funding, followed by loans (26%), equity transactions (19%) and debt convertible into equity (9%).[50]

Fundraising methods also vary according to the level of development of a certain impact business. Approximately 80% of businesses in the pre-operational

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[46] ANDE has gathered data from 83 investors headquartered in 18 different countries and with more than US$3.7 billion of assets under management targeting Latin American businesses. The survey does not include investments made by national or international development financial institutions.

[47] ANDE, *Investimentos de Impacto na América Latina Tendências 2018 & 2019*, 2020, p. 9, https://www.gov.br/produtividade-e-comercio-exterior/pt-br/assuntos/inovacao/enimpacto/RelatrioANDE2020.pdf.

[48] Depending on their field of activity, businesses may have access to the National Culture Support Programme. The programme is made up of the National Culture Fund and the Cultural and Artistic Investment Funds. Pursuant to Law No. 8,313 of 1991, resources of these Funds are used to finance cultural projects. Furthermore, resources from the National Scientific and Technological Development Fund may also be used to finance innovative companies through investment funds authorised by the Securities and Exchange Commission of Brazil (CVM) (Article 12, paragraph 1 Law No. 11,540 of 2007). Additionally, there are deductions for investors, supporters, donors and sponsors of sports and parasports projects (Law No. 11,438 of 2006), production of independent Brazilian audiovisual works (Law No. 8,685 of 1993) and of cultural projects (Article 26 Law No. 8,313 of 1991).

[49] Pipe, *Mapa de Negócios de Impacto Socioambiental*, 2021, pp. 8 and 9, https://mapa2021.pipelabo.com/downloads/3_Mapa_de_Impacto_Relatorio_Nacional.pdf.

[50] Ibid.

stage did not have access, or never even sought access, to any form of donation or investment, despite 47% of them having declared that they needed funds.[51] Among businesses at the early stage, 76% have received donations – and from those, 72% raised funds of up to R$500,000 (US$90,000).[52] Businesses at intermediate stages of development, but with high growth rates, have more diversified financing methods: 32% of them have raised funds through equity, and 35% through loans.[53] In order to expand their business faster, 58% of entrepreneurs at this level of development seek funds in amounts between R$500,000 (US$90,000) and R$2,000,000 (US$360,000).[54] In turn, 31% of the more mature projects, even at more advanced stages of development, have obtained funds through equity, and 33% through loans.[55] The demand for financial resources becomes even greater at this stage, with 76% of businesses seeking capital and 39% of those in amounts in excess of R$1,000,000 (US$180,000).[56]

Non-institutional or informal sources, such as so-called 'FFF' (friends, family and fools) investments, are the primary sources of financing sought by Brazilian impact businesses, available to 38% of them, followed by[57] institutes and foundations (28%), incubators or accelerators (21%), state agents, such as governments and public banks (17%), crowdfunding projects (12%), private commercial banks (12%), and private equity and venture capital funds (less than 5% each).[58]

In addition to the private sector, the Brazilian public sector is also a major potential investor. For this reason, promotion mechanisms and specific instruments have been developed to meet both the public demand for impact goods and services and the demand of impact businesses for financial resources. Public development banks have been active in the industry, even as parties to the ENIMPACTO, with BNDES being the main example, as previously mentioned.

Therefore, the impact investment market is still incipient in Brazil, although it is possible to find some initiatives that bring together impact entrepreneurs and investors (both private and public). Whether by means of donations, traditional investment schemes or more creative and complex methods, such as fundraising pursuant to collective investment agreements (crowd and equity funding), convertible bonds, or mutual and equity modalities

51 Ibid., p. 10.
52 Ibid., p. 11.
53 Ibid., p. 12.
54 Ibid.
55 Ibid., p. 13.
56 Ibid.
57 Ibid., p. 8.
58 Ibid.

conceived locally or inspired by foreign experience, investment in impact businesses is gradually growing.[59]

4. LEGAL OVERVIEW OF IMPACT BUSINESSES

In view of the current lack of specific legal forms in Brazil aimed at the incorporation of impact businesses, those ventures must necessarily be organised pursuant to legal types that already exist in the Brazilian legal system.

The most common corporate types among impact businesses are corporations (*sociedades anônimas*, SAs) and limited liability companies (*sociedades limitadas*, LTDAs), which are also the most common types among non-impact business. These corporate forms are governed respectively by the Brazilian Corporate Law (Law No. 6,404, dated 15 December 1976) and the Brazilian Civil Code (Law No. 10,406, dated 10 January 1976). Despite being commonly associated with commercial companies that exclusively pursue profits, neither legal form prevents or restricts the possibility of impact entrepreneurs also pursuing their social missions through them. In other words, both forms accept the concept of a double-bottom-line enterprise.

There is, therefore, relative legal flexibility that makes it possible to accommodate, in traditional corporate types, the structure of an impact business and the existence of a greater diversity of interests, both of shareholders and stakeholders. However, this means that there is no formal distinction between purely commercial companies, on the one hand, and impact businesses, on the other hand, and there is no legal protection aimed at maintaining the social mission for which the business was created. Nor are there state agents specifically responsible for enforcing such a mission. Although guarantees can be provided for in the company's articles of incorporation, the latter in general may be amended by the vote of shareholders.

In Brazil, enterprises seeking to create positive social and environmental impact may also use non-profit corporate forms: the most significant ones are foundations (*fundações*) and associations (*associações*), both regulated by the Brazilian Civil Code. However, unlike the corporate forms mentioned above (SAs and LTDAs), foundations and associations only allow for the conduct of economic or profitable activities on a secondary basis, since the proceeds earned must be used to maintain their core activity, and profit distribution is not allowed pursuant to the law. Therefore, it is not possible to use them to structure a double-bottom-line business.

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[59] According to Alliance, *Como as instituições financeiras locais e internacionais estão se posicionando no tema de investimento de impacto*, São Paulo 2017, p. 35, https://aliancapeloimpacto.org.br/wp-content/uploads/2020/02/paper-produtos-financeiros-ice-itau-portugues.pdf.

Finally, so-called cooperatives (*cooperativas*), also governed by the Brazilian Civil Code and by Federal Law no. 5,764, dated 16 December 1971, must be mentioned, despite the fact that this type of legal entity is not common in the Brazilian context.[60] The cooperative is listed by the Alliance as one of the possible corporate types that may be used to organise an impact business due to its intermediary nature between for-profit and non-profit purposes, as compared to other types mentioned above.[61]

However, in practice, impact businesses in Brazil are usually incorporated as an SA or LTDA. For the conduct of non-profit activities, the preferred legal types are foundations and associations. Cooperatives, despite being a legally viable alternative, are rarely used. The paragraphs below describe some of the rules applicable to these legal types.

4.1. THE CURRENT LEGAL SCENARIO

Some rules apply uniformly to the five models of legal entities mentioned above (SAs, LTDAs, cooperatives, associations and foundations). Whether or not they are for-profit, all these types of legal entities in Brazil must be formalised by filing with the public registries. Depending on the legal type and purpose of the entity, these filings are made with the Commercial Registries (*Juntas Comerciais*) or the Legal Entity Notary Public Offices (*Cartórios de Registro de Pessoas Jurídicas*). As a rule, the filing does not require government authorisation. The law provides only for formal requirements that need to be observed at the time of filing. Public filing makes the filed documents available to the public, although it is not always easy to access them. Requests must be made to the public registry with which the company was filed and it is not always easy to identify the correct office. In addition, in many cases, in order to obtain copies of such documents, one must pay notary fees and emoluments.

Specifically for LTDA, SA and cooperative businesses, companies considered to be 'large enterprises'[62] are required to prepare and disclose periodic financial

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60 According to data from the Ministry of Economy, cooperatives account for approximately 0.18% of the total number of 'active companies' in Brazil. See Ministério da Economia, *Mapa de Empresas – Boletim do 2º quadrimestre de 2021*, Brasília 2021, p. 9, https://www.gov.br/governodigital/pt-br/mapa-de-empresas/boletins/mapa-de-empresas-boletim-do-2o-quadrimestre-de-2021-1.pdf.

61 According to Alliance, *Carta de Princípios para Negócios de Impacto no Brasil*, São Paulo 2015, p. 10, https://aliancapeloimpacto.org.br/wp-content/uploads/2020/02/carta-principios.pdf.

62 Large enterprises are defined by Article 3 Law No. 11,638 of 2007. Currently, a large enterprise is considered to be a company or group of companies under common control that in the previous fiscal year had total assets in excess of R$240,000,000, or annual gross revenue in excess of R$300,000,000.

statements reviewed by independent auditors.[63] In addition, publicly traded SAs are subject to a typical capital market regime and the principle of full disclosure, which includes, for instance, disclosure of material facts and information on governance and business, as defined by law and the rules issued by the Brazilian Securities and Exchange Commission (Comissão de Valores Mobiliários, CVM).[64] There are only a few examples of impact businesses classified as large enterprises or that are SAs with appropriate qualifications, size and organisation to face the initial public offering (IPO) process – Natura being one of them. Therefore, the vast majority of impact businesses organised as LTDAs, SAs or cooperatives do not publicly disclose information other than in their articles of incorporation and some corporate acts.

Associations and foundations, on the other hand, have specific accounting obligations and must draft reports aimed at providing accounting details especially for tax purposes. In the case of foundations, these reports – which are not publicly available – must be submitted to the State Prosecutors' Office (Ministério Público Estadual) of the state in which they are headquartered.

Legal entities must define their corporate purpose in their articles of association or bylaws, as the case may be. In the case of SAs, LTDAs and cooperatives, their corporate purposes must be lawful and possible, and not in violation of the law, public policy or good customs.[65] Associations must identify their non-profit purposes and use the proceeds obtained from for-profit secondary activities to attain their not-for-profit purpose.[66] Foundations are not allowed to perform for-profit activities or to share profits, and must identify in their corporate purposes one or more of the activities listed in the exhaustive list set out in the subparagraphs of Article 62 of the Civil Code, which include social assistance, culture or the defence and conservation of historical and artistic heritage, education, and health, among others.

The Brazilian tax system is complex, onerous and full of exceptions. Having said that, as a general rule, the tax regime for for-profit businesses, such as SAs and LTDAs, depends on their revenue. Thus, depending upon the specific revenue range within which a legal entity falls, different regimes apply based on taxable income or presumptive income, regardless of the corporate type adopted.[67] Shareholders or members are usually remunerated by profit distribution or dividends. There is no direct taxation of the distribution of profits or dividends in Brazil, although from time to time the Brazilian Congress starts discussions regarding imposing taxation on them.

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[63] Article 3 Law No. 11,638 of 2007.

[64] Articles 157, 175 and 176 Law No. 6,404 of 1976, and CVM Resolution No. 44 of 2021.

[65] Articles 981, 982 and 983, combined with Articles 104 and 122 Civil Code.

[66] Article 53 Civil Code, which provides for associations organised pursuant to the Brazilian system, expressly imposes that requirement.

[67] Except for cooperatives that may not adhere to the *simples nacional* (national simple regime) system, as prohibited by Article 3 Supplementary Law No. 123 of 2006.

As provided by the Brazilian Constitution, all educational, health and social assistance non-profit organisations, whether incorporated as foundations, associations or other legal forms, have tax immunity regarding property, income and services if they comply with certain requirements established by law, such as applying all their resources to the maintenance and development of their social purposes.[68]

Scientific, charitable, cultural and recreational non-profit organisations are also exempt from income tax and social contributions on net profits if they comply with the same legal requirements – however, this special tax treatment is not assured by the Brazilian Constitution, but by federal law.[69]

Non-profit organisations may be exempted from other state taxes depending on the locale of their incorporation. In addition, non-profit organisations may receive certifications that provide some tax benefits to them.[70]

Governance requirements vary depending on the type and size of legal entity. In addition, some governance options are available at the election of a shareholders' meeting or upon the resolution of shareholders, members, associates and others.

Limited liability companies (LTDAs), corporations (SAs) and cooperatives must be managed by one or more executives in charge of the corporation's day-to-day activities. They can also have a board of directors (*conselho de administração*), a body responsible, among other duties, for establishing the general strategy of the business and for monitoring officers; or a fiscal council (*conselho fiscal*), which supervises directors and officers, as well as giving opinions regarding the compliance of the entity's financial statements with accountability rules.[71] These bodies will not always exist in a corporation (SA), limited liability company (LTDA) or cooperative, but if they do, their existence and method of operation must be provided for in the articles of incorporation or bylaws of the legal entity.[72] In addition, SAs, LTDAs and cooperatives also

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[68] Article 150, VI, c Brazilian Constitution; Article 12 Law No. 9,532 of 1997.

[69] Article 15 Law No. 9,532 of 1997.

[70] There are currently three main certifications, all of them provided by the Brazilian federal government: (i) OSCIP – Public Interest Civil Society Organisations (*Organizações da Sociedade Civil de Interesse Público*); (ii) CEBAS – Certification of Charitable Entities for Social Assistance (*Certificação de Entidades Beneficentes de Assistência Social*); and (iii) UPF – Title of Federal Public Utility (*Título de Utilidade Pública Federal*).

[71] For corporations (SAs), a board of directors is mandatory for publicly traded and authorised capital companies (Article 138, paragraph 2 Law No. 6,404 of 1976). Corporations (SAs) must have a fiscal council, which, however, may or may not be a permanent one (Article 161 Law No. 6,404). For cooperatives, the law provides an alternative regime between a board of executive officers or a board of directors, and the associates will decide at a meeting in favour of one or the other, and will also elect the members of that body. However, there is also the possibility of having more than one management body (Article 47, introductory paragraph, and paragraph 1 Law No. 5,764 of 1971).

[72] For associations, the management method and approval of the respective accounting must be provided in bylaws, under penalty of being considered null (Article 53 Civil Code).

have a shareholders' general meeting that needs to assemble at least once every year – this body is in charge, among other responsibilities, of voting on the entity's financial statements and electing the members of the board of directors, if one exists, or indicating the officers directly when the entity does not have a board.

Associations follow a similar governance regime, having officers, an optional board of directors and fiscal council, and the associates' general meeting as a superior body. In turn, foundations are governed by the bodies established in their articles of association as defined by their respective founders, usually an executive board and a trustee board.

Except for foundations, there is the possibility of converting one legal entity model into another, regardless of its purpose. That is to say, the conversion from a type with for-profit purposes to one without such purposes and vice versa is allowed[73] – even though some debates remain unsettled in courts, particularly concerning the tax effects of such transformation, as the law establishes that non-profit organisations when terminated must ensure the transfer of their assets to a public body or to another institution with similar purposes to enjoy tax immunity, in the event of incorporation, merger, spin-off or termination of its activities.[74] Whatever the case, the decision on conversion into a different corporate form will be made at the legal entity's associates'/shareholders' general meeting.[75]

Limited liability companies (LTDAs) are entitled to decide on the establishment of management bodies, but their existence must be defined upon agreement between the shareholders (Article 1,053 for the board of directors, and Article 1,066 for the fiscal council, both of the Civil Code). For corporations (SAs), the same applies, except that they must legally have at least one office (Article 138, introductory paragraph Law No. 6,404 of 1976). In the case of foundations, the management method is elected at the discretion of the founders, who must include it in the respective public deed or instrument of incorporation of the foundation (Article 62 Civil Code).

73 That possibility is provided for in Normative Instruction No. 81 of 2020, issued by the National Department of Business Registries and Integration. Chapter V, Title III of the Instruction governs the possibility of transforming associations and simple businesses into businesses and vice versa. Any amendments to the organisational documents of legal entities, including those that involve amendments to the articles of association, will be subject to the consent of all shareholders (Articles 997 and 999 Civil Code) and will be governed by the provisions of the Code (Article 2,033 Civil Code).

74 Article 12, §2º, g Law No. 9,532 of 1997.

75 In the case of corporations (SAs) shareholders' meetings have the exclusive duty to resolve on the transformation of the company (Article 122, subparagraph VIII Law No. 6,404 of 1976), and for businesses in general there is no provision regarding the participation of any group other than the shareholders in determining corporate issues (Article 1,114 Civil Code). Shareholders, members or associates of the company to be transformed must resolve and decide by themselves, without the interference of third parties, on the transformation (Article 63 et seq. Normative Instruction DREI No. 81 of 2020). Furthermore, there is no need for government authorisation regarding acts of transformation. For those, there is only the requirement to comply with the legal filing requirements (Articles 58 and 67 Normative Instruction DREI No. 81 of 2020).

In order to enable a comparison between the legal types (SAs, LTDAs, cooperatives, associations and foundations), the Appendix to this report provides a summary of their main similarities and differences.

Finally, considering the fact that there is no specific legal form covering impact businesses in Brazil, a private organisation named the Brazilian B System (*Sistema B do Brasil*) has carried out a certification processes to recognise impact business.[76] To receive B Corp certification, impact businesses must, among other requirements: (i) operate in a competitive market; (ii) be exposed to the common risks of any business activity; and (iii) include in their articles of incorporation two fundamental clauses, the first regarding corporate purpose, by which the company acknowledges its commitment to considering not only the short-term and long-term interests of the shareholders, but also the short-term and long-term economic, social, environmental and legal effects of the business's activities on employees, suppliers, consumers, creditors and the local and global community in which its operations are carried out; and the second clause concerning the duty of officers and directors to consider all of those interests when exercising their functions.

Given the certification's purpose to recognise businesses committed to having a positive impact on society and the environment, non-profit organisations, including foundations and associations, cannot apply for B Corp certification.

4.2. FUTURE PROSPECTS

There are currently two main initiatives that may change the Brazilian legal framework regarding impact businesses, both with the similar purpose of creating so-called 'benefits businesses' (*sociedades ou empresas de benefícios*, SBs). The SB was conceived to be a qualification aiming at identifying impact businesses based on purpose, accountability and transparency regarding the social mission and generation of positive social and environmental impact. This qualification would be available to businesses organised as one of the existing for-profit legal types. Therefore, corporate types such as LTDAs, SAs cooperatives and so-called single-person limited liability companies (*sociedades limitadas unipessoais*) would incorporate that qualification in order to stand out among regular ventures that are by their nature especially dedicated to having a positive social and environmental impact.

The first initiative is the draft bill prepared by the Brazilian B System and promoted through ENIMPACTO, which is currently being evaluated by the Ministry of Economy. Recently, however, the draft bill received a negative

[76] The Brazilian B System website is available at: https://www.sistemabbrasil.org.

opinion from the Economic Policy Secretariat, a body of the Ministry of Economy, for allegedly promoting unnecessary state intervention in the private sphere and contradicting the government's deregulation guideline.[77] In spite of the efforts of ENIMPACTO's working group in charge of promoting a legal framework suitable for impact business to reverse that negative opinion, there is still no forecast regarding when or if the draft bill will be referred for consideration to other ministries or to the legislative branch.[78]

The second initiative is Bill No. 3284 of 2021, currently being discussed by the Brazilian Senate.[79] According to this Bill, to qualify as an SB, an organisation would have to establish in its articles of association: (i) a commitment to the generation of a positive social and environmental impact while pursuing a corporate for-profit purpose; (ii) the duty of officers and directors to implement and monitor the achievement of a positive social and environmental impact; (iii) the obligation to, at least on an annual basis, draw up and publicly disclose an impact report; and (iv) solely for larger enterprises, the need to establish an impact committee in charge of monitoring and evaluating the social and environmental impact of the business's activities. The Bill also seeks to impose on officers, directors, members of the fiscal council and other bodies created by the articles of association, if any, as well as on shareholders, including controlling shareholders, the duty to assess the economic, social and environmental effects of the activities carried out by the business on local, regional, national and global communities, collaborators, suppliers and consumers.

Besides proposing the creation of the SB qualification – with similar requirements to the aforementioned draft – the Bill also suggests the creation of a Brazilian National Investment System and Impact Business (Sistema Nacional de Investimentos e Negócios de Impacto, SIMPACTO), which would be in charge of the coordination of ENIMPACTO and the state-level strategies aiming at fostering impact businesses.[80] ENIMPACTO's working group in charge of promoting

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[77] ENIMPACTO, *Relatório anual de atividades do Comitê de Investimentos e Negócios de Impacto*, 2021, pp. 78–80.

[78] Information disclosed in 2019 by the specialised agency Kaleydos showed that the Bill had already been reviewed by the Ministry's counsel and was awaiting submission to the Chief of Staff of the Presidency, to be subsequently submitted to the Brazilian Congress in case of approval, according to http://kaleydos.com.br/empresas-de-beneficio/. According to their Annual Report for 2019, representatives of Sistema B Brasil state that they work 'with the Ministry of Economy as members of ENIMPACTO, collaborating with a project called "Empresas de Benefício" that enables certifications for businesses in Brazil': https://www.sistemabbrasil.org/suhdo/storage/uploads/f8b83d96c49605fd64667c197f8ad52b/wysiwyg/pdf/Relat%C3%B3rio%20Anual%202019_FINAL.pdf.

[79] Available at https://www25.senado.leg.br/web/atividade/materias/-/materia/149934.

[80] After the creation of ENIMPACTO, eight of the 27 Brazilian states created, between 2019 and 2021, their own policies aimed at promoting impact businesses at the state level.

a legal framework suitable for impact business is also engaged in the discussions on the Bill, which, however, are currently at a very preliminary stage.

It is important to point out that, despite efforts by certain institutions to formalise the status of impact businesses, this is still a controversial topic among the members of the Brazilian ecosystem. Many question the real need for a proper legal qualification for impact businesses – mainly because this could allegedly create obstacles to the use of other legal formats for impact business development[81] – even though some disadvantages are frequently pointed out, such as difficulties with or lack of incentives for the development of programmes aimed at impact businesses.

5. CONCLUSION

Although incipient, the Brazilian industry of impact businesses, especially since 2014, has been increasing in maturity, particularly through an ecosystem that encourages companies with a double bottom line. Government authorities' agencies, intermediary organisations, social entrepreneurs, investors and many other individuals and institutions are part of a community whose shared focus is to foster the Brazilian industry of impact businesses.

Despite the results achieved so far, which should be celebrated, there is a consensus among those involved in the Brazilian industry of impact businesses, both public and private, that many challenges remain. There is no specific legal form to incorporate impact businesses. More importantly, there are also no official mechanisms to identify these businesses, which may hamper promotion programmes or regulatory incentives.

Therefore, although in Brazil there is a coordination between entities of different natures and industries, including significant civil society organisations and governmental authorities, which are prepared to propose and debate issues that are important to impact businesses, there are few concrete measures that can be highlighted, and this reality does not seem to be close to any substantial change in the near future.

[81] 'There is still no consensus on the need to create a specific corporate veil for impact businesses, nor a certification or stamp that would make these ventures stand out among others'. Alliance, *O Ecossistema de Investimentos e Negócios de Impacto entre 2015 e 2020*, São Paulo 2020, p. 45, https://aliancapeloimpacto.org.br/wp-content/uploads/2020/12/2020-relatorioalianca-15-20-v09.pdf.

APPENDIX

Table 1. Legal forms adopted by social enterprises in Brazil

<table>
<tr><th></th><th>Possible purposes</th><th>Discretion and limitations in the interest of stakeholders</th><th>Legal limitations on profitable activities carried out</th><th>Legal limitations on the profit-sharing</th><th>Legal requirements for employee hiring</th></tr>
<tr><td>Limited liability companies (sociedades limitadas or LLC)</td><td rowspan="3">Lawful and possible purposes, not in violation of the law, public policies or good customs.</td><td rowspan="2">Must seek profit, although they are not prevented from setting impact goals.</td><td rowspan="2">Provided that the purposes are lawful and possible, not in violation of the law, public policies or good customs, businesses may conduct any economic activities for profit.</td><td rowspan="2">The profit distribution regime for businesses complies with the provisions of the applicable laws and the company's articles of incorporation; there is no limitation on the profit distribution to shareholders.</td><td rowspan="3">Subject to the eligibility requirements provided for in the applicable laws, it is up to the articles of incorporation, to the shareholders' meeting and to the management bodies appointing the company's officers. There are no specific criteria for the hiring of other employees.</td></tr>
<tr><td>Corporations (sociedades anônimas or SA)</td></tr>
<tr><td>Cooperatives (cooperativas)</td><td>Must contribute with assets or services to conduct a certain economic activity for the common benefit of the cooperative members, without the objective of profit.</td><td>Provided that the purposes are lawful and possible, not in violation of the law, public policies or good customs, businesses may conduct any economic activities, which should occur, however, without the objective of profit and for the common benefit of cooperative members.</td><td>Proceeds of cooperatives' activities are shared in proportion to the transactions carried out by the associate or in accordance with bylaws. Any proceeds relating to transactions with non-associates should be allocated to the cooperative's 'Technical, Educational and Social Assistance Fund'.</td></tr>
</table>

(continued)

Table 1 *continued*

<table>
<tr><th></th><th>Possible purposes</th><th>Discretion and limitations in the interest of stakeholders</th><th>Legal limitations on profitable activities carried out</th><th>Legal limitations on the profit-sharing</th><th>Legal requirements for employee hiring</th></tr>
<tr><td>Associations (associações)</td><td>Non-profit purposes in general, without an exhaustive list defined by law.</td><td>Organised for the conduct of non-profit activities, which may include, for instance, social and cultural assistance, political representation, defence of class interests, philanthropy, among others.</td><td rowspan="2">May carry out profitable activities, but only on a secondary basis since the proceeds can only be used to maintain their non-profit purpose activity.</td><td rowspan="2">Necessarily non-profit activities. The distribution of proceeds or profits, if any, among associates or members is prohibited.</td><td>The association's bylaws should provide for the management method. Officers should necessarily be associates of the cooperative. There are no specific criteria for the hiring of other employees.</td></tr>
<tr><td>Foundations (fundações)</td><td>Foundations can only be organised for purposes of social assistance, culture, defence and conservation of historical and artistic heritage; education; health; food safety and nutrition; defence, preservation and conservation of the environment and promotion of sustainable development; scientific research, development of alternative technologies, modernisation of management systems, production and dissemination of information and technical and scientific knowledge; promotion of ethics, citizenship, democracy and human rights and religious activities.</td><td>Organised for the conduct of non-profit activities amongst the ones exhaustively defined by law.</td><td>The foundation's bylaws should provide for the management method. There are no specific criteria for the hiring of other employees.</td></tr>
</table>

Source: Compiled by the rapporteurs.

Table 2. Similarities and differences among legal forms adopted by social enterprises in Brazil

	Limited liability	Owners' rights regarding the management	Rights of other stakeholders regarding the management	Going concern	Transfer of ownership	Typical duties of diligence and loyalty	Voting rights of shareholders and stakeholders
Limited liability companies (*sociedades limitadas* or LLCs)	The liability of each shareholder shall be limited to the shares held.	One or more shareholders, or even non-shareholders, may manage the business. The articles of incorporation may provide for the existence of a board of directors or fiscal council; however, such bodies are not mandatory.		The company can be dissolved upon the expiration of its term, if any, by mutual agreement of the shareholders or by court order.	Shares may be transferred among shareholders or between the shareholders and third parties not related to the company, provided that there is no provision to the contrary in the articles of incorporation.	Typical duties of diligence and loyalty.	Shareholder resolutions will be adopted at a shareholders' meeting. There are specific quorums depending on the nature of the resolution. There is no provision regarding the participation of non-shareholders in corporate decisions.
Corporations (*sociedades anônimas or* SAs)	The liability of each shareholder will be limited to the issue price of the shares subscribed or acquired.	Management will be performed by a board of executive officers formed by two or more officers. There may be a board of directors and a fiscal council. Shareholders may be directors or officers, provided that they are	The law authorises the participation of representatives elected by employees on the board of directors in accordance with a statutory provision to that effect.	Corporations will duly continue to carry out their activities in case events set forth in the law, such as dissolution, liquidation and termination proceedings, are not initiated.	There are no restrictions on the transfer of shares.	Typical duties of diligence and loyalty.	There are (common) shares with voting rights and (preferred) shares with limited or even non-voting rights. Voting rights of common shares are in general proportional to the number of shares held by a shareholder. There is a possibility of establishing multiple votes for common shares.

(continued)

Table 2 ***continued***

	Limited liability	Owners' rights regarding the management	Rights of other stakeholders regarding the management	Going concern	Transfer of ownership	Typical duties of diligence and loyalty	Voting rights of shareholders and stakeholders
		elected by the shareholders' meeting or by the board of directors. Publicly traded companies must necessarily have a board of directors.					
Cooperatives (***cooperativas***)	The liability of shareholders may be limited or unlimited.	Management bodies must be formed exclusively by members elected by the association's shareholders' meeting.		Cooperatives are dissolved upon expiration of their term, if any, by mutual agreement of the cooperative members or by court order.	The assignment of shares is subject to amendment of the cooperative's bylaws and, therefore, consent of the other cooperative members.	Typical duties of diligence and loyalty.	Each associate shall be entitled to a single vote.
Associations (***associações***)	Case law acknowledges that their associates are not responsible for the obligations of the legal entity.	The board of executive officers may be formed of elected, chosen or appointed associates/founders or professional officers engaged for that purpose.		Associations are dissolved upon expiration of their term, if any, by mutual agreement of the cooperative members or by court order.	As a rule, the positions of the associates are not transferable unless there is a previous provision in the bylaws to the contrary.	There are no specific provisions in this regard, but if there are irregularities, managers can be held accountable.	Decisions are made by a majority of votes of the associates attending the meeting.

Foundations (***fundações***)	Not applicable.			Foundations will be terminated in case they become illegal, impossible or useless, or upon expiry of their term, if any.	Not applicable.		According to the foundation's bylaws.

Source: Compiled by the rapporteurs.

SOCIAL ENTERPRISES IN CHILE

Juan E. Ibáñez, Francisco Loyola, Sofía Bernier
and Begoña Albornoz

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1. INTRODUCTION

There is no specific law for social enterprises or public benefit corporations in Chile. In the last decade entrepreneurs have used different traditional statutes to pursue their commercial initiatives that have a social or environmental positive impact. In this work we used the concept of 'purposeful corporations', developed by the British Academy in their *Principles for Purposeful Business*[1] – which

[1] British Academy Future of the Corporation Programme, *Principles for Purposeful Business: How to Deliver the Framework for the Future of the Corporation: An Agenda for Business in the 2020s and beyond* (2019) https://www.thebritishacademy.ac.uk/documents/224/future-of-the-corporation-principles-purposeful-business.pdf.

was led by Prof. Colin Mayer – to refer to commercial enterprises that aim to solve the needs of people or the planet in a profitable way, without causing more harm in the process.

In this report, first, we review the existing legal framework that is available to entrepreneurs in Chile to develop social purpose enterprises: non-profit foundations, cooperatives and for-profit corporations. We describe each legal form, highlighting their limitations to fully allow every purposeful corporation to achieve their own potential. We also discuss the challenges of using a limited liability company or other traditional commercial legal forms to develop a purposeful corporation and briefly delve into the issue of how to interpret what Chilean legislators intended by incorporating the term 'social interest' in the legal definition of corporation. This doctrinal discussion is even more relevant in a country where commercial practice, regulation and judicial review rests, to a large extent, on the paradigm of profit maximisation as the main objective of the corporation, which may, in some regards, collide with the notion of social enterprise. As we will see, the profit maximisation theory is based on an interpretation of the Chilean norms rather than on its literal content. Then, we review the influence of private certification to obtain acknowledgement as a purpose-driven corporation in the absence of statutory recognition. We explore the status of B Corporations (B Corps) in Chile. Finally, we trace the legal initiative that aims to recognise public benefit corporations in Chile, which, as will be explained, is not even close to being a reality.

2. THE CONCEPT OF PURPOSEFUL CORPORATION

In 2019, the British Academy developed a framework for the Future of the Corporation and took on the difficult task of defining corporate purpose, which resulted in the following: 'the expression of the means by which a business can contribute solutions to societal and environmental problems. Corporate purpose should create value for both shareholders and stakeholders'.[2] This is a high standard, and how to measure it or when to consider it achieved is a work in progress.[3] However, it is a concept broad enough to include all enterprises that want to go beyond the profit maximisation paradigm to contribute to the common good. Since these business initiatives do not have legal recognition in Chile or a unique statutory foundation, we will analyse different legal forms and models that could be or have been used in Chile as a legal vehicle for this type of commercial venture.

[2] Ibid., p. 16.

[3] For further discussion, visit the Enacting Purpose Initiative reports: https://www.enactingpurpose.org/.

3. EXISTING LEGAL FRAMEWORK FOR SOCIAL ENTERPRISES IN CHILE

In the last decade, Chilean entrepreneurs who want to establish a legal vehicle for their companies that recognises the pursuit of a positive social and/or environmental impact have adopted different structures of corporate governance. Due to the absence of a specific law that regulates public benefit corporations, the most popular legal forms that have been used are: (i) non-profit organisations, (ii) cooperatives, and (iii) traditional limited liability companies or for-profit corporations with an embedded social purpose in their statutes or bylaws. These three models have been the main forms adopted in practice, and despite their limitations, they are still able – at least partially – to fulfil the role of a legal vehicle for a purposeful corporation.

In 2015, Chile's Congress started to discuss a new law that would recognise public benefit corporations in the country.[4] Even though the project was presented by representatives of a wide political spectrum, there has not been much political interest in advancing the project to become law. This has meant that Chilean entrepreneurs have had to use traditional legal forms to develop their particular objectives, which has been a path strewn with some difficulties. The following section delves into the inherent challenges of each legal alternative.

3.1. NON-PROFIT FOUNDATIONS

A first option for Chilean entrepreneurs is to organise their enterprise under the structure of a non-profit organisation. The Chilean Civil Code defines a non-profit foundation as a collection of goods directed to a particular end of general interest.[5] As discussed by Prof. Felipe Hübner, the term 'general interest' is broad enough to encompass either the funder's interest or a public interest.[6]

However, the main issue with using a non-profit organisation as a legal vehicle for a purposeful corporation is that the Chilean Civil Code clearly stipulates that foundations are not allowed to distribute any profits by any means, so this vehicle is relegated only to charitable or social organisations that do not disburse dividends.[7] Any financial gain that the foundation may obtain must be used exclusively for the realisation of the purposes of the foundation itself.

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4 For more information refer to the following: https://www.camara.cl/legislacion/ProyectosDeLey/tramitacion.aspx?prmID=10745&prmBOLETIN=10321-03.

5 Código Civil de Chile, Article 545.

6 F. Hübner, *Instituciones sin fines de lucro: asociaciones, corporaciones y fundaciones*, Ediciones Universidad Católica de Chile 2021.

7 Código Civil de Chile, Article 556.

While in 2011 the Chilean Civil Code was amended to improve the corporate governance of non-profits, it is still forbidden to distribute profits to funders. Moreover, a recent judicial decision from the Chilean Constitutional Court[8] affirmed that members of the board of directors of a non-profit organisation cannot be paid for their job, which makes them weaker as a legal form to carry on a social enterprise that needs a professional and dedicated board of directors.[9]

In practice, however, some business groups have incorporated foundations into their societal structure to pursue objectives that go beyond the pursuit of distribution of profits. In fact, in recent decades, business groups have traditionally created related foundations to do philanthropy. As an example, in the Chilean forestry sector, Empresas CMPC has Fundación CMPC, while ARAUCO runs Fundación Arauco, both dedicated to promoting educational opportunities for children in the areas where they operate.[10] These foundations, however, are not directly linked to their business operation, despite the fact that most of the directors of the foundations are executives of the related companies.

Notwithstanding, a foundation can still be useful for purposeful enterprises in Chile. It could, for example, become the owner of a company or a group of companies, as a parent or holding legal entity. This scheme has become the model used to implement what has come to be known as steward-ownership. This model seeks to preserve 'the power of entrepreneurial for-profit enterprise while preserving a company's essential purpose to create products and services that deliver societal value and protect it from extractive capital'.[11]

According to the Purpose Foundation, steward-owned companies are committed to self-governance. Control remains within the company with the people directly overseeing its operation and mission. Profits serve the company's purpose, by being either reinvested in the company, shared with stakeholders (i.e. employees), or distributed to and donated by the foundation. According to Purpose, Chilean examples of steward-owned companies are Late!, Doble Impacto and Locales Comunales; however, this was not verifiable on their websites or publicly disclosed information.[12] To the best of our knowledge, this model is very rare in Chile and there is not enough information to evaluate their performance.

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8 Tribunal Constitucional de la República de Chile, Sentencia Rol 12.558-2021, Requerimiento de inaplicabilidad por inconstitucionalidad respecto del artículo 551-1 del Código Civil, Caso Mutual de Seguros de Chile.

9 Tribunal Constitucional de la República de Chile, Sentencia Rol 12.558-2021, 15 November 2022, https://www.diarioconstitucional.cl/wp-content/uploads/2022/12/STC_Rol_N__12_558-21-INA.pdf.

10 For more information about these initiatives see https://www.fundacioncmpc.cl/ and https://www.fundacionarauco.cl/, respectively.

11 For more information see https://purpose-economy.org/en/whats-steward-ownership/.

12 Purpose, 'El Poder del Propósito', https://purposelatam.org/elpoderdelproposito/.

Another limitation of using a foundation as a parent company is that it is only useful to determine the destination of the profits after they are distributed by the subsidiary. Yet it has no legal effect on how the subsidiary should be run and on how the administration should take its decisions, for example whether these decisions should be based on something other than profit maximisation. This is especially true if there are other shareholders participating in the ownership of the company that claim that their best interest has not been upheld, as the business would be pursuing objectives that go beyond the pursuit of profits and are not included in the company's bylaws.

Despite the limitations mentioned, in particular the prohibition of paying board members, using a non-profit organisation in Chile can be a useful and legitimate legal model for entrepreneurs that want to serve public objectives, in collaboration with the state, or to establish a business in areas of significant public interest to the economy, such as health or education.

3.2. THE COOPERATIVE: A STRUCTURE FOR MUTUAL ASSISTANCE

Another option for Chilean entrepreneurs is cooperatives. Cooperatives are defined by Chilean law as 'associations whose purpose is to improve the living conditions of their members in accordance with the principle of mutual assistance'.[13] There are some cases of successful cooperatives in Chile, both in terms of their business models and in terms of their legitimacy in the communities where they operate, such as the milk producer COLUN, the alcoholic local producer CAPEL or the financial firm COOPEUCH.[14] This vehicle is not widely used. In 2021 the Ministry of Economy of Chile determined that there were 3,567 cooperatives in Chile, but only 39% of those were active, which amounts to 1,391 active cooperatives. According to the same study, approximately two million members belong to those 1,391 active cooperatives.[15]

As stated above, a cooperative's social purpose is the betterment of the living conditions of its members. In fact, while the respective statutes allow cooperative members to define other purposes in their bylaws – besides mutual aid – such as a social or environmental benefit, they should be subordinated to the objectives and structures imposed by mutual aid. In practice, this may operate as a limiting factor for purposeful corporations using the cooperative form in Chile.

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13 Decreto con Fuerza de Ley No. 5 sobre Ley General de Cooperativas, Article 1.

14 For more information about each one of these cooperatives see https://www.colun.cl/, https://www.cooperativacapel.cl/inicio, and https://www.coopeuch.cl/cooperativa, respectively.

15 Chilean Ministry of Economy, Development and Tourism, 'Cooperativas de Chile' (2021) https://asociatividad.economia.cl/wp-content/uploads/2021/03/01_2021_COOP.pdf.

Another disadvantage of this structure is that cooperatives also have the 'one person, one vote' system, which might work well for small groups of people, but not for larger projects with disproportionate contributions of capital. A cooperative's 'one person, one vote' structure means that it has an administration with particularities that obey mutual aid, which makes it less flexible. Therefore, cooperatives only seem advisable for purposeful business when the purpose and business project is strongly linked to a group of people who, jointly, with a relatively stable composition, and with a high participation in its administration, decide to carry out an enterprise.

On the other hand, one of the advantages of being constituted as a cooperative is that they enjoy tax benefits that corporations do not have. In consideration of the nature and purpose of a cooperative, the main tax relief is that cooperative members are exempt from paying income tax and value-added tax on the goods and services produced by the cooperative.[16] While the fiscal benefits continue to be centred on the cooperative itself, recent regulatory modifications have sought to facilitate and create incentives for business between cooperatives.[17]

In addition, cooperatives can serve as an excellent way to link business and communities in the search for shared value. In fact, when companies want to work with local communities, the cooperative allows them to involve community members in a coordinated way. In fact, this legal form requires consensus and collective action for the common good of members. To illustrate, the Cooperativa de Turismo y Comercio de Los Vilos, a cooperative located in a fishing village close to a mining facility in the north of Chile, brought together a group of restaurant owners and local chefs to create a high-quality kitchen that produces local food for mining employees.[18] This project has been such a success that the mining company now requires at least 20% of its food purchases to be sourced from this local cooperative. On the social side, this collaboration between a mining company and a local cooperative has created business opportunities, increasing social mobility and cohesion.

In conclusion, regarding the use of cooperatives in Chile as a legal entity to develop a purposeful corporation, it seems limited to some cases where the local, historical and social conditions make them suitable. For a new, large or scalable business, however, it seems more appropriate to use it as a way to organise local communities or territories where the purposeful corporation wants to create a long-standing positive impact.

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16 DFL No. 5 sobre Ley General de Cooperativas, Title VII.

17 National Congress Library, 'Cooperativismo y cooperativas en Chile Serie Minutas Nº 30-22, 21/06/2022' (2022) https://obtienearchivo.bcn.cl/obtienearchivo?id=repositorio/10221/33400/1/N_30_22_Cooperativismo_y_cooperativas_en_Chile.pdf.

18 For more information about the activities of the local cooperative, see https://www.df.cl/df-lab/innovacion-y-startups/cooperativa-de-turismo-y-comercio-de-los-vilos-entra-a-la-industria-de.

3.3. THE FOR-PROFIT STRUCTURE: FROM PROFIT MAXIMISATION TO A PURPOSEFUL CORPORATION

The third option, and the one that has been used most frequently by entrepreneurs seeking to develop businesses with responsible conduct, is to use a traditional for-profit structure in its different variants (i.e. corporations, limited liability companies or joint stock companies) by adding a clear purpose in their bylaws or simply adopting a business strategy to do so, without any special legal forms or protections. Although it is arguable that the for-profit legal form requires a particular legal or statutory exception to go beyond profit maximisation, there are some risks and precautions that need to be considered by social entrepreneurs seeking to use a for-profit structure to carry out their purposeful endeavour.

3.3.1. Corporations under Chilean Law: The Intriguing Concept of 'Social Interest'

A for-profit corporation is defined in the Chilean Civil Code as 'a contract in which two or more persons stipulate to contribute something in common with the aim of distributing among themselves the benefits arising therefrom'.[19] From this definition alone it does not necessarily follow that the purpose of the company is to maximise profits, since it uses the broader concept of benefit distribution.

Further discussion of the possibility of the company pursuing purposes other than the sole generation of profits has taken place in relation to the concept of social interest. This issue has been especially discussed in recent times. Even though the concept does not have an express and definitive definition in the Chilean legal system, it carries tremendous importance, since it is referred to in several regulations, as something different from the interest of the shareholders, and it has been affirmed both by jurisprudence and by several authors that the concept of corporate interest should guide the diligent fulfilment of the duties of the company's administrators.[20]

Two theories have been proposed on the matter: an 'institutionalist' doctrine and another that postulates a criterion based on 'contractualist' principles.[21] The institutionalist doctrine proposes that corporations may evolve, but at their core they have always been constituted by a contractual nucleus around which

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19 Código Civil de Chile, Article 2053.

20 M. Vasquez 'El interés social en las sociedades anónimas chilenas: una relectura a la luz del buen gobierno corporativo' (2023) 44 *Revista de Derecho Privado* 215, http://www.scielo.org.co/pdf/rdp/n44/0123-4366-rdp-44-215.pdf.

21 E. Alcalde 'Relaciones entre el Interés Social y el Interés Personal de los Directores de una Sociedad Anónima' (2002) 5 *Revista Actualidad Jurídica* 243, https://derecho.udd.cl/actualidad-juridica/files/2021/01/AJ-Num-5-P243.pdf.

several interests revolve, where the interest of the shareholders is only one of many. This position states that the multiple powers granted by the legislator to the legal institution of the corporation (i.e. legal personality, limitation of liability, collegiate administration, free transfer) enable the community in which the corporation operates to have certain expectations of it, basically relating to the fulfilment of its legal and ethical duties, in good faith, and internalising all its externalities.

In this way, the institutionalist conception understands the corporation as an instrument at the service of society and stakeholders, where not only the interest of the owners is relevant, but also that of workers, consumers, suppliers, creditors and the public in general, thus encompassing a much broader view than the other position. This position, however, to the best of our knowledge has not had judicial recognition in Chile.

On the other hand, the contractualist conception understands corporate interest as that of the owners, rather than of society or stakeholders. In order to argue this position, it is also necessary to connect the corporate interest with the object and cause of the for-profit contract. Nevertheless, as will be seen, a large part of the doctrine holds that the cause of the contract, that which has motivated the parties to contract, is the maximisation of profits. In this regard, it has been held by the Chilean Supreme Court that the corporate purpose is 'the tendency to achieve the ultimate purpose of the company, which is the cause of the contract, and which as such is common to all the partners and is none other than to achieve the maximum possible profit through the corporate activity'.[22]

This last position, most predominant in Chilean practice, maintains that it was the legislator's intention for corporations to serve the objective of maximising profits. This position stated that linking social interest with any purpose other than maximum profit would entail problems with the so-called fiduciary duties of corporate administrators, mainly the duties of diligence and loyalty. Indeed, if the purpose is to maximise profit, then these fiduciary duties are aimed at protecting the interests of the shareholders themselves, to whom corporate directors are accountable (under this doctrine).

Under this view, the opposite, i.e. if the purpose and fiduciary duties were to include other objectives, would be a risk to accountability and governance that could even lead the board to look after the interests of the stakeholders to the detriment of the shareholders' interests. This, in turn, as Prof. Enrique Alcalde and Prof. Eduardo Walker have pointed out, 'entails the obvious danger of providing directors with an autonomy and independence in relation to the owners of the

[22] E. Alcalde, 'El interés social ante la Corte Suprema', Documento de Opinión Centro de Gobierno Corporativo Pontificia Universidad Católica de Chile (2021) https://centrogobiernocorporativo.uc.cl/images/opinion/Opini%C3%B3n_2021/Columna_Enrique_Alcalde_49.pdf.

company that lacks constitutional justification and, in the immediate term, the fact that such administrators must face absolute uncertainty regarding the scope of their fiduciary duties'.[23]

Faced with this discussion, national academics have emerged seeking to expand the scope of the corporate purpose in order to provide organisations with an effective purpose, within the realm of the fiduciary duties and the legal definition of the corporation. This, as a way to allow the board to identify, manage and balance the environmental, social and governance impacts of the corporation on stakeholders, would give the board the authority to consider the legitimate expectations of the stakeholders, with the objective of promoting the success of the corporation in the long term.

Thus, for example, Prof. Jaime Alcalde proposes a solution to this dichotomy of concepts of corporate interest. He starts from the idea that shareholders seek value creation through their business development and the fact that corporations may define in their bylaws other purposes not incompatible with the distribution of financial benefit. In this line of argument, Prof. Alcalde quotes Jesús Alfaro, recalling that 'an obvious assumption that is sometimes forgotten: the purpose of the company must be that which has been established in the bylaws and, presumably, that is, unless the partners say otherwise, maximising the joint profitability of the investments made'.[24]

In other words, Prof. Alcalde proposes that companies define in their bylaws the corporate interest they are pursuing, leaving the door open to providing necessary relevance to different stakeholders. In the event that these clarifications are not introduced, then the interest of producing benefits to be shared among the shareholders, as a residual object or cause, takes precedence. In this way, and as long as it does not go against the nature of the corporate contract – which implies seeking an interest or benefit to be shared among the shareholders (and which can only be moral) – the incorporators or the parties that concur in the incorporation of the company may establish a specific corporate purpose, such as training or welfare of the workers, respect for the environment, welfare of the communities where the company operates, or health of consumers, just to name a few. Such purposes, as long as they do not denaturalise the corporate form by preventing the generation and distribution of profits, are lawful, can be included and are binding on the boards of directors and those to whom they delegate administration, such as managers.

It remains to be discussed, however, who would have the right of action to demand compliance with such objectives. According to the Chilean Corporations Law, only shareholders can demand compliance with the corporate purpose,

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[23] E. Alcalde and E. Walker, 'La nueva regulación de la SVS: dudas convergentes en perspectivas diferentes', Documento de opinión emitido por el Centro de Gobierno Corporativo Pontificia Universidad Católica de Chile (2015).

[24] J. Alcalde, 'Propósitos', *El Mercurio Legal* (2021), p. 2.

but not third parties who could benefit from a possible statutory declaration, such as workers, communities, suppliers, etc.[25] It is explicitly recommended that this limitation in the right of action, as we will see later in this report, is adopted by B Corps in Chile. The derivative action contemplated by the Corporations Law grants an action for violation of the bylaws to shareholders representing at least 5% of the shares or to any of the directors.[26]

3.3.2. Additional Limitations of the Traditional Tool for Purpose-Driven Entrepreneurs

Other difficulties faced by corporations who want to become purposeful corporations are the administrative rules around tax expenditure and donations. In effect, there is the risk that expenses that have been generated to promote and satisfy purposes other than the maximisation of profits will be seen by the Chilean Internal Revenue Service as expenses outside the company's line of business, and thus be considered expenses 'not necessary' for the generation of income.[27] This would prevent their deduction as expenses, and their use for such purposes may eventually be subject to fines. In 2022 an amendment was passed that expanded the activities that can legitimately be funded by business, but it is still not clear how they will be interpreted by the regulatory agency.[28]

Another hurdle for the for-profit model in the implementation of a purpose-driven business is the tax limitation that has been imposed in Chile that establishes maximum donation amounts.[29] This limit has been solved via the hybrid model of making a foundation the majority shareholder of the company, making withdrawals of the profits and leaving them immediately at the disposal of the foundation, as is the case of the B Corp Late!.[30]

This model is interesting to analyse, as it has been used in various parts of the world to ensure the corporate purpose in the long term. However, it presents two kinds of problems: on the one hand, the legal form does not fit well with the form of the foundation described above – which has a series of governance

25 Ley No. 18.046 de Sociedades Anónimas, Title V.
26 Ley de Sociedades Anónimas, Article 133 *bis*. Please note that there is very little Chilean commercial jurisprudence on this subject given that parties are usually bound by mandatory arbitration clauses.
27 Ley No. 824 de 1974, del Ministerio de Hacienda sobre Impuesto a la Renta.
28 Ley No. 21.440 de Régimen Donaciones con Beneficios Tributarios en Apoyo a las Entidades Sin Fines de Lucro.
29 Ley No. 16.271 de Impuesto a las Herencias, Asignaciones y Donaciones.
30 L. Cisternas, 'Competir por Solidaridad' in Instituto de Innovación Social, *Innovación social: Una herramienta para mejorar la calidad de vida de las personas* (2016), p. 27, https://negocios.udd.cl/files/2014/03/LibroInnovacion_18.pdf. For more information visit the company's website at https://late.cl/.

problems; and, on the other hand, it only solves the charitable situation and purpose of the foundation that owns the shares of the company, but does not allow the company itself to solve a social or environmental need, which is the object often sought by purpose-driven companies.

This can be seen, with special emphasis, in so-called B Corps (modelled after benefit corporations in Anglo-Saxon countries), which, with the support of private initiatives such as Sistema B in Chile, have resorted to adapting their corporate structure to remove any doubts regarding their objectives.[31] Prof. Jaime Alcalde defines B Corps as 'commercial companies where transparency, workers' participation and positive impact on the community and the environment are statutorily added to the lucrative object they develop, creating a welfare that can be quantified under measurable standards'.[32]

Beyond B Corps, there are numerous companies that are adapting their business models to sustainable practices, measuring and reporting their environmental, social and governance (ESG) practices. While it is arguable, from a legal standpoint, that a 'purposeful' company requires a legal status different from that of the traditional corporate structure used by companies in Chile, B Corps have not been enshrined in Chile as a legal form. This has caused their founders to work with the various pre-existing models. In the region, the closest we can observe to a special regulation of social enterprises is found in Colombia and Ecuador, where laws have legally recognised benefit and collective interest companies.[33] This regulation in Colombia, for example, gave recognition to collective benefit and interest companies (BICs), which implies a change in the corporate purpose of the company to include those activities that seek to generate an impact beyond the mere generation of profits.[34] In the following section we will discuss the situation in Chile.

3.3.3. Other Considerations Regarding Traditional Corporations in Chile: The Rise of Sustainability and ESG

An important part of what has been analysed applies to publicly traded companies, which are structured in Chile mostly using the form of the *Sociedad Anónima abierta*. This type of legal entity requires further study to include all regulations imposed by the local agency in charge of overseeing financial markets in Chile.

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31 For more information about the Chilean Sistema B see https://www.sistemab.org/chile/.

32 J. Alcalde, 'El Lado B del Derecho Societario', *El Mercurio* (2020) http://derecho.uc.cl/images/El_lado_B_del_derecho_societario.pdf.

33 Ibid.

34 Developed by Ley No. 1901 de 2018, and regulated by Decreto No. 2046 de 2019 and Resolución No. 200-004394.

All things considered, there has been a significant development in large publicly traded companies in Chile regarding these matters. This development has been carried out in specific areas (i.e. environment, human rights, etc.) and in a rather inorganic form, with specific companies taking the lead in each industry. It is worth noting that the Financial Market Commission has also recently signalled the importance of reporting on matters of corporate sustainability and good governance, as it has considered that these topics are essential for investors to assess medium- and long-term asset performance and market gaps where there could be space for future regulation.[35] In turn, we expect that in the following years there will be noticeable changes – especially in publicly traded companies, as they are the ones bound by this novel administrative norm – in how companies reflect on and disclose their purpose, risk assessment and impacts. This new regulation, the Norma de Carácter General No. 461 issued by the Financial Market Commission, will provide the market and academia with more information to evaluate sustainable practices and performance of large corporations.

As an example of ESG and good corporate practices, recent developments in a specific area worth considering can be found in a report published by the International Labour Organization in 2023, which evaluated the implementation of the United Nations Guiding Principles on Business and Human Rights (UNGP) in Chile. The study applied to the largest Chilean companies traded on the Santiago stock market during 2022, using the methodology of the Corporate Human Rights Benchmark from the World Benchmarking Alliance. In this report, some Chilean companies, such ENEL Chile, FALABELLA, EMPRESAS CMPC and AGUAS ANDINAS, obtained scores that show a deep commitment to and level of implementation of the UNGP and, in consequence, the social pillar of ESG.[36] Despite those exceptional frontrunners, Chilean companies only achieved 20% implementation of the evaluated standard, with an average of eight points (on a scale with a maximum of 24 points). This result, however, is similar to other countries where companies were evaluated under the same methodology, like Spain.[37]

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35 For more information refer to Norma de Caracter General No. 461 of the Financial Market Commission: https://www.cmfchile.cl/sitio/aplic/serdoc/ver_sgd.php?s567=c7cce0d0ef34e69eb4391d1a345c9d81VFdwQmVVMVVSWGhOUkZFeFRtcFpkMDFuUFQwPQ==&secuencia=-1&t=1636726759f.

36 J. Ibáñez, F. Loyola and S. Bernier, 'Primer Diagnóstico Empresas y Derechos Humanos en Chile', Organización Internacional del Trabajo (2023) https://www.ilo.org/wcmsp5/groups/public/---americas/---ro-lima/documents/publication/wcms_865164.pdf.

37 ECODES, 'Derechos Humanos en la cadena de valor de las empresas españolas. Análisis de la calidad de políticas y sistemas para identificar, mitigar y remediar riesgos y vulneraciones de derechos humanos en el IBEX35' (2022) https://ecodes.org/images/que-hacemos/04.Produccion_Consumo/Analisis_DDHH/Informe_An%C3%A1lisis_IBEX35_Metodolog%C3%ADa_CHRBCore_ResumenEjecutivo_def.pdf.

4. IN THE ABSENCE OF LAW, PRIVATE CERTIFICATION: THE STATUS OF B CORPS IN CHILE

Chile, like other countries in the region, enthusiastically initiated a project for social interest companies in 2015.[38] However, as will be shown, after a promising start, interest gradually declined and today the project is still in the National Congress after several years, as it has not been a priority. For this reason, many entrepreneurs use the traditional for-profit corporation model, adding some particularities from the B Corp model, as an alternative to implement a meaningful and purposeful business. Some national examples of the most famous B Corps are the retailer Algramo, the bottled water company Late!, the cemetery Parque del Recuerdo, the agricultural business Empresas Sutil, and the financial services company Cumplo.[39]

Although the B Corp model is not the only one that can host a purposeful business, given that these companies have generated a community where learning is shared and, in addition, has a seal of recognition, in practice they have been an effective way for the development of these types of companies.

In fact, B Corps are committed to continuous improvement and place their business purpose – whether social or environmental – at the centre of their business model. This effectively redefines the meaning of the company's success. In Chile, this B Corp certification is delivered by Sistema B, a non-governmental organisation associated with B Lab for the entire Latin American region. Chile has been one of the leading countries in the Latin American region, with the number of companies seeking to become a B Corp growing year by year.[40] According to Prof. Jaime Alcalde, 'as of February 2022, there [were] 810 certified companies in Latin America, 210 of which [were] Chilean'.[41]

In order to be certified as a B Corp, a series of requirements must be followed. Among them there are two fundamental points that must be included in the bylaws: (i) the legal protection of company directors and managers when considering the interests of all stakeholders, and not only shareholders, when

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[38] F. Cabrera, 'Empresas B: Certificación B Lab y Empresas Chilenas Certificadas', Departamento de Estudios Extensión y Publicaciones (29.12.2017) https://obtienearchivo.bcn.cl/obtienearchivo?id=repositorio/10221/24921/1/Empresas_B_certificacion_y_empresas_chilenas_Final.pdf.

[39] For more information see https://algramo.com/, https://late.cl/, https://parquedelrecuerdo.cl/, http://www.empresassutil.cl/, and https://cumplo.cl/. The aforementioned companies obtained their B Corp certification, which implies that in addition to modifying their bylaws to comply with particular Empresa B (Chilean member of the B Global Network) requirements, they have designed their business around a societal or environmental need.

[40] Endeavor, 'Iniciativa Chile Sostenible: Estudio de caracterización 2022' (2022) https://www.endeavor.cl/wp-content/uploads/2023/01/20230110-Chile-Sostenible_V3.pdf.

[41] J. Alcalde, 'Purpose-Driven Companies and the Projected Legal System for Benefit and Collective Interest Companies in Chile' in H. Peter, C. Vargas Vasserot and J. Alcalde (eds), *The International Handbook of Social Enterprise Law*, Springer, Cham 2022, p. 473.

making decisions; and (ii) ensuring that the company's mission incorporates creating a positive effect on the community, individuals associated with or related to the company, part or the environment.[42]

This model of private certification does not require a new corporate form or type, but only requires the inclusion of certain statutory clauses associated with the duties of directors and partners to extend their scope of responsibility – without necessarily affecting the degree to which they will be held accountable – to the considerations mentioned in the preceding paragraph. For example, administrators undertake an obligation to report to their investors or publicly disclose information in their annual reports regarding the company's actions to protect the local and global environment. In addition, there is the requirement to modify and expand the corporate purpose of the company following the same criteria.

However, despite the objectives mentioned, the recommendation made by Sistema B in Chile is to modify bylaws to make clear that 'only the partners or shareholders of the Company may seek compliance with the provisions' of the article that stipulates the purpose or social objective of the corporation.[43] This, in turn, excludes communities or other stakeholders from being legitimate actors to demand compliance with those provisions.

From a practical perspective, the B Corp certification process creates an access barrier for those companies that are larger or more complex. It has been argued that these hybrid forms can be useful when the company is in its early stages and has a relatively modest scale. However, it may become more complicated when growing, diversifying, internationalising, seeking resources from capital markets or entering into mergers and acquisitions with companies that are likely to have a traditional legal form.[44]

In addition, the development of a more robust system for reporting the social and environmental impact companies seek to generate is still pending in Chile. In fact, to the best of our knowledge, the Sistema B reporting system has not evolved as fast as the local regulation regarding non-financial information now requires. As mentioned before, the current regulation incorporates new requirements, including a materiality assessment and reporting under the Sustainability Accounting Standards Board categories. Without this improvement in the realm of private certifications, it will be increasingly hard for the public to verify compliance with a company's objectives and their positive impact on society.

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42 For more information see https://www.sistemab.org/ser-b/.

43 For more information visit the Sistema B website: https://www.sistemab.org/modificaciones-legales-chile/.

44 A. Vives, 'Cuarto sector: Hacia una mayor responsabilidad social empresarial' (2012) 4(3) *Revista de Responsabilidad Social de la Empresa* 154.

These difficulties, in addition to the legal recognition that these companies seek, have prompted congressmen from different sectors to seek to find a regulatory solution for companies that want to have a purpose beyond maximising profits, but not necessarily to become certified and comply with the requirements for being a B Corp.[45] However, in spite of having promoted the law in its beginnings, there is no evidence that the Chilean branch of Sistema B is now pushing for a special legal form. It seems that Sistema B is satisfied with promoting the use of the traditional legal form of a for-profit corporation with the particular requirements that they have for their associates.

5. STATUS OF THE LEGAL INITIATIVE REGARDING PUBLIC BENEFIT CORPORATIONS IN CHILE

The Latin American region stands out as an active agent in the debate on the concept of purposeful enterprise, with two laws approved, one registry regulation and four bills in the pipeline.[46] Thus, Chile has had a series of bills that aim to regulate BICs.

BICs have been understood as a Latin American response to the United States' benefit corporation model and have two distinctive features: on the one hand, they are for-profit, being able to distribute profits among their shareholders, and on the other hand, they have a legal mandate by which shareholders and administrators must seek a public benefit and the creation of profits. The essential pillars on which these BICs are built are the existence of a social and environmental benefit purpose that is complementary to the economic activity, the difference in the company's liability regime, and the mandatory transparency and reporting regime.[47]

In Chile, the project that seeks to regulate the creation and operation of BICs began when it was presented by Congresswoman Maya Fernández and Congressman Felipe Kast on 6 October 2015, an initiative that was debated in the Economy Commission, but did not continue its legislative course.[48] The same Congresspersons made a second attempt on 13 June 2017.[49] The stated purpose of the 2017 proposed legislation was to lend credibility and legal certainty to

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[45] F. Cabrera, 'Empresas B: Certificación B Lab y Empresas Chilenas Certificadas', Departamento de Estudios Extensión y Publicaciones (29.12.2017) https://obtienearchivo.bcn.cl/obtienearchivo?id=repositorio/10221/24921/1/Empresas_B_certificacion_y_empresas_chilenas_Final.pdf.

[46] C. Connolly, J. Mujica and S. Noel 'Movimiento legislativo de Sociedades de Beneficio e Interés Colectivo (B.I.C) en América Latina' (2020), p. 4, https://idl-bnc-idrc.dspacedirect.org/bitstream/handle/10625/58656/IDL-58656.pdf.

[47] Ibid., p. 11.

[48] Boletín No. 10.321-03.

[49] Boletín No. 11.273-03.

these companies in the eyes of both wider society and investors. By creating a legislative framework, it would broaden access beyond B Corps. Those rules would govern not only B Corps but other companies as well, including those without interest or capacity to be certified, so long as they share the objective of having a social impact.

The aforementioned bills define a BIC as:

> a legal entity formed by a common fund provided by its funders who are responsible only for their respective contributions, a company that is constituted or is covered by the provisions of this law and that includes in its corporate purpose of its bylaws the positive impact or the reduction of some negative effect on the community and the environment.[50]

This definition does not specify what should be understood as 'positive impact' or 'reduction of some negative effect', nor the degree of impact or reduction, nor whether it should be measured with respect to the overall activity of the company or only around one aspect of its activity.

This project is currently moving through the pipeline, albeit slowly, with no incentives put in place to accelerate its journey since early 2021.[51] Previously, the executive introduced a series of amendments that significantly changed the original motion, considerably reducing the regulation regarding transparency of information. In fact, after a parliamentary discussion in January 2018, the government's proposal was rejected and a new definition of 'collective benefit and interest' was introduced:

> transparent governance and positive impact deriving from the prevention and mitigation of negative effects and the promotion of actions in favour of the community, workers, the value chain or the environment. This impact shall be publicly disclosed through the forms provided for in this law. Likewise, a company of collective benefit and interest is understood to be a legal entity that is registered in the National Registry of Companies of Collective Benefit and Interest.[52]

Subsequently, this project was discussed in the Economy Committee without further activity until 7 January 2019, when it received the endorsement of the executive branch.[53] The congresspersons who make up the Economy Commission have since changed, so it will have to be discussed again by the new commissioners or it may be presented again with modifications.

The introduction of BICs into the Chilean legal framework would provide an option for companies that wish to convey full legal certainty regarding their

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[50] Boletín No. 10.321-03 and Boletín No. 11.273-03.

[51] Mensaje No. 473-368 introduced a motion of simple urgency to the bill.

[52] Boletín No. 11.273-03.

[53] Moción No. 811-366.

commitment to pursuing the public interest and, consequently, the application of the rules on fiduciary duties to ensure they honour those commitments. However, given the national legislative situation – which has been dominated by the discussion of a new Constitution since late 2019 – it is unlikely that Chile will formally recognise this form soon.

All things considered, at this time, companies that want to pursue a public interest beyond profit maximisation usually adopt the form of a for-profit corporation, and include a particular mention of the purpose it aims to achieve in its bylaws. Some of those corporations apply to Sistema B to gain Empresas B[54] status, while many others simply pursue their operations with a broader purpose beyond profit maximisation. To the best of our knowledge, there have been no judicial decisions that test the scope of the fiduciary duties regarding stakeholders or the activities of the corporation in the search of public benefits. However, if these activities are made in good faith and supported under the rationale of promoting the success of the corporation in the long term, it seems to be enough to be acceptable under the current Chilean commercial legislation.

6. CONCLUSIONS

In Chile, there is no legal regime that recognises a particular legal form for social enterprises. Therefore, the most frequent models adopted by social enterprises include the establishment of a foundation, a cooperative or a for-profit corporation with tailored bylaws to reflect its particular purpose. As mentioned, the bill creating BICs is currently languishing in the National Congress, and it is unlikely that its legislative process will conclude in the near future. Due to the lack of legal recognition of social purposes, some companies opt to apply to the private certification process of Sistema B.

Despite the limitations exposed, and considering the legal alternatives mentioned in this report for purposeful corporations, at the moment we see neither the need nor the existence of a suitable legislative environment to create a purpose-driven legal commercial vehicle in Chile. The existing laws are sufficient, despite their limitations, and have not been contested in court. In order for regulators and shareholders to achieve greater certainty in their pursuit of the standard of purposeful business and responsible conduct, they may rely on internal governance provisions and use contractual agreements with stakeholders and interest groups that promote collaboration and generation of shared value, so long as they promote the success of the company in the long term.

[54] For further clarification, the specific qualification of Empresa B is obtained by companies in Chile that are approved by Sistema B, the Chilean branch of the B Global Network and are the Chilean equivalent of a B Corp.

Notwithstanding the above, a legislative change would be useful in providing legal certainty to shareholders and directors of companies regarding permissible corporate goals and, consequently, the fiduciary duties of the board of directors. Although we believe that all those aspects relevant to the business of the company (including non-financial aspects) must be addressed by the board of directors of any company, regardless of its purposes (since they may have an impact on the course of corporate business), given the extension of the doctrine of the primacy of the shareholders' interest, legislative authorisation would provide reassurance to companies that pursue purposes beyond the maximisation of profits for their shareholders.

Finally, it should be noted that in recent times companies in Chile have been committing themselves to a more sustainable development, whereby social and environmental concerns – not traditionally considered by boards of directors – have been incorporated in the corporate decision-making process. There has been a change in paradigm that has pressured companies to contribute to solving the challenges faced by society and consider different stakeholders and interest groups that nurture their business. All in all, these companies seek to create value in the long term. Additionally, there is greater creativity and legal innovation. Chilean companies have developed new instruments to adequately manage their social and environmental impact and have introduced new contractual terms with local communities and cooperatives in order to make them part of the development of their sustainable businesses.

SOCIAL ENTERPRISES IN CHINA

Meng Ye

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1. INTRODUCTION

Social enterprises as a hybrid organisational type that balances financial and social purposes are still quite new in China, given the country's relatively short history of both the private for-profit sector and the non-profit sector

in their modern forms. Although the social enterprise sector, or 'the fourth sector' according to some scholars, is quite small, social enterprises have gained increasing popularity among both Chinese practitioners and policy entrepreneurs.[1] There are already numerous associations, research institutions, social impact investment platforms and professional servicing organisations dedicated to the topic of social enterprise, such as the China Social Enterprise and Impact Investment Forum, the China Social Enterprise Service Centre and the Social Enterprise Research Centre. Local policy entrepreneurs and policymakers also favour social enterprise as a handle for policy innovations. Four social enterprise certification systems have been rolled out, in Chengdu, Shunde, Shenzhen and Beijing respectively, either by government agencies or private entities.

The idea of achieving social goals using business methods in innovative ways manifests the trend of convergence of the business sector and non-profit sector in an increasingly complex and interlocked society in China. Although there are indigenous traditions and values that emphasise the balance of social values and seeking profits, the modern concept of social enterprise was introduced into China in around 2008.[2] International social enterprise intermediary organisations, especially the British Council, which ran a 10-year training programme for social entrepreneurship in China beginning in 2009, have played catalytic roles in the emergence of social enterprises.[3] Domestically, social and environmental challenges have grown dramatically after over 40 years of prioritising economic development since the 'economic reform and opening-up'.[4] In response, the for-profit sector has started to progress down a more sustainable path. Some entrepreneurs focus more on resolving social issues when designing their business models. Meanwhile, non-profit organisations have been experiencing a decline of international funding and unstable domestic contributions as the economic growth slows down. Hence, more non-profit organisations have begun to explore earned revenue strategies to be less financially dependent on donations.[5]

The purpose of this report is to comprehensively introduce and review the legal system that governs social enterprises in China. Overall, laws and regulations on social enterprises in China are quite immature. The term 'social enterprise' has not appeared in any national-level legal sources, while several

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1 Meng Zhao, 'The Social Enterprise Emerges in China', *Stanford Social Innovation Review* 10, no. 2 (2012).

2 Weiyan Zhou et al., 'China Social Enterprise and Social Impact Investment Development Report (Chinese Version)' (Social Enterprise Research Center et al., 2015).

3 Xuanqi Liu, 'A Brief History of Social Enterprises in China', *China Development Brief* (2018).

4 Yonglong Lu et al., 'Forty Years of Reform and Opening Up: China's Progress toward a Sustainable Path', *Science Advances* 5, no. 8 (2019).

5 J. Gregory Dees, 'Enterprising Nonprofits: What Do You Do When Traditional Sources of Funding Fall Short', *Harvard Business Review* 76, no. 1 (1998).

local-level policymakers have piloted standards certifying social enterprise within the extant for-profit and non-profit framework. Yet there is no special attention in formal laws or policies to reconciling the hybrid nature of social enterprises. Therefore, this report develops the discussion on social enterprise law in China by analysing how existing laws apply to social enterprises.

It is worth noting that China has a statutory legal system that resembles civil law. Different sources of law can be divided into the following categories based on the hierarchy of legal forces:[6]

1. the Constitution promulgated by the National People's Congress (national);
2. laws promulgated by the National People's Congress and its Standing Committee (national);
3. regulations issued by the State Council (national);
4a. regulations passed by Provincial Congresses (local);
4b. rules issued by Ministries of the State Council (national);[7]
5. rules issued by local governments and their departments; and
6. binding documents: Notices, Opinions and Guidance, etc. issued by various authorities (legislative, administrative and the Communist Party) at both national and local levels.

2. WHAT IS A SOCIAL ENTERPRISE?

2.1. THE CONCEPTUALISATION OF SOCIAL ENTERPRISE IN CHINA

Social enterprise is a fuzzy concept and there are great disputes over what social enterprise should mean in China. This section will focus on what social enterprise means for practitioners, academics and social enterprise certification standard makers in China, to convey a more comprehensive picture of how social enterprises are conceptualised.

The understandings of social enterprises vary the most among practitioners. A very lax conceptualisation of social enterprise held by one of the most prestigious pioneers in the non-profit sector[8] is to judge the 'social' dimension of social

6 Adapted from Meng Ye, 'Building an Enabling Legal Environment: Laws and Policies on Social Enterprises in China', *Journal of Asian Public Policy* 14, no. 2 (2021). See details in the Legislation Law of China.

7 Regulations passed by provincial congresses and rules issued by ministries of the State Council both have legal force below State Council Regulations. Neither one of them is regarded as higher in the legal hierarchy than the other.

8 Mr Xu Yongguang initiated the most famous Chinese non-profit programme 'Project Hope' and now is the chair of the board of directors of the Narada Foundation, the first grant-making foundation in China dedicated to supporting civil society in China.

enterprises based on results rather than the organisations' social purposes.[9] In other words, ordinary enterprises with positive social externalities are also considered social enterprises within this extremely broad view. If we use the 'spectrum' illustration[10] of social enterprises between the two poles of pure for-profit and pure non-profit organisations, this conceptualisation of social enterprise is very close to the purely for-profit end. A more moderate view of social enterprise integrates corporate social responsibility into the concept of social enterprise, as some in China regard certified B Corps as social enterprises too. In contrast, there are also practitioners who believe social enterprises should have clear social goals in their missions, while not fixating on whether they have sustainable business models. This view falls closer to the non-profit end of the spectrum. A hybrid view is probably the most popular among practitioners, which is that social enterprises are those organisations that achieve social ends through business means.

Comparatively, academics and certification standards are more sophisticated and specific in their definition of social enterprises. A broadly recognised academic definition of social enterprises is Zhao and Guo's 'combination of multiple elements' approach to conceptualise social enterprise.[11] They argue social enterprises are organisations that show all the following four elements: (i) being dedicated primarily to pursing a social goal; (ii) seeking opportunities for social change where government failure and market failure overlap; (iii) using innovative methods to solve social issues; and (iv) having clear mechanisms in place to prevent mission drift. These four elements are to some extent assimilated into the four existing social enterprise certification systems launched in Shunde, Shenzhen, Beijing and Chengdu between 2015 and 2018.

Another important study on social enterprise, the China Social Enterprise and Social Investment Landscape Report 2019 (Landscape Report), uses both narrow and broad definitions to estimate the total number of social enterprises in China.[12] According to the Landscape Report, the narrow definition of social enterprises only requires the satisfaction of the following three criteria: having a social or environmental goal; earned income as the main financing source; and a larger portion of the profits being used to develop the business rather than distribution. The narrow definition of the Landscape Report also requires social enterprises to be purposefully dedicated to solving social issues. The broad definition used by the Landscape Report includes as social enterprises all

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9 Yongguang Xu, *Charities to the Right and Commerce to the Left: Social Enterprise and Social Impact Investing* (Zhong Xin Press, 2017) (in Chinese).

10 J. Gregory Dees, *Social Enterprise Spectrum: Philanthropy to Commerce* (Harvard Business School, Publishing Division, 1996); Janelle A. Kerlin, 'Social Enterprise' in Stefan Toepler and Helmut K. Anheier (eds), *The Routledge Companion to Nonprofit Management* (Routledge, 2020).

11 Meng Zhao and Xinnan Guo, 'Defining Social Enterprise in China: From the Dichotomic View to the Combinative View', *R & D Management* 30, no. 2 (2018) (in Chinese).

12 Guosheng Deng, *China Social Enterprise and Social Investment Landscape Report 2019* (CSEIF and Narada Foundation, 2019) (Chinese abbreviated version).

organisations that incorporate social or environmental values in any stages of their business, such as staff composition, the production process and the nature of the products or services produced.[13]

In sum, although the conceptualisation of social enterprise varies greatly and can be opaque to the general public, most in the social enterprise community in China (including practitioners, academics and policymakers) agree that social enterprises should prioritise achieving a clear social goal and rely primarily on certain business models to financially support their endeavours to achieve their goals.

2.2. OVERALL SIZE AND EXEMPLARY SOCIAL ENTERPRISES

Using a snowball sampling method and applying its narrow definition, the Landscape Report estimated the total number of self-identified social enterprises at 1,684. These are social enterprises that have become known to the professional community, by either applying to be certified, participating in social innovation competitions, or attending workshops and trainings on related topics. In contrast, using its broader definition,[14] the Landscape Report estimated that the total number of social enterprises may be as high as 1.75 million. This effort roughly combined portions of the total number of farmers' specialised cooperatives (regarded as an indigenous form of social enterprise) and social service organisations (a non-profit legal vehicle for social enterprises, also referred to as 'private non-enterprise units').[15] The majority of social enterprises included in this broad definition would be unaware of the notion that they are 'social enterprises'.

Two examples of Chinese social enterprises will help contextualise the notion of social enterprises in China. Probably without controversy, the most famous and 'oldest' social enterprise is Canyou Group.[16] Founded in 1997, Canyou Group (meaning 'friends of the disabled' in Chinese) is dedicated to providing

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13 Ibid.

14 See also Jian Li, *Social Enterprise Policy: International Experience and China's Choice* (Social Sciences Academic Press of China, 2018) (in Chinese); Meng Ye, 'Building an Enabling Legal Environment: Laws and Policies on Social Enterprises in China', *Journal of Asian Public Policy* 14, no. 2 (2021).

15 The statistics are just a rough estimation. The report explains that the State Administration for Market Regulation estimated in 2017 that there were about 1.93 million farmers' cooperatives in China. But it is also argued that many famers' cooperatives are 'shell entities' or 'zombie entities'. A report on farmers' cooperatives estimates that around 74% of the famers' cooperatives are actually running. And Mr Xu Yongguang (see footnote 9) estimates that 80% of the 0.4 million social service organisations are social enterprises. Thus, the report estimates that, taking the broad definition, the number of social enterprises in China may be as high as 1.75 million ($1.93 \times 74\% + 0.4 \times 80\%$). Even though the broad definition includes the 1,684 self-identified social enterprises, this number is negligible in the sum.

16 Li Jian, 'Legitimacy Acquisition of Social Enterprise in China: A Case Study of Canyou Initiatives', *Journal of Chinese Governance* 2, no. 2 (2017).

non-manual work opportunities (especially computer science, e-commerce, Photoshopping, etc.) and capacity building for disabled persons in China. Having begun as a typing and printing workshop with only five disabled employees and one computer, Canyou has evolved into an integrated group including one charitable foundation, 14 social organisations (non-profit organisations) and over 40 high-tech for-profit enterprises.

While the status of Canyou as a social enterprise is quite secure, controversy surrounds whether large IT companies that produce positive externalities but prioritise financial returns should be regarded as social enterprises. For example, when the Mobike Technology Co., Ltd was awarded the China Social Enterprise Award in 2017, there were great disputes over whether it qualifies as a social enterprise. Mobike is a phenomenally successful[17] IT start-up company that promotes a station-less bicycle-sharing system, providing a more flexible, convenient and green solution to people's commuting needs in big cities. As it does so in a fashionable, low-cost and carbon-emission-free manner, as well as offering synergies with the booming mobile payment industry in China, venture capital flooded in to finance Mobike.[18] But these investors are only aiming to achieve financial returns rather than social impact. Moreover, the viral growth of Mobike after the excessive injection of capital has had negative ramifications, such as taking up too much public space, and its model of expansion has become a controversial issue in itself. Similar controversy also surround online platforms like GoFundMe, which individuals use to seek financial help for their personal difficulties (mostly medical expenses).

At this stage of development, most social enterprises are smaller businesses, and none are sufficiently big and influential to be a 'household name'. Setting aside large conventional corporations that may produce positive externalities, there is not yet any widely accepted social enterprise that is publicly held.

2.3. COMMON WORK AREAS AND FUNDING SOURCES

According to the statistics of a sample of 370 social enterprises surveyed by the Landscape Report, the top areas of work of the sample are education, community development, employment and skills, environment and energy, and supporting social innovation. Details of the data are shown in Figure 1. Specific business model examples include microfinancing for the poor, first-aid education, providing free independent toxicological risk assessments of products and selling products they endorse, and designing accessible technology products for disabled persons.

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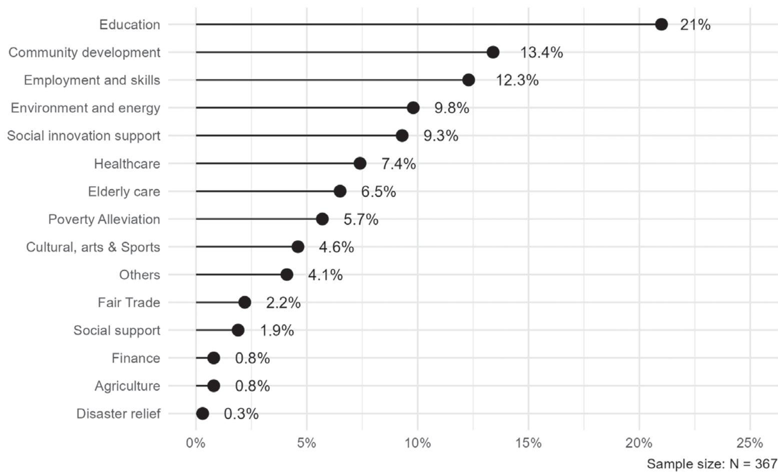
17 The number of Mobike users grew from 177,000 in June 2016 to 34.5 million in May 2017. In June 2017, Mobike also secured equity financing of US$600 million for the Series E funding round. See the original report in Chinese at https://www.qianzhan.com/analyst/detail/220/180404-0a116fff.html.

18 Liang Hao and C.W. Chan, 'Mobike: A Worthy Bike-Sharing Unicorn?', https://cmp.smu.edu.sg/case/3976.

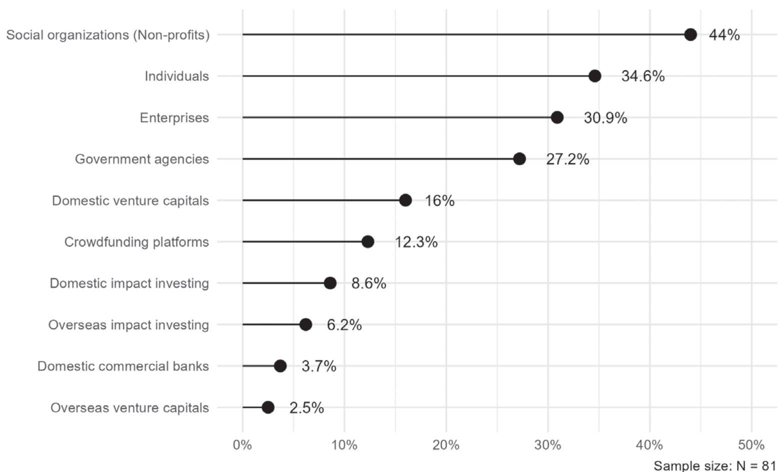
The Landscape Report also surveyed the sample about sources of initial investment and earned revenues. The results in Figure 2 show that the largest revenue sources are non-profits (including foundations), and individuals rank second. Then follow enterprises, government agencies and domestic venture capital firms. The statistics indicate that institutional investors – both venture capital firms and impact investing agencies – still account for a lower portion of financing sources of Chinese social enterprises' ongoing operations, though the sample is not randomly selected and may have some bias.

Figure 1. Distribution of social enterprise work areas



Data source: The Landscape Report. Data visualisation by the rapporteur.

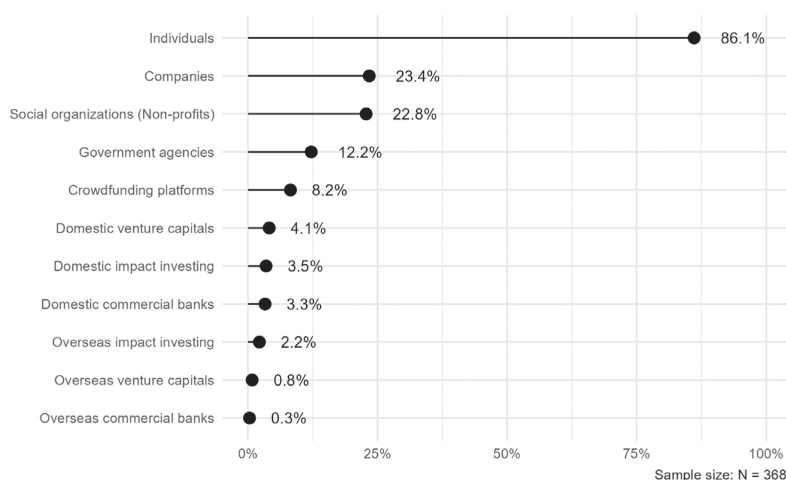
Figure 2. Rank of social enterprises' financing sources



Data source: The Landscape Report. Data visualisation by the rapporteur.

Figure 3 shows the results of funding sources for social enterprises to obtain the initial set-up capital. Individuals comprise a much higher portion than other financing sources.

Figure 3. Rank of social enterprises' registered capital sources



Data source: The Landscape Report. Data visualisation by the rapporteur.

3. FORMS OF ORGANISATION FOR SOCIAL ENTERPRISES

In China, there currently are no special legal forms for social enterprises. The legal forms that house social enterprises in China and the relevant regulations are listed in Table 1.

Table 1. Available legal forms for social enterprises and corresponding organisational laws

Legal Forms	Organisational Laws / Regulations
Civilian-run non-enterprise units or social service organisations (SSOs)	Interim Management Regulation for the Registration of Civilian-Run Non-Enterprise Units (1998)
Limited liability companies (LLCs)	Company Law (2018)
Companies limited by shares (CLSs)	Company Law (2018)
Farmers' specialised cooperatives (FSCs)	Farmers' Specialised Cooperative Law (2017)
Social welfare enterprises (SWEs)	Rules on the Recognition of Social Welfare Enterprises (abolished in 2016)

Source: Compiled by the rapporteur.

3.1. NON-PROFIT SOCIAL ORGANISATIONS

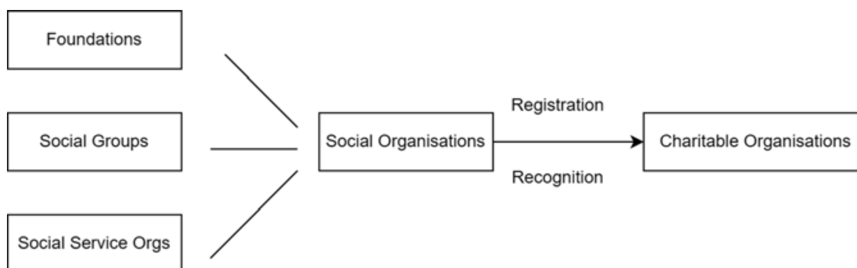
Firstly, social enterprises can take non-profit form in China. In such cases, there is no problem for social enterprises to pursue social missions, as this is the intended purpose of non-profit organisations. However, having a high ratio of earned income could make it more difficult for non-profits to obtain tax-exempt status.[19]

'Social organisations' is the term used by Chinese policymakers and administrators essentially as a synonym for non-profit organisations. Under Chinese non-profit law, non-profit organisations are not supposed to be set up as companies. Instead, three types of social organisations, as defined in three State Council Regulations, provide specific stand-alone legal forms for non-profits.

The first type is the foundation, regulated by the Management Regulations on Foundations (2016). The concept of a foundation in China is similar to that in other countries, referring to non-profits that have larger endowment funds (at least 2 million RMB Yuan to register) and either make grants to other implementing organisations or operate programmes for themselves. The second type is the social group, regulated by the Regulations on the Registration and Management of Social Groups (2016). Social groups are member-based associations, most of which are mutually beneficial. The third type is social service organisations[20] or civilian-run non-enterprise units, regulated by the Interim Management Regulation for the Registration of Civilian-run Non-enterprise Units (1998) (SSO Regulation).

SSOs are the most suitable non-profit legal forms for social enterprises because such non-profits may run specific businesses or implement programmes. Private medical, educational and elderly care agencies are registered as SSOs in China.

Figure 4. Relationship between three types of non-profits and charities



Source: Produced by the rapporteur.

[19] Meng Ye, 'Building an Enabling Legal Environment: Laws and Policies on Social Enterprises in China', *Journal of Asian Public Policy* 14, no. 2 (2021).

[20] The Charity Law refers to this type of non-profits as 'social service organisations'.

The Charity Law 2016 is also important for social enterprises operated as non-profits because it governs charitable activities by all kinds of entities. Figure 4 illustrates that all three types of social organisations need to go through further registration or recognition process to obtain charitable status. The Charity Law is the first-ever national law that regulates charitable activities, including requirements for charitable status application, charitable fundraising and charitable asset management, and charitable trusts. Social enterprises operating as non-profits and engaging in these activities must abide by the Charity Law. Much stricter regulatory requirements apply to non-profits with charitable status, including additional reporting and information disclosure requirements, an overhead ratio cap, and a minimum charitable expenditure ratio. Meeting these stricter requirements allows non-profits that have qualified to operate in the name of 'charity' or 'public benefit' and to fundraise from the public. Without this qualification, it is illegal to fundraise publicly, either online or offline.

For social enterprises taking the legal form of an SSO, whether they are charitable or not, a clear non-distribution constraint applies. Such constraint is stipulated in both the SSO Regulation and the General Provisions of the Civil Law Code (2020). In the definition of a non-profit legal person, it is stipulated that it 'shall not distribute any profit to its capital contributors, incorporators, or members'.[21] When terminated, any 'residual assets shall continue to be used for public welfare, as is stipulated in the articles of association or the resolution made by the governing body.' There is also a cy-près doctrine requiring use of the non-profit's assets for similar purposes when the use for exactly the same purpose is not viable.[22]

The SSO Regulation defines the allowable purposes of SSOs very generally, describing them as established to engage in non-profit social service activities and barring them from infringing on national security or public interests or violating social ethics and morality.[23] The Charity Law is more specific about the scope of charitable purposes. According to Article 3, charitable purposes include poverty alleviation, helping people in need, the elderly or people with disabilities, disaster alleviation, public health, education, arts and culture, science, sports, and environmental protection.

The limitation on trading activities of non-profits in China is a little unclear. First, there is no distinction between related versus unrelated business as in the US or primary purpose trading versus non-primary purpose trading as in the UK. Second, earned income is not prohibited for SSOs according to the Ministry of Finance's Accounting Rules for Non-Profit Organisations (2005).

21 See Article 87 of the Civil Code.
22 See Article 95 of the Civil Code.
23 See Articles 2 and 4 of the SSO Regulation.

Earned income from providing services and sales of goods are listed in the regulation as lawful incomes for non-profits.[24] However, there are no clear rules or thresholds on what kinds of business activities SSOs can engage in and how much earned income SSOs can attain. As a result, there is much discretion and variation in regulators' attitudes towards SSOs with a high ratio of earned incomes.

Related to such regulation is that it is quite difficult for non-profits to obtain tax-exempt status and tax-deductible qualifications for their donors. In China, the misunderstanding that non-profits mean 'free' products and services and that they should not charge their beneficiaries money as for-profit organisations do is still widely held in among the public, stakeholders of non-profits, and even government officials. Therefore, having a high ratio of earned income could jeopardise the application for favourable tax treatment by social enterprises that assume the non-profit form.

3.2. COMPANIES

For-profit enterprises in China mainly include individual proprietorships, partnerships, state-owned enterprises, farmers' specialised cooperatives (FSCs), and two types of companies – limited liability companies (LLCs) and companies limited by shares (CLSs). Since individual proprietorships and partnerships neither have independent legal person status and nor offer their owners limited liability, very few social enterprises use these two types of legal forms.

According to the Company Law (2018), LLCs and CLSs are both independent legal persons and their shareholders only assume limited liability. LLCs are smaller companies with no more than 50 shareholders and have more flexibility in terms of dividing shares and distributing profits, while CLSs are larger companies whose equity can only be divided into equal shares and the distributions to shareholders can only be based on the number of shares each shareholder holds. The governance structure of companies, as well as the rights and obligations of the shareholders, board of directors and supervisors are also specified in the Company Law.

Entities with non-profit purposes should register as one of the three types of social organisations discussed above under the Chinese legal system. The Company Law does not specify what objects companies should pursue but states that the object of the law as 'maintaining the socialist economic order and promoting the development of the socialist market economy.'[25] Therefore, companies are viewed as market sector entities, with the object of pursuing

[24] See Article 58 of the Accounting Rules for Non-Profit Organizations.

[25] Article 1 of the Company Law.

returns on investment for investors. Given that having purely social goals is not allowed for companies in China,[26] whether mixing for-profit objects with social goals is permissible is still a grey area. This also means a for-profit-type social enterprise runs the potential legal risk of violating the legal doctrines protecting shareholder rights if the company's profit-making ability is impacted by the pursuit of its social goals.

The Company Law also specifies the rights of employees to participate in the management and decision-making process of companies. First, the employees of a company shall form a labour union to safeguard the legal rights and interests of employees. In addition, the board of directors may include representatives of employees, which is required for state-owned companies. The board of supervisors of LLCs shall include representatives of employees at an appropriate ratio specified by the bylaws. For CLSs, representatives of employees shall make up no less than one-third of the members of the supervisory board.

Two major taxes applying to companies are enterprise income tax (regulated by the Enterprise Income Tax Law (2018)) and value-added tax (regulated by the State Council's Interim Regulation on Value Added Tax (2017)). The normal enterprise income tax rate is 25% of taxable income; the value-added tax rate ranges from 3% to 17% depending on the industry. Various tax relief policies for companies can apply to social enterprises and will be discussed in the section on subsidies and benefits below.

It is also important to discuss how laws on companies could reconcile the profit-seeking goals and social goals for social enterprises or how much legal room social enterprises registered as companies have to serve stakeholders beyond shareholders. As discussed, the Company Law does not prohibit mixing social goals with profit-seeking, but it does have articles protecting shareholders' rights.

First, shareholders are protected against the misconduct of board directors and managers. Article 152 of the Company Law grants shareholders the rights to sue board directors and managers if they violate their fiduciary duties and damages are incurred to shareholders. Second, shareholders are protected against the misconduct of other shareholders. Article 20 of the Company Law stipulates that no shareholder may injure the interests of the company or of other shareholders by abusing the shareholder's rights. This article is often applied where small shareholders' benefits are harmed by large shareholders with dominant voting power. The guilty shareholders shall compensate the damages either to the company or the other harmed shareholders.

These mechanisms are designed to protect shareholders' rights to investment returns. There are not yet any exemptions for social enterprises. The business models of social enterprises may not be the optimal way of maximising profit

[26] See the Interim Measures for Banning Illegal Non-Governmental Organizations (2000).

if, for example, they lower the price for unprivileged communities or raise the costs by using greener methods of production at a level not required by the law.[27] The challenges of reconciling social enterprises' hybrid nature and extant legislation's focus on shareholders' rights would be more salient when there is a need for additional investors (ordinary ones aiming for financial returns) to scale up. From the perspective of protecting the rights to investment returns of such new investors, the aforementioned articles may be used to claim damages from the social entrepreneurs' focus on social impact.

There are two mechanisms in the existing company law framework to reconcile such tension. The first one is the dissenting shareholders' right to demand a buy-back of their shares at reasonable price when a major company decision impacts their benefits (borrowed from the common law's appraisal right of dissenters).[28] One of the situations where shareholders can execute this right is when the company does not distribute surplus for years despite the conditions for dividends being met. This mechanism can make investment in social enterprises less risky and more attractive to normal investors, and hence can potentially benefit social enterprises in need of equity funding and scale-up. However, it can also harm the financial stability of the social enterprise if this right is executed.

The second mechanism is unique to LLCs. For both LLCs and CLSs, the shareholders' rights to vote and receive dividends should correspond to the amount of equities/shares they hold, but only shareholders of LLCs are allowed to mutually agree to distribute the voting rights and dividends in different ways. Therefore, shareholders of LLCs can agree to override the principle of distributing profits based on the share of equities. Social-oriented investors can agree to have distributions lower than their shares to compensate normal investors for the reduced probability because of balancing social and financial goals.[29]

3.3. OTHER SPECIAL FOR-PROFIT FORMS

Farmers' specialised cooperatives (FSCs) are another special legal form of for-profit entities in China. Many scholars also consider them to be potential social enterprises because, in addition to functioning as mutual-aid organisations among farmers in the production and sale of agricultural products, they also commonly have the functions of microfinancing, poverty alleviation, preserving

27 See more discussion in Robert Kuttner, 'Neoliberalism: Political Success, Economic Failure', *The American Prospect* 25 (2019).
28 See Article 75 of the Company Law.
29 Meng Ye, 'Building an Enabling Legal Environment: Laws and Policies on Social Enterprises in China', *Journal of Asian Public Policy* 14, no. 2 (2021).

traditional craftsmanship, and rural community building.[30] However, only a small proportion of FSCs in China are 'self-identified' social enterprises. Social welfare enterprises (SWEs) had been a category of for-profit enterprises, formed with the purpose of providing employment opportunities for people with disabilities. However, the recognition of this special organisational form was abolished in 2016 and the policies encouraging the employment of people with disabilities shifted to a system of tax refunds for each disabled employee for ordinary companies. Therefore, this section will focus on discussing the legal framework for FSCs.

According to the Law on Farmers' Professional Cooperatives (2017), FSCs are mutual-aid economic organisations established by farmers who form such alliances voluntarily. The object of an FSC is to serve its members and pursue their common interests. Its functions include purchasing and using agricultural means of production, collaborating in the production, sale, processing, transportation and storage of agricultural produce, developing rural crafts and other rural community functions, and providing technology and information facilitation to members. FSCs are independent legal persons and members of FSCs assume limited liabilities to the extent of their contributions.

The organisational structure of FSCs is very similar to companies (both LLCs and CLSs). The members are the owners of FCSs, playing a similar role to shareholders of companies. Members can be farmers or enterprises, public institutions[31] or social organisations, but farmers must account for at least 80% of the members of FSCs. Since farmers are both the owners and beneficiaries of the social goals of FCSs, there is little conflict between financial and social goals for this legal form of social enterprises. The decision-making body is the member assembly, with each member allotted one voting right, with the exception that members whose contributions to the FSC are significantly larger can be allotted additional voting rights up to a cap.

4. LIFECYCLE

Generally, the rules on lifecycle – formation, maintenance and termination – are simpler for for-profit-type social enterprises.

[30] Tracy Shicun Cui and Janelle A. Kerlin, 'China: The Diffusion of Social Enterprise Innovation: Exported and Imported International Influence' in Janelle A. Kerlin (ed.), *Shaping Social Enterprise: Understanding Institutional Context and Influence* (Emerald Publishing, 2017); Xiaomin Yu, 'The Governance of Social Enterprises in China', *Social Enterprise Journal* 9, no. 3 (2013).

[31] Public institutions are entities such as government-run hospitals and schools.

4.1. REGULATIONS FOR SOCIAL SERVICE ORGANISATIONS

It can be quite difficult to form and register an SSO mainly because of the 'dual-management' legal system for non-profits in China. The SSO Regulation stipulates that the registration of an SSO shall be approved by its regulator, the Civil Affairs Department, as well as a professional supervisory unit (PSU).[32] A PSU is the governmental department in charge of the specific area of work to which an SSO is dedicated. Since the potential PSU does not have the legal obligation to assume such roles, this requirement can present a roadblock for successful registration of an SSO. Between 2009 and 2016, various cities piloted a direct registration reform that allowed non-profits to directly register with and be regulated by the Civil Affairs Authority.[33] This approach was formally adopted at the national level thereafter for social organisations working in four areas: chambers of commerce, technology organisations, charitable organisations, and community service organisations.[34] Other requirements for registration including legal name, domicile and assets are specified in Table 2.

To maintain their legal identities, SSOs must abide by the rules on organisational governance, information disclosure and financial management stipulated by the SSO Regulation. For example, they shall not conduct activities beyond their registered business scope, conduct for-profit businesses, establish branches, or use donations in violation of their purposes.[35] SSOs also have the obligation to submit annual reports, including how the SSO fulfils its mission through its activities, a financial statement, and any changes in personnel or governance structures, first to their PSU and then to their registering Civil Affairs Authority.[36] If an SSO holds charitable status, it also needs to abide by a cap on administrative costs (13–20% of annual total expenses depending on different asset sizes) and a floor for charitable expenditures (70% of last final year's annual revenues for charities with public fundraising

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32 Qiusha Ma, 'The Governance of NGOs in China since 1978: How Much Autonomy?', *Nonprofit and Voluntary Sector Quarterly* 31, no. 3 (2002); Meng Ye, 'Building an Enabling Legal Environment: Laws and Policies on Social Enterprises in China', *Journal of Asian Public Policy* 14, no. 2 (2021).

33 Meng Ye, 'Building an Enabling Legal Environment: Laws and Policies on Social Enterprises in China', *Journal of Asian Public Policy* 14, no. 2 (2021).

34 See State Council and Central Committee of the Communist Party's *Opinion on the Reform of Social Organizations' Regulator System and the Promotion of The Healthy Development of Social Organizations*.

35 Article 25 of the SSO Regulation.

36 See more in the Ministry of Civil Affairs Rules: Measures for Annual Inspection of Private Non-enterprise Entities (2005).

qualifications, and 6–8% of total net assets depending on different asset sizes for charities without public fundraising qualifications). There are even more requirements, such as having at least an 'AAA' rating in social organisation evaluations,[37] if the SSO wants to apply for qualification for public fundraising.

PSUs and the Civil Affairs Authority also regulate SSO exit. For an SSO to dissolve, split or merger, it must set up a liquidation team under the guidance of the PSU and submit an application to be deregistered together with the PSU's inspection opinion to the Civil Affairs Authority within 15 days after the liquidation process. As discussed, any residual assets of SSOs must be disposed of according to the Civil Code's rules on non-profit legal persons to other non-profit organisations with the same or similar social missions.

4.2. REGULATIONS FOR THREE FOR-PROFIT FORMS

Registering a social enterprise as any of the three types of for-profit entities will be easier. Unlike the registration of SSOs, the registration of for-profit entities is not subject to approval. The applicants only need to file the basic information, proof of identity of key stakeholders and the bylaw of the for-profit entity, following the legal procedures (see details in Table 2). As long as the conditions are met and the documents are complete, there will be no bottleneck in the process.

After registration, the main legal requirements to satisfy to maintain the lawful identity is to file annual reports of key business information, as well as update the registered information on file as they change. When the occasions for termination occur according to the law or the for-profit entities' bylaws, the assets shall be disposed of following the liquidation procedures.

Applicable laws regarding the regulation of for-profit legal forms of social enterprises are the Company Law (2018), the State Council's Regulation on the Administration of Company Registration (2016), the State Council's Administrative Regulation on the Registration of Farmers' Specialised Cooperatives (2014), and State Administration for Market Regulation's Interim Measures for the Publicity of Annual Reports of Farmers' Specialised Cooperatives (2014).

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[37] The social organisation evaluation is organised by the Civil Affairs Bureau to rate the quality of social organisations with levels from the highest, AAAAA, to the lowest, A.

Table 2. Summary of the rules on the life cycle of three types of for-profit social enterprises

Items	LLCs / CLSs	FSCs
Requirements for registration	– lawful name – bylaw agreed upon by the shareholders – certain amount of registered capital (subscribed by promoters if established by promotion, or total actually paid capital if established by stock floatation) – legal representative as a natural person – organisational structure required by law – clear domicile, business scope and duration – no more than 50 shareholders (LLCs)	– more than five members and over 80% of the members are farmers – lawful name and domicile – bylaw as required by the law – organisational structure as required by the law – capital that confirms to relevant rules
Registering authority	State Administration of Market Regulation and local-level (provincial and municipal) Market Regulation Bureaus	County- and district-level Market Regulation Bureaus
Registering steps and timelines	– pre-approval of company name – open account and capital verification – submit formation registration with the market regulation authorities – accept application if materials are complete or advise how to complete – formation registration decision made – register with other departments such as the tax administration Decision on registration shall be made within 15 days of receiving the complete application For CLSs formed by stock floatation, the board of directors of the company shall apply to the company registration authority for formation registration within 30 days after the end of the foundation meeting	– pre-approval of organisation name – submit formation registration with the market regulation authorities – accept application if materials are complete or advise how to complete – formation registration decision made – register with other departments such as the tax administration – file information with agricultural department Decision on registration shall be made on-site or within 20 days of receiving the complete application

(continued)

Table 2 ***continued***

Items	LLCs / CLSs	FSCs
Documents to submit for registration	– written application for formation registration signed by the legal representative of the company – certificate on the designation of a representative or the joint authorisation of an agent by all the shareholders – bylaws of the company – eligibility certificate of each shareholder which is an entity or the identification of each shareholder who is a natural person – documents stating the names and domiciles of all the directors, supervisors, and managers of the company and certificates on the relevant appointment, election, or employment – appointment document and the identification of the legal representative of the company – notice of pre-approval of enterprise name – certificate of domicile of the company – other documents as required For CLSs formed by stock floatation, the minutes of the foundation meeting and a capital verification certificate issued by a legally formed capital verification agency shall also be submitted; and if the CLS formed by stock floatation offers shares to the public, the relevant approval document issued by the securities regulatory authority of the State Council shall also be submitted	– application for formation registration – minutes of the establishment meeting signed or sealed by all founders – bylaws signed or sealed by all founders – appointment documents and identification of legal representatives and directors – list of capital contributions that specify the name of the member, the form and amount of their capital contribution, the total capital contribution of all members, with signatures and seals of all the contributing members – member roster – proof of lawful use right of the domicile – proof of the designation of the representative or authorised agent by all founders

(continued)

Table 2 *continued*

Items	LLCs / CLSs	FSCs
Maintenance	– submit audited annual report for the previous year to the registering agency between 1 January and 30 June – the annual report should include key business information such as shareholders subscribed and paid-in capital, investment and equity holding of the company, any information online shop the company runs, and information on the number of employees, external guarantees, total owner's equity, total assets, liabilities, profits, and total taxes, etc. – follow the legal procedure to update the registration if any of the items as stated in the business licence is changed	– when member composition changes and does not comply with the legal requirements, correct within six months – follow the legal procedure to update the registration if any of the items as stated in the business licence is changed – submit annual report for the previous year to the registering agency between 1 January and 30 June – annual report includes information on the FSC's licence state, financial statement, and any online shop opened – board of supervisors conducts internal audits; the membership assembly can also decide to do external financial audit
Exit	Circumstances of dissolution and liquidation of company: – term expires or dissolution condition met according to the bylaw – decided by the decision-making agency – due to merger and split of the company – licence is cancelled – apply for bankruptcy when applicable	Circumstances of dissolution and liquidation of an FSC: – dissolution condition met according to the bylaw – decided by the member assembly – due to merger and split of the FSC – licence is cancelled – apply for bankruptcy when applicable

Source: Compiled by the rapporteur.

5. STATE/PRIVATE CERTIFICATIONS AND METRICS

5.1. OVERVIEW OF THE FOUR CERTIFICATION SYSTEM

Currently, there are already four social enterprise certification systems across different areas in China which can be classified into three models by the nature of the certifiers. The four systems are those of Chengdu, Shunde, Shenzhen (China Charity Fair) and Beijing. Some basic information about the four social enterprise certification systems is shown in Table 3.

Table 3. Social enterprise certification systems in China

System (year launched)	Applicable forms	Locality scope	Count
Model 1: Government-led certification			
Chengdu (2018)	Companies	Limit to local SEs	99 certifications
Model 2: Certification by a chartered entity			
Shunde (2015)	For-profits	Limit to local SEs	30 certifications
Model 3: Certification by government-organised NPOs			
China Charity Fair (Shenzhen) (2015)	For-profits and non-profits	No restriction on localities	314 certifications
Beijing (2018)	For-profits and non-profits	Limit to local SEs	88 certifications

Source: Compiled by the rapporteur.

Launched in 2015, the Shunde system is the earliest social enterprise certification system in China. It is classified as 'certification by a chartered entity' because the certification is operated by Shunde Social Innovation Centre (SSIC), a legal entity established by a particular regulation passed by the local congress. The Shenzhen certification system is run by China Charity Fair Development Centre, a non-profit organisation established by the municipal Civil Affairs Bureau of Shenzhen, the registering authority for non-profits. The Beijing social enterprise certification system is also operated by a government-organised NPO. The only government-run social enterprise certification is the Chengdu system. Initiated by the Municipal Government of Chengdu in 2018, the certification of social enterprises is conducted by the Chengdu Administration of Market Regulation (the regulator of for-profit organisations). The involvement of the regulator means the accredited social enterprises can choose to use 'social enterprise' in their legally registered names.

As for accessibility, Shunde and Chengdu only accredit for-profit enterprises, while Beijing and Shenzhen accredit both for-profit and non-profit organisations. Shenzhen is the only system that accepts applications from all over China, due to the national influence of the China Charity Fair. As of the end of 2021, Shenzhen has certified most social enterprises, a total of 314, while Shunde, Beijing and Chengde had accredited 30, 88 and 99 social enterprises respectively.[38]

Over the years since 2015, there have been updates to the certification criteria. Earlier versions of Shunde and China Charity Fair resemble international models more, while later versions of all four systems are becoming similar to each other and more attuned to the Chinese context.[39]

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38 Data from the website of Shunde Social Innovation Centre, http://www.ss-ic.org.cn/; Beijing Social Enterprise Promotion Association, http://www.bsep.org.cn/; and Chengdu Social Enterprise Service Platform, http://cd.socialenterprisechina.com/.

39 See Meng Ye, 'Building an Enabling Legal Environment: Laws and Policies on Social Enterprises in China', *Journal of Asian Public Policy* 14, no. 2 (2021).

5.2. THE KEY CERTIFICATION CRITERION

Table 4 summarises the key requirements of certification of social enterprises in the four systems. The discussion will focus on the Shenzhen China Charity Fair system.

The current Shenzhen certification can be regarded as a two-stage process: certification and rating. Specifically, once an applicant meets the four criteria set out by the Shenzhen system, it will be certified. It will then be evaluated against 27–28 items which add up to a total score of 100. Applicants that score 60 and more are graded as a 'good social enterprise' and those score 80 and are graded as a 'gold social enterprise'.

The four certification criteria are as follows.

1. The applicant shall be an independent for-profit or non-profit entity that has been lawfully registered in China for one year or more, has three or more FTE (full-time equivalent) employees, and has a formal and complete accounting mechanism.
2. The applicant shall primarily pursue social goals of solving societal problems, improving social governance, serving vulnerable communities and communities with special needs, promoting community interests, or protecting the environment. It shall also establish mechanisms to ensure the focus on the social goals (to avoid mission drift).
3. The applicant shall innovatively solve social problems through market measures.
4. Its social impact and economic outcomes shall be clearly identifiable and measurable.

The specific items used for rating are grouped based on these four criteria, with innovation treated as a separate category. Expert referees grade the applicants against these metrics based on the information in their application materials and collected during on-site visits.

Comparatively, the other three certification systems also have similar requirements. Both the Shunde system and the Beijing system also have a rating system in addition to certification, while the Beijing system is more specific on how grades are differentiated. As for the certification criteria, Shunde does not include innovation in the standards, while Beijing has a couple more requirements, including 'having good social credit records' and 'engagement with stakeholders from broader communities'. The Chengdu system does not have a rating system. Compared with Shenzhen, it does not include the innovation requirement but has the additional requirement of good social credit records.

Table 4. Comparison of social enterprise accreditation systems in China

Criteria	Chengdu	Shunde		Shenzhen		Beijing
		old version	new version	old version	new version	
Legal form	companies	companies and other for-profit enterprises	companies and other for-profit enterprises	for-profit organisations and non-profits	for-profit organisations and non-profits	for-profit organisations and non-profits
Accrediting agency	government	chartered entity		government-organised NPO		government-organised NPO
Social goal	required	required	required	required	required	required
Business income	not specified normally ≥ 60%	not specified	expected no clear threshold	≥ 50%	expected no clear threshold	not required ≥ 30% (1 star) ≥ 50% (2–3 stars)
Profit distribution	not specified	≥ 50% to social purposes ≤ 30% to shareholders	expected no clear threshold	non-profits: no distribution companies: ≤ 35% to shareholders	not specified added points if do	not specified
Asset lock	suggested no ratio specified	2/3 of residual assets locked	not specified	not specified	not specified added points if do	not specified
Organisational conditions	run independently for ≥ 1 year ≥ 3 employees	run in Shunde independently for ≥ 1 year	run independently for ≥ 0.5 years ≥ 3 employees	run independently for ≥ 2 years ≥ 1 employee	run independently for ≥ 1 year ≥ 3 employees	run independently in Beijing for ≥ 2 years ≥ 3 employees
Results	label and legal identity	label	three grades: A, AA and AAA	label	three grades: SE, Good SE, Gold SE	three grades: 1 star, 2 stars, 3 stars

Source: Adapted from Meng Ye, 'Building an Enabling Legal Environment: Laws and Policies on Social Enterprises in China', *Journal of Asian Public Policy* 14, no. 2 (2021).

6. SUBSIDIES/BENEFITS

6.1. BENEFITS DESIGNED FOR SOCIAL ENTERPRISES

Most of the benefits or incentives that these systems design for social enterprises are nominal or potential opportunities, but there are also exceptions. Currently these certification systems do not have any benefits for investors of social enterprises.

Specifically, the Beijing system provides: (i) capacity building (training and mentor matching, etc.); (ii) brand promotion support; (iii) for certified social enterprises, membership of and the opportunity to join the board of Beijing Social Enterprise Promotion Association; and (iv) certain financial support and priority in being connected with potential social impact investment opportunities. But there is no clear timeline when the benefits will be in place and no guarantee that every social enterprise certified will be able to enjoy them. The Shunde system's benefits are similar to Beijing, providing more of a potential opportunity than guaranteed rewards. In addition, since the Shunde local authority has established special funds to support innovative social governance programmes run by private entities, and some local foundations have programmes dedicated to social innovation, the SSIC can facilitate certified social enterprises to apply for this funding. On the positive side, these related local programmes have already been actually rolled out, yet certified social enterprises will still need to compete with other organisations to obtain the funding. The China Charity Fair offers similarly nominal benefits. It only provides certified social enterprises networking opportunities with social investment funds taking advantage of the China Charity Fair platform.

As the only certification launched by the government, the Chengdu system provides not only incentives similar to those available to social enterprises certified by Beijing, SSIC and China Charity Fair, but also concrete rewards in various districts in Chengdu. For example, the Wuhou District government has adopted a policy of awarding social enterprises 100,000 RMB Yuan after certification by the Chengdu system.[40] The policy also rewards social enterprises based in the Wuhou system for being certified by other systems. B Corp certified social enterprises receive 80,000 RMB Yuan and China Charity Fair social enterprises can receive 30,000–80,000 RMB Yuan, depending on their grades under the system. Chengdu-certified social enterprises can enjoy other benefits such as low-interest loans, the same priority as non-profits in government contracting, and a local tax credit equivalent to 100% of the

[40] See Chengdu Wuhou District Interim Measures of Supporting Social Enterprises. See also Chengdu Social Enterprise Service Platform's Wechat Official Account Article, https://mp.weixin.qq.com/s/RNCuM3OgtBTCPLruJlEFEQ.

value of the enterprise's actual contribution to the local GDP in the first two years. Other districts in Chengdu also have similar incentives for social enterprises.

6.2. OTHER BENEFITS SOCIAL ENTERPRISES CAN ENJOY

At the national level, non-profit-type social enterprises enjoy tax exemption, and their donors qualify for tax deductions. Non-profits' income from donations, government grants and accruals from these two types of income are tax-exempt.[41] Even for non-profit social enterprises, however, earned income remains taxable, whether mission-related or not. Individual donors can deduct up to 30% of their taxable annual income and corporate donors can deduct up to 12% of their taxable annual income. Non-profits need to apply and meet additional requirements for both tax-exempt and tax-deductible status. For example, to obtain tax-exempt status, the average salaries of employees cannot exceed twice the local average salary.

Some for-profit social enterprises will also qualify for other preferential tax programmes. These include tax relief or subsidies for small and micro businesses, FSCs, enterprises that hire disabled employees, and enterprises that work on elderly care and environmental protection.

These tax benefits are designed as policy tools to support certain organisational types, hiring practices and investment in some industries. The details of these benefits are summarised in Table 5.

Table 5. Summary of key benefits applicable for social enterprises

Document name	Eligible entities	Benefits
Notice on Implementing the Policy of Inclusive Tax Relief for Small and Micro Enterprises (2019)	Enterprises with a monthly turnover under 100,000 RMB Yuan	Exempt from VAT
	Enterprises with annual taxable income under 1 million RMB Yuan	Lower income tax rate at 20% and only 25% of the taxable income is taxed
Notice on the Tax Policy Related to Farmers Specialised Cooperatives (2008)	Registered FSCs	Sales of produce of members by the FSCs are exempted from VAT and the stamp duty

(continued)

[41] See *Notice of the Ministry of Finance and the State Administration of Taxation on the Issues Concerning Tax-exempt Income in Enterprise Income Tax of Non-profit Organizations* (2009).

Table 5 *continued*

Document name	Eligible entities	Benefits
Regulation on the Employment of the Disabled (2007) Notices on Further Enhancing the Employment of the Disabled Persons (multiple cities)	Any enterprises that hire disabled employees and pay a salary higher than 1.2 times the minimum income (Beijing as an example)	Subsidies equal to 6–8 times the local minimum salary for each eligible disabled hire (Beijing as an example)
Notice on Preferential Value-Added Tax Policies for Promoting the Employment of the Disabled Persons	Enterprises that have 25% or more disabled employees and the total number is no fewer than 10 people (5 for message business)	VAT refund as much as 4 times the social minimum salary
Implementation Opinions on Encouraging Private Capital to Participate in the Development of the Elderly Care Service Industry	Private elderly care agencies that file their documents with Civil Affairs Authorities	VAT is exempted for income from the elderly care services they provide

Source: Compiled by the rapporteur.

7. PRIVATE CAPITAL

7.1. INVESTORS

In China, most existing investors in social enterprises (other than initial individual founders) are organisations from the non-profit sector, the public sector, or organisations established by the public funds. The Landscape Report's snowball sample of 44 investing agencies of social enterprises offers a useful illustration of typical investors. The authors interviewed 44 investors, including 19 foundations investing in social enterprises, and found they mainly conduct impact investing or venture philanthropy. Examples include: the Yifang Foundation, a private foundation, which has investing in social enterprises as one of its core businesses; and Shenzhen Social Commonwealth Foundation, a government-organised NGO with a mission of supporting social innovation and conducting social impact investment. Among the 44 investors, there were 13 governmental agencies providing funding, via both the social welfare lottery fund and other public finance sources. For example, the Guangzhou Social Organisation Bureau has been running venture philanthropy programmes since 2014, from which social enterprises have received funding. It is worth noting that its venture philanthropy funds are mainly grants provided to social organisations (non-profits), not investments made with the expectation of financial returns. In addition, the Report describes 12 private investing agencies, seven of which are dedicated to impact investment, while the other five conduct both social and financial investment.

Chinese regulation of foundations' investment in social enterprises is still quite obscure. Most foundations are charities, hence their investments are regulated by the Interim Measures for the Administration of the Investment Activities for Value Preservation and Appreciation of Charitable Organizations (2018). These rules do not differentiate between mission-related investment and financial investment by foundations, so the focus of the law is to delineate which investments by charities are permissible, in order to protect charitable assets from excessive risks. For example, it prohibits charities from direct investment in the stock market; they can do so only by delegating the task to a professional investment agent. Some foundations have set up subsidiaries as asset management companies to do either financial investment, social investment, or both like the DunHe foundation.[42] Others invest in social enterprises directly, like the Yifang Foundation, but engage in regular consultation with their registering Civil Affairs Bureau to ascertain the boundaries of allowable behaviours.[43] In sum, investment in social enterprises by foundations is not prohibited, but clear legal guidance is lacking.

7.2. SECURITIES LAW

Since social enterprise is not yet a legal term in China, it is unsurprising that the Securities Law (2019) does not mention social value investment. Rather, the Securities Law takes the traditional view of maintaining financial order and protecting investors' rights. Its chapter on 'the protection of investors' adopts a shareholder value-maximising stance for publicly held companies, stipulating that they must state clearly in their bylaws the measures and decision-making process for distributing profits and ensuring the lawful rights of shareholders to have investment returns.[44]

A recent regulation on private tutoring agencies does touch on the issue of equity financing by social enterprises. In July 2021, the General Offices of the State Council and the Communist Party issued the *Opinions on Further Reducing the Burden of Homework and Off-Campus Training for Students in the Compulsory Education Stage*. The binding document dramatically impacts the private education sector because it requires private educational organisations (tutoring agencies) that serve compulsory education stage students on core courses (e.g. Chinese and mathematics rather than music or sports) to register as non-profit organisations and bans them from equity financing on the stock market.[45]

42 See the website of the DunHe foundation, http://en.dunhefoundation.org/index_en.php.

43 See the website of the Yifang Foundation, http://www.yifangfoundation.org/[EN]about_us-synopsis.html.

44 See Article 91 of the Securities Law.

45 Thomas Peter, 'China's New Private Tutoring Rules Put Billions of Dollars at Stake', *Reuters*, https://www.reuters.com/world/china/chinas-tal-education-expects-hit-new-private-tutoring-rules-2021-07-25/.

This new rule indicates that policymakers in China still hold a conservative attitude towards financing crucial social service providers with equity financial instruments. Whether policy development in other social service areas, such as elderly care and green energy, will go down similar or different paths is still unclear.

8. OTHER ISSUES

8.1. OTHER CONSTITUENCIES

At this time, China lacks any studies or regulation on stakeholders' roles in protecting the social missions of social enterprises. At this start-up stage for most social enterprises in China, the commitment and determination of the social entrepreneurs that establish the social enterprises play more important roles than legal or other mechanisms to empower stakeholders to check the evolution of the missions of social enterprises. The development of formal mechanisms addressing stakeholders' role will likely occur over time, hand in hand with: (i) a more formal legal definition of social enterprises, including having substantial rights and obligations for social enterprises at the national level; and (ii) an increased need for such mechanisms when the transfer of leadership in social enterprises begins to happen more frequently.

8.2. PROSPECTIVE CHANGES IN LAW

As discussed at the beginning of this report, China's economic growth strategy has begun to shift focus from speed to quality. Social investment and 'environment, social and governance' (ESG) investing have appeared in multiple national policy documents, such as the General Office of the State Council's binding document *Opinions on Further Boosting the Dynamism of Investment in the Social Field*, and the People's Bank of China, the Ministry of Finance, the National Development and Reform Commission and other departments' binding document *Guiding Opinions on Building a Green Financial System*. In line with these developments, social enterprises and social impact investment will become increasingly important in China. However, the systematic overhaul of the company law framework and related securities laws remains quite unlikely in the near future.

9. CONCLUDING REMARKS

Social enterprise is still a new concept in China, despite its increasing popularity in both the for-profit and non-profit sectors. Correspondingly, the Chinese legal

system governing social enterprises remains immature. No national law has ever used 'social enterprise' as a legal term. Nor is there a special legal form designed for social enterprises to accommodate their hybrid nature. Chinese social enterprises can currently choose only from among the existing for-profit and non-profit organisational types for their legal forms, none of which include mechanisms to directly reconcile the pursuit of social and financial goals. In the absence of national regulation, four local social enterprises certification systems have been rolled out, including one launched by local government. Although these local social enterprises certification systems have been developing and each system has certain incentive measures to promote social enterprises, a more comprehensive enabling legal environment, including tax law, securities law and regulation on social enterprise investment by both for-profit and non-profit organisations, is yet to be established.

SOCIAL ENTERPRISES IN COLOMBIA

Alvaro Pereira and Raymundo J. Pereira*

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1. INTRODUCTION

In June 2018, Colombia introduced 'companies of collective benefit and interest' (BICs), a legal certification available to all registered businesses committed to pursuing profits and social objectives.[1] It was the first explicit legal recognition of social entrepreneurship in the country, which gave rise to a series of policies to foster businesses that aim to increase profits and social impact. Within months, governmental agencies published guidelines outlining the main innovations of BICs, initiated pedagogical campaigns around the country and

* We thank Raymundo Pereira Lentino and Svitlana Lebedenko for insightful comments on an earlier draft. All legal references allude to Colombian law and all translations are our own. Usual disclaimers apply.

[1] Law 1901 (2018), Article 2. ('To have the BIC certification, companies will include in their purpose clause … those activities of benefit and collective interest that they intend to promote').

established working groups to develop policies.[2] The government also issued a decree delineating specific benefits for BICs and assigning new responsibilities to several agencies and regulatory bodies to foster these enterprises.[3] With these new policies, social entrepreneurship has gained visibility, legal recognition and governmental support – long-awaited changes that contribute to expanding opportunities for social entrepreneurs and identifying shortcomings that might merit further reforms.

Prior to the introduction of BICs, social entrepreneurship in Colombia was mainly informal or organised through non-profit entities.[4] These circumstances diminished their competitiveness and ability to scale up. Informal businesses still lack access to credit and external finance, and non-profits, which predominantly rely on donations, lack the incentives to generate economies of scale.[5] Because only registered for-profit entities qualify for the many entrepreneurship incentives created over the last few decades, most social enterprises were also unable to benefit from them.

Despite these difficulties, social enterprises have been fundamental economic and social actors in Colombia, even before the introduction of BICs. Informal businesses have resolved crucial local problems in communities with scarce government support.[6] Non-profit entities have channelled funds to formal and informal businesses in regions and demographics with limited access to financial services and government support, such as people recovering their freedom after serving time in prison.[7] Cooperatives, which have benefited from tailored policies for decades and the support of an independent regulatory agency,[8] have provided high-quality services to their members and communities at large (e.g. supplying credit).[9] Some mission-driven entrepreneurs have also registered their businesses as standard for-profit legal entities, competing in the market successfully while maximising their social and environmental impact.[10] Still, absent a special legal framework, the majority of these initiatives deprioritised growth and sacrificed continuity, limiting the scope of their impact.

In this context, the creation of BICs is a first but important step toward providing legal foundations and institutional support for social enterprises in Colombia. BICs must explicitly commit to advancing activities of collective benefit and

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2 See section 4.
3 Decree 2046 (2019), introducing amendments to Decree 1074 (2015).
4 See section 2.
5 See section 2.
6 See section 2.1.
7 See section 2.2.
8 The agency is called the Superintendencia de Economía Solidaria. For an overview of its history and role in supporting cooperatives, see https://supersolidaria.gov.co/es/content/resena-historica.
9 See section 2.3.
10 See section 2.4.

interest, by including in their purpose clause at least one such activity in each of five dimensions (business model, corporate governance, labour, environment and social practices)[11] and by publishing an annual report detailing progress in each.[12] The report should follow a legally recognised international standard and must be available to all stakeholders,[13] who may request the revocation of the BIC certification.[14] These obligations not only increase transparency and accountability, but also enable the government and other capital providers to identify mission-driven businesses when designing policies or making investment decisions. These legal provisions also reassure founders and impact investors that the enterprise's social mission will be preserved, as BIC directors are explicitly authorised to advance the activities of collective benefit and interest and therefore are shielded from shareholder litigation.[15]

While the law is still recent, there are signs of progress and clear pending tasks. The number of BICs has increased exponentially, particularly in 2021 and among micro-businesses in the service industry, showing that the certification may be contributing to increasing business formalisation and social entrepreneurs' access to a broader set of financial resources. BICs qualify for tax benefits, special rates for registration of copyrights and preferences when participating in bidding processes for public contracting.[16] To date, however, there is no special registry of BICs, which limits their recognition among consumers and other stakeholders. There are also no incentives for investors or a legal framework to list BICs on the stock exchange, a circumstance that may also cap their growth potential and the scope of their impact. As a valuable alternative to expanding the range of social enterprises in Colombia, BICs should be supported by policies increasing their visibility and facilitating their access to finance.

To understand the development of Colombian social enterprise law, the remainder of this report is structured as follows. Section 2 reviews the most common organisational forms adopted by these businesses prior to the introduction of BICs. Section 3 details BICs' main characteristics, benefits and shortcomings. Section 4 discusses the experience of BICs since their creation and considers weaknesses in the current framework that merit further reform. Section 5 presents the main conclusions.

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11 Decree 1074 (2015), Article 2.2.1.15.5, as amended by Decree 2046 (2019), Article 1.

12 Law 1901 (2018), Article 5; Decree 1074 (2015), Article 2.2.1.15.6, as amended by Decree 2046 (2019), Article 1.

13 Law 1901 (2018), Article 5.

14 Decree 1074 (2015), Article 2.2.1.15.8, as amended by Decree 2046 (2019), Article 1.

15 Article 14 ('In addition to the rules provided for in terms of liability in Law 222 of 1995, the administrators of BICs must take into account the interest of the company, that of its partners or shareholders and the benefit and collective interest that has been defined in their charters'). See also section 3.1.

16 While there are no tax incentives specific to BICs, they may access a variety of legal benefits detailed in section 3.2.

2. SOCIAL ENTREPRENEURSHIP WITHOUT SOCIAL ENTERPRISE LAW

Colombia is one of the largest and fastest-growing economies in Latin America.[17] According to the latest report by the Global Entrepreneurship Monitor, '[a]round one in five of all adults in … Colombia are both starting or running a new business', making it one of the most entrepreneurial nations in the world.[18] Still, approximately half of its economy is informal.[19]

Informality has hampered market development (given the uneven competition between formal and informal businesses), workers' and informal businesses' access to credit, and tax collection, limiting the government's ability to implement policies.[20] This vicious circle of informality has hindered the growth potential and visibility of social enterprises, which have not had a specialised legal framework or incentives equivalent to those granted to standard for-profit businesses. They have not even been identified in official statistical surveys, which has created difficulties in monitoring their performance and designing sensible policies. Nonetheless, the resilience and creativity of social entrepreneurs are apparent in how they have leveraged available legal tools and social policies to establish successful business models with social impact, whether in the informal economy or organised as non-profits, cooperatives or for-profit business entities.

2.1. INFORMAL BUSINESSES

A recent study by RECON, a non-profit dedicated to supporting the social economy, found that approximately half of all social enterprises in Colombia are informal.[21] These businesses are generally run by founders driven to resolve a local problem.[22] The potential impact of these businesses is, nonetheless, limited, as non-registered entities cannot be state contractors or access credit or equity finance, and even have difficulties in receiving donations, as donors cannot

17 Colombia has a population of over 50 million and an average annual growth rate above 3%. In six decades, it has only experienced negative growth twice, in 1998 and 2020, due to a global economic crisis. Data available from World Bank national accounts data, data.worldbank.org.

18 Global Entrepreneurship Monitor, '2020/2021 Report' (2021), p. 45, https://www.gemconsortium.org/report/gem-20202021-global-report.

19 C. Salcedo-Perez, F.F. Moscoso-Duran and M.P. Ramirez-Salazar, 'Economía informal en Colombia. Iniciativas y propuestas para reducir su tamaño' (2020) 41 *Revista ESPACIOS* 20.

20 Ibid.

21 RECON Colombia, 'Radiografia del Emprendimiento Social en Colombia 2020' (2021), p. 11.

22 A.O. Penagos, 'Emprendimiento Social Como Alternativa para la Solución de Problemas Personales y Sociales en Colombia' (2019) 3 *Revista Loginn: Investigación Científica y Tecnológica* 30.

deduct them in their tax returns. Many entrepreneurs behind these informal businesses are unaware of the benefits of entering the formal economy.[23] Others are discouraged by the realities of registering and operating a formal business, including the costs of local and national taxes, commercial licences and social security contributions.[24]

Despite this persistent challenge, there is evidence of a decreasing trend in informality. The proportion of non-registered social enterprises fell from 61.1% in 2018 to 44.8% in 2020.[25] It reflects improvements in their visibility, fostered by the government's more active support and legal recognition, not only through BICs but also through broader policies creating benefits for new and smaller businesses.[26] Formalisation of social enterprises is also a consequence of changes in consumer and investment behaviour,[27] and the work of impact investors and non-profit organisations that have found in social enterprises an ally to effect social change.

2.2. NON-PROFITS

Within the formal economy, it is estimated that most social enterprises operate as non-profit entities.[28] While these organisational forms reduce incentives to generate economies of scale (e.g. they prevent founders and investors from receiving dividends or selling their stake), entrepreneurs' decision to register as such is mainly driven by a preferential tax treatment and broader access to donations, as donors can deduct them from their taxes.[29] The most common non-profit entities among Colombian social entrepreneurs are *fundaciones* and *corporaciones* (not to be confused with the term 'corporation' in English). The main differences among them are that *fundaciones* are independent of their founders and pursue a general benefit for society, while *corporaciones* are established by members for their own benefit, whether physical, intellectual or moral.[30]

Fundaciones are important actors in Colombian social economy. They can be established by a single natural or legal person, receive donations from

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23 RECON Colombia, 'Radiografia del Emprendimiento Social en Colombia 2020' (2021), p. 12.

24 C. Fernández, 'Informalidad Empresarial en Colombia' (2020) 50 *Coyuntura Económica: Investigación Económica y Social* 133.

25 RECON Colombia, 'Radiografia del Emprendimiento Social en Colombia 2020' (2021), p. 62.

26 See section 4.

27 S. Quevedo, '¿Qué Tan Dispuestos Están los Colombianos a Hacer un Cambio Ecológico?' (04.2021) (reporting results of survey that found over 40% of Colombians stopped puchasing products based on environmental impact considerations).

28 RECON Colombia, 'Radiografia del Emprendimiento Social en Colombia 2020' (2021), p. 11 (estimating that 71.1% of formal social enterprises are organised as non-profit entities).

29 Ibid.

30 See Corte Suprema de Justicia, Sala de Negocios Generales, Sentencia 21.08.1940.

individuals, governments and international organisations, and contract with the government.[31] With adequate management, they have proven capable of scaling up and achieving efficiencies comparable to traditional businesses, while advancing a social mission.[32] They can also channel funds to business projects that do not adapt to the risk profile of the financial sector.

A remarkable example of the prolific role of these types of entities in social entrepreneurship is Fundación Acción Interna (FAI). Founded by former actress Johana Bahamon in 2013 to support women in penitentiaries, FAI has acted as a sponsor or 'incubator' of businesses developed by women that are incarcerated or have recently recovered their liberty.[33] Some of these social enterprises are run by women inside prisons, such as publicity agency Agencia Interna or restaurant Interno, which Time Magazine recognised as one of 'The World's Greatest Places' in 2018.[34] Other enterprises are managed by women who have recently recovered their freedom, such as garments factory Creaciones C & C.[35] FAI also connects companies with potential employees that have participated in their programmes,[36] and recently contributed to the design of a legal reform aimed at improving the employability of people who have been incarcerated.[37]

Although many *fundaciones*, like FAI, directly influence the social economy, these types of entities continue to be predominantly selected for purely beneficial (i.e. not business-related) purposes.[38]

Corporaciones, the second type of non-profit, do not pursue a general benefit for society, but are established to advance the benefit of its members, who, by default, have direct participation in the governance.[39] Because *corporaciones* can function with 'open doors', welcoming new members according to their

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31 See, generally, R. Villar Gomez, *Las Fundaciones en Colombia* (Asociación de Fundaciones Familiares y Empresariales, 2018).

32 C. Rojas and G. Morales, 'Contribuciones Privadas a la Esfera Pública: Las Fundaciones Empresariales en Colombia' in C. Sanborn and F. Portocarrero S. (eds.), *Filantropía y Cambio social en América Latina* (Universidad del Pacífico, Centro de Investigación 2008), pp. 207–32.

33 See Fundación Acción Interna, https://fundacionaccioninterna.org/.

34 Time, 'World's Greatest Places 2018', https://time.com/collection/worlds-greatest-places-2018/.

35 Fundación Acción Interna, 'Emprendimientos', https://fundacionaccioninterna.org/emprendimientos/creaciones-c-c/.

36 Fundación Interna, 'Segundas Oportunidades', https://segundasoportunidades.org/empleabilidad/.

37 See Cámara de Representantes, Gaceta No. 192 (2021).

38 J. Santamaría-Ramos and C.A. Madariaga-Orozco, 'Determinantes de la Innovación Social en las Dundaciones de Cuarta Generación de Barranquilla, Colombia' (2019) 29 *Innovar: Revista de Ciencias Administrativas y Sociales* 113.

39 Civil Code, Article 638.

own rules,[40] in practice they also advance the interest of a given community. For this reason, they have traditionally been created to support specific communities.

A noteworthy example is Corporacion Centro de Innovacion Del Pacifico (CCDP), founded by educator Jimmy García to advance robotics education in his native Pacific Coast, a region with one of the lowest incomes per capita in the country.[41] CCDP offers high-quality training in robotics in this region and supports related projects. For instance, Made in Chocó manufactures robotics kits to help children in their initial learning stages, and Escuela Robótica provides extracurricular training activities for teenagers and young adults, helping many of them to get into the top universities in the country.[42]

2.3. COOPERATIVES

Colombian social enterprises have been organised as cooperatives as well. Cooperatives are also non-profit entities but are regulated by a diverse legal regime, supervised and supported by different governmental agencies, and have distinctive characteristics.[43] For example, they must have a minimum of three members, who should have equal rights and obligations.[44] Moreover, cooperatives have to comply with additional legal obligations, such as keeping annual reserves of capital for educational programmes of their members,[45] and cooperate with local authorities in sustainable development programmes.[46]

Among all non-profit organisational forms in Colombia, cooperatives have been the most successful in developing economies of scale and competing in various industries. In the 1990s, some of the most prominent credit providers in the country were cooperatives. However, the financial crisis that took place at the end of that decade exposed misconduct of some managers as well as flaws in the regulation and supervision of these entities, weakening trust.[47] A more robust

[40] Civil Code, Article 642 (establishing the mandatory nature of charter rules).

[41] iNNpulsa Colombia, 'Analítica' (11.2021), p. 69, https://innpulsacolombia.com/sites/default/files/documentos-recursos-pdf/Botlet%C3%ADn%20Anal%C3%ADtica%20Emprendimiento%20Social.pdf.

[42] Ibid.

[43] See generally G.A. Hernández Salazar and A.M. Olaya Pardo, 'El Marco Legislativo y su Efecto Sobre el Crecimiento del Sector Cooperativo en Colombia (1933–2014)' (2018) 127 *Revista de Estudios Cooperativos* 139.

[44] See Law 2069 (2020), Article 22 (reducing the minimum members of cooperatives from 20 to three), and Law 454 (1998), Article 6 (establishing members' equality of rights and obligations).

[45] Ibid.

[46] Law 454 (1998), Article 12.

[47] L.P. Pardo Martínez and M.V. Huertas de Mora, 'La Historia del Cooperativismo en Colombia: Hitos y Periodos' (2014) 22 *Cooperativismo & Desarrollo* 49.

regulatory framework was issued shortly after, and the governmental agencies responsible for their supervision and support have restructured on various occasions since then.[48] As a result, cooperatives have retained an essential role in the economy – and not exclusively in the financial sector.

Copservir, for example, owns and operates Drogas La Rebaja, one of the country's largest pharmacies. With over 5,000 employees-members and over 700 stores in 160 counties, and being recognised as one of Colombia's best places to work in 2015,[49] Copservir is an example of the scale at which cooperatives can operate and the impact they can have.

It is estimated that only 1.6% of social enterprises in Colombia are organised as cooperatives.[50] The comparatively low proportion of mission-driven businesses that adopt this entity form may be associated with the distrust that followed the 1990s financial crisis and compliance costs (e.g. annual reserves for educational programmes). Considering their unique legal nature and long-lasting history in Colombia, however, it is also possible that many cooperatives are not considered to be or even self-identify as social enterprises. Still, it is worth noting that the Colombian government recently established a five-year policy and specific budget to support cooperatives, which may strengthen the attractiveness of this entity form among new social entrepreneurs, particularly in rural sectors, whose productivity is expected to improve with these policies.[51]

2.4. FOR-PROFIT AND FOR-IMPACT BUSINESSES

The last organisational options available for social entrepreneurs are for-profit entities. Traditionally, the forms most used by all types of entrepreneurs have been the *sociedad anonima* (i.e. the corporation) and the *sociedad de responsabilidad limitada*, a hybrid form with weaker limited liability and reduced compliance obligations.[52] As in other Latin American jurisdictions, Colombian law had strict requirements for registering and operating both types of business entities, including a mandatory public deed for incorporation and charter reform, and a minimum number of founders and capital.[53] These costs contributed to the

48 J. Martínez Collazos, 'Políticas Públicas para la Economía Solidaria en Colombia: Antecedentes y Perspectivas en el Posconflicto' (2017) 123 *Revista de Estudios Cooperativos* 174.

49 Great Place to Work Institute Colombia, 'Best Workplaces in Colombia 2015', https://www.greatplacetowork.com.co/es/listas/los-mejores-lugares-para-trabajar-en-colombia/2015.

50 RECON Colombia, 'Radiografia del Emprendimiento Social en Colombia 2020' (2021), p. 11.

51 See Departamento Nacional de Planeacion, 'Política Pública para el Desarrollo de la Economía Solidaria' (27.09.2021), https://colaboracion.dnp.gov.co/CDT/Conpes/Econ%C3%B3micos/4051.pdf.

52 See Code of Commerce, Book 2.

53 Ibid., Articles 98 and 110.

aforementioned informality cycle, deterring social entrepreneurs from pursuing a social mission through a registered business.

Notwithstanding these and other burdensome costs and regulatory requirements, Colombian businesses can also include in their purpose clause activities other than profit-making.[54] For-profit entities can also participate in public procurement processes, improve their competitiveness through mergers, acquisitions and tailored contractual associations with other businesses, and qualify for various incentives for entrepreneurship and employability issued by virtually all governments since the enactment of the 1991 Constitution.[55] Moreover, they can capitalise on foreign investments, which have also been incentivised by legal reforms.[56] These benefits largely explain why, despite registration costs, approximately one-quarter of all formal social enterprises are estimated to have selected a for-profit entity.[57]

A paradigmatic example of the viability of the corporate form to organise a successful social enterprise is Crepes & Waffles S.A., a restaurant chain established in 1980 by two young entrepreneurs in Bogota.[58] Since its founding, it almost exclusively hires female heads of households, pays higher-than-average salaries, and has gradually embraced ambitious sustainability goals. Currently, it is supplied by local farmers with sustainable practices, to whom it also provides training and support, and it has a permanent employee development programme, 'Academia de las Artes'. In 2016, it was certified as a B Corporation, after satisfying a rigorous and independent evaluation process by B Lab.[59] Without changing its legal form, Crepes & Waffles S.A. has been able to expand the reach of its social mission and currently has over 200 shops in nine countries,[60] with over 1,600 employees.[61]

The case of Crepes & Waffles S.A. is nevertheless exceptional, as the regulatory and financial costs to create and operate a for-profit entity in Colombia were burdensome for most businesses.[62] It is possible that such costs were particularly

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54 Ibid., Article 100. To be clear, businesses may advance those other purposes *as long as* profits are not compromised. See Superintendencia de Sociedades, 'Comentarios Proyecto de Ley 135 de 2016 – Senado', Oficio 2016-01-560266 (24.11.2016).

55 See H.G. Hernández, W.A. Niebles and J.J. Feria, 'Creación de Empresas y Políticas Públicas para la Promoción del Emprendimiento en Colombia' (2020) 41 *Revista ESPACIOS* 14; and J.A.B. Nova, 'Emprendimiento en Colombia' (2014) 43 *Administración & Desarrollo* 7.

56 A. Pereira, 'Legal Stability Contracts in Colombia: An Appropriate Incentive for Investments? Historical Causes and Impact Analysis of Law 963 of 2005' (2013) 12 *Richmond Journal of Global Law & Business* 237.

57 RECON Colombia, 'Radiografia del Emprendimiento Social en Colombia 2020' (2021), p. 11.

58 Crepes & Waffles, 'Historia', https://crepesywaffles.com/nosotros/historia.

59 B Lab, 'Crepes & Waffles', https://www.bcorporation.net/es-es/find-a-b-corp/company/crepes-y-waffles-colombia/.

60 Crepes & Waffles, 'Ubicaciones', https://crepesywaffles.com/ubicaciones.

61 Portafolio, 'Empleos de calidad, una de las claves de Crepes & Waffles', https://www.portafolio.co/economia/finanzas/empleos-calidad-claves-crepes-waffles-284166.

62 A. Pereira, 'Simplified Corporations and Entrepreneurship' (2021) 21 *Journal of Corporate Law Studies* 433.

burdensome for social enterprises, which had to compete with both formal and informal businesses that were often better placed to reduce operational costs.

In 2008, however, Colombia introduced the *sociedad por acciones simplificada* (SAS), a corporate form with strong limited liability and investor protection.[63] SASs can be registered and operated by a single founder with no minimum capital, and do not require costly and time-consuming public notary certifications (i.e. public deeds) for any purpose.[64] SASs can also have single-member boards and are not obliged to have an external auditor, unless expressly required by law due to the nature of their activities.[65] The introduction of the SAS not only facilitated the registration and operation of for-profit businesses, but also their ability to access external finance, as it enabled the creation of classes of shares and granted wide flexibility to structure the governance.[66]

Despite being conceived to improve formalisation and private firms' access to external finance, SAS have also proven useful for social entrepreneurs with innovative business models, high capital needs and barriers to credit. One such business is World-Tech Makers. Founded by serial entrepreneur Ilana Milkes, World-Tech Makers aims to enhance the information and communication technology (ICT) capabilities of a new generation of Colombians and Latin Americans.[67] It started by organising boot camps and producing interactive kits, through which children, teenagers and young adults could learn how to code. Without sacrificing its mission, it has raised funds from private investors to expand its reach, offering ICT training services to companies and developing a successful 100% placement rate among alumni.[68]

The SAS unequivocally improved the regulatory framework for entrepreneurship in Colombia, but it did not address all the needs of social enterprises. Three pervasive challenges are salient. The first is the disparity between companies' economic and social purposes. While an SAS may advance any social purpose, it must not compromise profits in the process, which clearly denotes a scheme of priority in which profits come first.[69] The second challenge

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63 See Law 1258 (2008). See also F. Reyes, 'Modernizing Latin American Company Law: Creating an All-Purpose Vehicle for Closely Held Business Entities – The New Simplified Stock Corporation International Academy of Commercial and Consumer Law: Corporate Law' (2010) 29 *Penn State International Law Review* 523.

64 Law 1258 (2008), Articles 1, 5 and 9.

65 Ibid., Article 28.

66 A. Pereira, 'Simplified Corporations and Entrepreneurship' (2021) 21 *Journal of Corporate Law Studies* 433.

67 World-Tech Makers, 'Story', https://worldtechmakers.com/story.html.

68 Ibid. Also see Crunchbase, 'World-Tech Makers', https://www.crunchbase.com/organization/world-tech-makers.

69 In fact, the prevailing interpretation of the law is that non-profit expenses by for-profit entities should be 'examined on a case-by-case-basis and with a restrictive criteria'. See Superintendencia de Sociedades, 'Comentarios Proyecto de Ley 135 de 2016 – Senado', Oficio 2016-01-560266 (24.11.2016).

is directors' limited accountability to stakeholders. While directors owe duties to the company as a whole, they are expected to respect the referred scheme of priority, and, in any case, only shareholders have legal standing to enforce the duties.[70] Hence, despite SASs' high flexibility in terms of structuring the capital, some social entrepreneurs may have hesitated to raise equity finance, as investors would be legally protected if they intended to seek returns at the expense of the social purpose. A third and related challenge is the protection of the social mission. While SASs can establish a governance structure that allows various stakeholders to participate in the board or committee,[71] the law did not establish disclosure procedures or a legal mechanism for stakeholders to challenge actions that diminish the social mission.

In sum, for-profit business organisational forms, in particular the SAS, offered a viable alternative for social entrepreneurs and impact investors to structure dual-purpose businesses, *if* they could retain control and protect the social mission and stakeholders' interests.

3. THE COMPANY OF COLLECTIVE BENEFIT AND INTEREST: A FIRST STEP

Although entrepreneurs, donors and investors have successfully used the aforementioned legal entities to structure organisations with direct social impact, social enterprises were not acknowledged by Colombian policymakers, even conceptually. At the beginning of the 21st century, the certification system established in the United States by non-profit B Lab generated interest among Colombian entrepreneurs in terms of the possibility of creating dual-purpose entities with long-lasting safeguards to protect both profits and social impact, and enable consumer recognition. In 2012, the movement started by B Lab formally reached the shores of Latin America, when entrepreneurs from Argentina, Chile and Colombia created Sistema B and started certifying businesses based on B Lab's framework.[72]

In 2016, Iván Duque, who at the time was a senator, attended Sistema B's first conference in Medellín, and shortly after presented a legislative project based on the discussions and analysis of his own legal team. The project, which highlighted the need to legally recognise the social role of businesses beyond the generation of wealth, was approved by both chambers of Congress without delays.[73] On 18 June 2018, the newly appointed President Duque sanctioned the project as Law 1901 (BIC Law), introducing BICs.

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70 Law 222 (1995), Article 25.

71 Law 1258 (2008), Article 17 ('the constitutive documents will determine freely the organic structure of the company').

72 Sistema B, 'Quiénes Somos', https://sistemab.org/quienes-somos-4/.

73 The legislative history is available at http://leyes.senado.gov.co.

The legislative debate was guided by the experiences of the United States and the United Kingdom, where new legal entities were created. However, the BIC Law opted for the creation of a legal certification system available to all for-profit legal entities. The enthusiasm about promoting 'business with purpose' was confronted with concerns that a new legal form could generate difficulties for tax collection (e.g. the tax treatment of for-profit and non-profit activities) and new duties for directors.[74] By opting for a legal classification instead of a new entity form, the depth of the reform was also compromised; some innovations that had proven successful elsewhere, such as the capital lock-in in the United Kingdom,[75] were also disregarded.

3.1. LEGAL INNOVATIONS

The BIC Law introduced four main legal innovations.[76] The first, in Article 2, is the expansion of a company's interest, which should include the activities of collective benefit and interests that the company aims to promote. To the extent that it could have inverted the priorities of for-profit entities, this provision was widely discussed during the legislative process.[77] However, the version that made it to the law did not prioritise non-profit activities and simply made it mandatory for BICs to include such activities in their interest clauses, something that was already possible (though voluntary) with other for-profit entities.[78] In that sense, the law may have facilitated the adoption of the BIC qualification among businesses committed to or interested in having a social impact, regardless of their business models or specific undertakings.

In 2019, however, the government issued a Decree requiring BICs' purpose clause to include at least one activity in each of five dimensions (business model, corporate governance, labour practices, environmental practices, and social practices) and establishing that companies already certified as BICs had 12 months to update their charter.[79] The 2019 Decree thus enhanced clarity and established a higher bar to acquire the BIC qualification, without altering the for-profit nature of these businesses.

[74] See e.g. Superintendencia de Sociedades, 'Comentarios Proyecto de Ley 135 de 2016 – Senado', Oficio 2016-01-560266 (24.11.2016).

[75] See J.S. Liptrap, 'British social enterprise law' (2021) *Journal of Corporate Law Studies* 1.

[76] See A. Pereira, 'The Pacific Alliance: An Opportunity for a Sustainable System of Corporate Law and Governance in Latin America' in B. Sjåfjell and C.M. Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press, 2019), pp. 331–44.

[77] Superintendencia de Sociedades, 'Comentarios Proyecto de Ley 135 de 2016 – Senado', Oficio 2016-01-560266 (24.11. 2016).

[78] Code of Commerce, Article 100.

[79] Decree 1074 (2015), Article 2.2.1.15.5, as amended by Decree 2046 (2019), Article 1.

A second innovation that the BIC Law introduced was to explicitly require directors to 'consider the collective benefit and interest' defined in the purpose clause.[80] Because Colombian law did not require directors to focus exclusively on profits,[81] the main implication is that BIC directors approving companies' activities of collective benefit and interest are shielded from shareholder litigation. Still, directors are only expected to 'consider' such interests, and therefore their decision to prioritise them over profits in specific circumstances may still be challenged judicially. The law did not change the legal standing to enforce this new duty either. Hence, although this and other directors' duties are owed to the company, only shareholders can enforce them.[82] In other words, only shareholders can protect the social mission through litigation.

Another area in which the BIC Law innovated was introducing reporting and disclosure requirements. Article 5 of the BIC Law provides that the company's legal representative must prepare an annual report of the company's impact in a given year, detailing the activities of public benefit and interest advanced by the company.[83] To provide a quantitative and qualitative measure of the impact, the report must follow an independent standard recognised by the Superintendence of Companies.[84] At the time of writing, there were five: Certified B Corporation (by B Lab), ISO 26000 (by the International Organization for Standardization), AA1000 (by AccountAbility), GRI (by Global Reporting Initiative), and SDG Compass (by GRI, the United Nations Global Compact and the World Business Council for Sustainable Development).[85] The report not only has to be approved by shareholders in the general meeting, but it also has to be published on the company's website and be available to anyone who requires it through formal communication to the company's legal representative.[86] In tandem, shareholder approval and publicity are requirements that enhance transparency and accountability. Lack of reporting or misreporting may give rise to shareholder litigation or requests for revocation of the BIC qualification, the fourth main innovation of the BIC Law.

Consumers and anyone who can demonstrate that they have suffered any damage from a BIC can formally request the Superintendence of Companies to remove the legal certification for lack of compliance.[87] The Superintendence of

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[80] Law 1901 (2018), Article 4.

[81] Code of Commerce, Article 100.

[82] Law 1901 (2018), Article 14, and Law 222 (1995), Article 25.

[83] Law 1901 (2018), Article 5 ('The company's legal representative shall prepare and present to general meeting a report on the impact of the company's performance, in which the activities of benefit and collective interest carried out by the company will be reported').

[84] Law 1901 (2018), Article 6, and Decree 1074 (2015), Article 2.2.1.15.6, as amended by Decree 2046 (2019), Article 1.

[85] Superintendencia de Sociedades, Resolución 200-004394 (2018).

[86] Law 1901 (2018), Article 5.

[87] Law 1901 (2018), Article 7, and Decree 1074 (2015), Article 2.2.1.15.7, as amended by Decree 2046 (2019), Article 1.

Companies will only order the revocation of the BIC certification if it identifies a 'reiterated and gross' lack of compliance,[88] a matter that appears problematic. On the one hand, it may enable companies that do not perform at the highest standards to retain the BIC legal certification and enjoy the legal and regulatory benefits associated with it, as well as consumer recognition. On the other hand, it may deter frivolous claims by competitors or ill-intentioned parties from presenting baseless requests for revocation against otherwise compliant companies.

3.2. LEGAL BENEFITS AND INCENTIVES

The BIC Law instructed the government to take further measures to promote BICs.[89] While the 2018 presidential victory of BIC promoter Iván Duque generated the expectation of new tax incentives, such a possibility was remote and has not yet materialised, as taxes must always be approved by Congress (which, incidentally, experienced a backlash and protests that were broadcast worldwide precisely as a result of ill-judged tax reform in this period).[90] Instead, the 2019 Decree confirmed that salaries paid to employees with BIC shares were not taxable, a benefit already available for traditional companies.[91] Crucially, however, the Decree established that BICs could qualify for Economia Naranja (Orange Economy), another of President Duque's flagship programmes to support businesses in cultural and creative industries.[92] Hence, BICs that develop high-tech products or services, for example, may qualify for a seven-year tax exemption.[93] Although not cumulative, BICs may also apply for a tax credit for investments in research and development.[94]

BICs were subsequently granted benefits previously available only to small and medium-sized enterprises (SMEs), for instance a 28% discount on copyright registration fees[95] and preferential treatment when applying

[88] Decree 1074 (2015), Article 2.2.1.15.11, as amended by Decree 2046 (2019), Article 1.
[89] Law 1901 (2018), Article 8 ('The national government will evaluate the necessary measures so that the entities of the Executive Branch can promote the development of BICs, under the premise of formalisation, the social function of the company and the benefit and collective interest').
[90] Economist, 'Protests in Colombia derail an important tax reform' (2021).
[91] Decree 1625 (2016), Article 1.2.1.7.9, as amended by Decree 2046 (2019), Article 2.
[92] Law 1834 (2017). See also I.D. Márquez and P.F.B. Restrepo, *La Economía Naranja: Una oportunidad infinita* (Inter-American Development Bank, 2013).
[93] Tax Statute, Article 235-2.
[94] Tax Statute, Article 256-1. See also Dirección de Impuestos y Aduanas Nacionales, Concepto 989(906532) (02.07.2021).
[95] Superintendencia de Industria y Comercio, Resolución 26878 (2020).

for SME-specific government credit programmes.[96] Since 2020, BICs that participate in public procurement processes are also preferred over non-BICs with identical scores.[97]

3.3. LIFECYCLE

To obtain a BIC legal certification, new and established businesses must include in their constitutive document at least one activity in each of the five dimensions referred to above.[98] Chambers of Commerce, which are private organisations entrusted with the responsibility of keeping companies' registrar, review whether such activities are clearly indicated and, when that is the case, must register the company with the BIC certification.[99] The social mission is thus unequivocally framed by the law. There is no legal requirement to specify directors' duties, as the BIC Law explicitly provides that they have a duty to consider the collective and beneficial interest determined in the constitutive document, i.e. the activities identified by law.

Once the business is registered as a BIC, it may qualify for the aforementioned benefits and must comply with additional responsibilities. Chief among them is the obligation to prepare and disclose to the public the annual report. As indicated above, breach of this obligation or misreporting may lead to shareholder litigation or to the revocation of the BIC certification. To date, we are not aware of any decision finding liability for breach of the obligation to report or any revocation, which is unsurprising for three main reasons. The first reason is that it is still a new legal and regulatory framework. The BIC Law was enacted in 2018 with a loose requirement of including non-profit activities in the company's interest clause. While the 2019 Decree made it stricter, defining the legally recognised activities, it also established a 12-month period for 'first-generation BICs' to adopt such changes and prepare the report,[100] which means that the current framework has only been binding for about two years. The second reason is that the number of registered BICs exposed to shareholder litigation or revocation is still negligible. Although there were over 1,000 registered BICs by the end of 2021, numbers were significantly lower

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[96] For instance, a one-year government credit programme for new equipment needed to increase competitiveness or to confront the pandemic. See Bancoldex, Circular 030 (01.08.2020), https://www.bancoldex.com/soluciones-financieras/lineas-de-credito/linea-mipymes-competitivas-para-escalamiento-productivo-2020-3753).

[97] Law 2069 (2020), Article 35.

[98] Decree 1074 (2015), Article 2.2.1.15.5, as amended by Decree 2046 (2019), Article 1.

[99] Ibid.

[100] Ibid., Article 2.2.1.15.4, as amended by Decree 2046 (2019), Article 1.

than in previous years: close to 300 in 2020,[101] 34 in 2019, and 23 in 2018.[102] In other words, most BICs presented their first annual report in 2022. Finally, the Superintendence of Companies will only order the revocation if it finds proof of 'reiterated and gross breach of independent standards'.[103] Hence, a revocation appears rather unlikely in the short term. Opting for the BIC certification is voluntary and does not automatically entail significant economic benefits, since most legal incentives are granted upon request and are not exclusive to BICs.[104] It thus seems to be an option for businesses with an actual social mission. Given that companies have the possibility of selecting only one activity in the five dimensions determined by law, it is reasonable to expect current registered BICs not to grossly and reiteratively breach such a commitment.

4. SOCIAL ENTERPRISE LAW POST-BICs

The introduction of BICs increased the visibility of established social enterprises and the viability of new innovative business models with social purposes. For the first time in history, there is explicit legal recognition of businesses that pursue profits and social impact, and a legal framework providing the grounds for their creation, governance and finance. This emerging legal framework is, of course, not comprehensive. Yet it has been fundamental in engaging regulators and governmental agencies, which have established new policies to support social enterprises or granted them access to pre-existing programmes for entrepreneurs, such as tax exemptions and credits. It has also motivated financial institutions to design new products for social entrepreneurs and contributed to fostering investments in mission-driven businesses, regardless of their legal organisational form. Therefore, while the reform is still recent and more time is required to assess its impact, it is worth discussing evidence of encouraging outcomes and areas in which further measures will be required.

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101 Confecamaras, 'Sociedades BIC: empresas que apuestan por la sostenibilidad en Colombia' (07.10.2021), https://www.confecamaras.org.co/noticias/800-sociedades-bic-empresas-que-apuestan-por-la-sostenibilidad-en-colombia.

102 L. Vita Mesa, 'Desde su regulación en 2018 se han registrado 323 sociedades de Beneficio e Interés Colectivo (BIC)', *Asuntos Legales* (20.11.2020), https://www.asuntoslegales.com.co/consumidor/desde-2018-se-han-registrado-323-sociedades-de-beneficio-e-interes-colectivo-bic-3091344.

103 Law 1901 (2018), Article 7.

104 See section 3.2.

4.1. THE BIC EFFECT

The number of BICs has grown exponentially, from 23 in December 2018 to over 1,000 by the end of 2021, a record in Latin America.[105] To strengthen this trend further, the Ministry of Commerce, Industry and Tourism, along with Chambers of Commerce and the Superintendence of Companies, have created online courses and guidelines for pedagogical purposes.[106] Crucially, these agencies started gathering and periodically reporting information about BICs, which, albeit not uniform, allowed us to identify trends and areas of potential improvement.

Since the first official report, we have observed two recurrent trends. First, over half of BICs operate in the service industry. This is a foreseeable outcome, as it is an industry with fewer barriers to entry and one that has experienced higher growth since the economy started recovering from the 2020 pandemic shock.[107] However, it is also an early indication that BIC certification may be more helpful for projects that would have otherwise been organised as for-profit entities rather than those that have traditionally opted for non-profits. In other sectors of the economy in which non-profits are more active, such as finance or education, there are fewer registered BICs.[108] BICs may therefore coexist with traditional non-profits, and simply offer an alternative to organising other business models.

A second trend relates to firm size. Most BICs are micro or small businesses that are either entirely new or have been operating for less than five years.[109]

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105 See L. Vita Mesa, 'Desde su regulación en 2018 se han registrado 323 sociedades de Beneficio e Interés Colectivo (BIC)', *Asuntos Legales* (20.11.2020), https://www.asuntoslegales.com.co/consumidor/desde-2018-se-han-registrado-323-sociedades-de-beneficio-e-interes-colectivo-bic-3091344; and V. Pérez Díaz, 'Colombia, el país de la región con más sociedades de Beneficio e Interés Colectivo', *La Republica* (24.11.2021), https://www.larepublica.co/economia/colombia-el-pais-de-la-region-con-mas-sociedades-de-beneficio-e-interes-colectivo-3266685.

106 See Ministerio de Comercio Industria y Turismo, 'Sociedades BIC', https://www.mincit.gov.co/minindustria/sociedades-bic.

107 Portafolio, 'Los sectores que más aportaron al PIB del segundo trimestre en el país' (17.08.2021), https://www.portafolio.co/economia/finanzas/pib-segundo-trimestre-del-2021-sectores-que-mas-aportaron-555216. Historical and updated data on economic is available at https://www.dnp.gov.co/estudios-y-publicaciones/estudios-economicos/Paginas/estadisticas-historicas-de-colombia.aspx.

108 An interesting exception is Banco Finandina SA BIC, an online bank that adopted the BIC certification in early 2021. See Banco Finandina, 'Finandina: Primer banco de beneficio e interés colectivo, BIC, en Colombia y América Latina', https://www.bancofinandina.com/finanblog/noticias/2021/02/18/finandina-primer-banco-de-beneficio-e-interes-colectivo-bic-en-colombia-y-america-latina.

109 iNNpulsa Colombia, 'Analítica' (11.2021), p. 61, https://innpulsacolombia.com/sites/default/files/documentos-recursos-pdf/Botlet%C3%ADn%20Anal%C3%ADtica%20Emprendimiento%20Social.pdf.

While there is no official census of the proportion of informal businesses that qualify as social enterprises, informality prevails among micro-businesses, generally speaking.[110] Hence, this trend suggests that the BIC legal framework and institutional support established for it may be helpful to increase formalisation, one of the main challenges for social enterprises in Colombia, as detailed above.

Still, it should be noted that BIC legal certification is not reserved for small or new businesses. The BIC Law clearly states that all businesses, including those already registered, can opt for the certification by including the legally recognised activities of collective benefit and interest in their purpose clause.[111] Neither the law nor its complementary regulation include any measure of firm size as a circumstance for revoking the certification. Reforming the purpose clause in this matter is certainly harder for a large company, as the legally recognised activities likely require changes in the governance structure and employment policies – but that is a practical difficulty, not a legal limitation.

In fact, some large companies have already opted for BIC legal certification. Alpina S.A., one of the country's top dairy producers, did so in November 2020.[112] Movistar, one of the country's largest telecommunication companies and affiliated with Spanish multinational Telefónica, followed in April 2021.[113] Like Alpina and Movistar, many large companies may be working to change their practices and opt for BIC certification, and some have done so already.[114] From public communications, it appears that the primary motivation is to strengthen pre-existing social-impact policies and reputational value.[115]

Official data on BICs does not provide details about their finances, but publicly available information sheds light on how the new framework may influence changes in companies' access to credit and external finance. To date, there is no unique public credit programme for BICs, but the government explicitly included BICs in a line of credit specially designed for SMEs during the first year of the pandemic.[116] Younger BICs may also finance with public funds administered by agencies such as iNNpulsa Colombia or Fondo Emprendedor, which provide

110 C. Fernández, 'Informalidad Empresarial en Colombia' (2020) 50 *Coyuntura Económica: Investigación Económica y Social* 133.

111 Law 1901 (2018), Article 2.

112 Alpina, 'Alpina Cambia su razón Social a Sociedad BIC', https://www.alpina.com/corporativo/somos-alpina/noticias/alpina-cambia-su-razon-social-a-sociedad-bic.

113 Telefónica, 'Movistar, primera telco en Colombia en ser reconocida por su compromiso con el desarrollo sostenible' (13.05.2021), https://www.telefonica.co/ver_noticia?id_not=409602453.

114 See Ministerio de Comercio Industria y Turismo, 'Sociedades BIC', https://www.mincit.gov.co/minindustria/sociedades-bic.

115 Se e.g. Alpina, 'Alpina Cambia su razón Social a Sociedad BIC', https://www.alpina.com/corporativo/somos-alpina/noticias/alpina-cambia-su-razon-social-a-sociedad-bic.

116 See Bancoldex, Circular 030 (01.08.2020), https://www.bancoldex.com/soluciones-financieras/lineas-de-credito/linea-mipymes-competitivas-para-escalamiento-productivo-2020–3753.

seed investment and non-reimbursement capital to companies that meet certain requirements.[117]

The private sector has not explicitly designed financial products for BICs either, but these businesses may still access a growing number of products tailored for innovative start-ups and business projects with social impact, regardless of the BIC legal certification.[118] Impact investors, accelerators and incubators have also proliferated in the last few years, and many of them are now specialising in mission-driven businesses in lower-income regions. For example, Insitubg focuses on women-led projects and projects in the south Pacific Coast of Colombia.[119]

In sum, in three years, the BIC Law has mostly impacted young companies in the service industry, potentially driving informal entrepreneurs to formalise. The new legal framework has not directly expanded BICs; sources of finance or consumer recognition. Still, by requiring businesses to clearly establish a purpose of collective benefit and interest and produce a report detailing the activities advanced to fulfil their mission, BICs may have facilitated certain social enterprises' ability to raise funds from impact investors and government programmes, which are on the rise.

4.2. PENDING TASKS

Despite the encouraging experiences of the first three years, there are pressing challenges for BICs as boosters of social entrepreneurship. The main one, paradoxically, is increasing visibility. As has happened in other jurisdictions that have adopted a legal certification system,[120] BICs are recognised among certain social entrepreneurs but unknown to most consumers. To foster BICs, the government, through its ministers and Superintendencies, could establish a public record of BIC companies by industry and region, allowing consumers, suppliers, investors and other stakeholders to easily identify the companies that have opted for this form. Visibility could also improve the quality of BICs, making the threat of a revocation request by stakeholders more credible. Currently, other types of businesses, such as technology start-ups, have greater recognition and

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117 Updated information is available at https://innpulsacolombia.com/.

118 For example, Crediprogreso, by Banco de Bogotá, offers small loans to entrepreneurs with no credit history and at a fixed rate, among other benefits. See Banco de Bogotá, 'Crediprogreso', https://www.bancodebogota.com/wps/portal/banco-de-bogota/bogota/bancas/para-ti/banca-microfinanzas/creditos/crediprogreso.

119 Instubg, https://insitubg.co/.

120 See Social Entrepreneurship Association of Latvia, 'Social Entrepreneurship Certification and Labeling: An Analytical Report on Existing Social Value Labeling Practices, and a Way Forward for Latvia, Estonia and Denmark' (2018), https://sua.lv/wp-content/uploads/2018/03/SE-labeling-and-certification-Report-2017.pdf.

support from consumers, financiers and employees. Hence, increased visibility could directly improve their ability to grow and have a more significant impact.

Some commentators have supported the idea of granting additional incentives enabling BICs to contract with the government.[121] In our view, this may not be the wisest approach to support and foster social entrepreneurship in Colombia. Most social enterprises in Colombia are not BICs, and many of them have developed successful business models with social impact, leveraging the governance and financial advantages of alternative organisational forms.[122] Granting additional public procurement incentives to BICs could diminish the competitiveness of those impactful businesses, while potentially giving an advantage to new companies that do not necessarily advance a social mission.[123] A better approach is the one adopted by the law, which only gives BICs preference if they are tied in the selection process.[124] In doing so, the law ensures that scarce public resources are assigned to the most qualified proponent (including other non-BIC social enterprises), depending on the specific contract, only favouring a BIC if it is proven that, among those, it is the most qualified.

To improve BICs' viability and potential contribution to the social economy, a pending task is to introduce incentives for investors, in particular suppliers of growth capital. Incentives for investors in technology start-ups (e.g. tax benefits)[125] have supported the growth of that industry, making it one of the most attractive in Latin America, the fastest-growing region of the world.[126] While some social enterprises and BICs incorporate technological development in their business models and thus may benefit from such policies, it is far from the general rule, as most of them still concentrate on the micro-business segment. With proper incentives for BICs, impact investment in Colombia could experience similar growth to venture capital investment.

[121] C.E. Fernández Olaya, Y. López Castro, M.I. Stazzone Favotti and V. Wavner Gutiérrez, *Las Empresas con Propósito y la Regulación del Cuarto Sector en Iberoamérica: Informe Jurisdiccional de Colombia* (Secretaría General Iberoamericana (SEGIB), Programa de las Naciones Unidas para el Desarrollo (PNUD), and International Development Research Centre (IDRC), 2021), p. 33.

[122] See section 2.

[123] With the current framework, a company that does not comply with the social mission may still keep the BIC certification for a while. See section 3.1.

[124] Law 2069 (2020), Article 35.

[125] See A. Pereira, 'Simplified Corporations and Entrepreneurship' (2021) 21 *Journal of Corporate Law Studies* 433 (discussing investment incentives for new businesses).

[126] See J. Glasner, 'Here's What's Driving Latin America's Rank As The World's Fastest-Growing Region For Venture Funding', *Crunchbase* (01.21.2022) (noting that 'Latin America was the fastest-growing region in the world for venture funding in 2021, according to Crunchbase data for the six largest geographies' and that 'Brazil was the top destination for funded companies, followed by Mexico, Colombia, Chile and Argentina').

A final area of improvement is the development of a legal and regulatory framework to list BICs on the stock market.[127] Such a framework could further incentivise impact investors to focus on the growth of social enterprises and encourage social entrepreneurs to scale up. This is a major challenge for the Colombian stock exchange and financial regulator, considering the limited number of listed firms (less than 70)[128] and the comparatively low participation from retail investors.[129] Still, recent developments may be paving the way for social enterprises' inclusion on the stock market. On the one hand, BICs may benefit from a reform allowing SASs (i.e. simplified corporations) to temporarily issue bonds tradeable on the stock exchange,[130] which has demonstrated that alternative entities could participate in public markets safely. On the other hand, the emergence of start-ups enabling the trading of stocks through apps promises to connect companies with a wider set of retail investors.[131] These developments should be leveraged to enable BICs' participation in the stock exchange. The previously mentioned public record of BICs could be a starting point in a new regulatory framework, facilitating impact investors' investments by enhancing transparency.

5. CONCLUSION

Colombian social entrepreneurs have been critical economic actors that have predominantly operated informally due to the traditionally high entry barriers to the formal economy, or organised as non-profits, to enjoy preferential tax treatment and better conditions to receive donations. However, over the last four decades, the costs of registering and operating a business have been reduced dramatically, and policies to support new businesses have proliferated. Access to credit and equity finance has also improved but has not been directed to social enterprises.

With the introduction of BICs in 2018, Colombia legally recognised the existence of dual-purpose companies and initiated a process of formalisation and promotion of social entrepreneurship. While other organisational forms

[127] While most BICs are small companies, the increasing number of large companies adopting the BIC certification demonstrates that it is suitable for large-scale businesses that could benefit from participating in the stock market and contribute to its development. See section 4.1.

[128] An updated list is available at https://www.bvc.com.co/.

[129] U. Garay and F. Pulga, 'The Performance of Retail Investors, Trading Intensity and Time in the Market: Evidence from an Emerging Stock Market' (2021) 7 *Heliyon* e08583.

[130] Decree 817 (2020).

[131] See Portafolio, 'La negociación de acciones a través de celular logra récord' (29.04.2021), https://www.portafolio.co/economia/la-negociacion-de-acciones-a-traves-de-celular-logra-record-551505.

remain available for social entrepreneurs, the law is an important instrument to support them. It has already contributed to improving the visibility of new and established social enterprises among customers, employees and other stakeholders. It has also created awareness among regulators and financiers, and exposed the need to support these businesses with new policies and alliances with private actors. BICs could be leveraged to expand social enterprises' access to equity finance and even raise capital on the stock market, allowing them to better compete with traditional companies and accelerate the transition towards sustainable business practices.

SOCIAL ENTERPRISES IN DENMARK

Karsten Engsig Sørensen

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1. WHAT IS A SOCIAL ENTERPRISE?

In Denmark the social economy has a long history, but the term 'social enterprise' has only been used in recent times. In fact, the term normally used in Denmark is *socialøkonomisk virksomhed*, which translates as 'social economic enterprise'. The term 'social enterprise' will, however, be used here.

The focus on social enterprises has increased over the last 10-plus years.[1] In 2008, the Danish government published an action plan aiming to promote

[1] A more detailed account of the development may be found in for instance the overview in the report prepared for the Commission by L. Hulgård and L.M. Chodorkoff, *Social enterprises and their ecosystems in Europe. Country report: Denmark*, European Commission, 2019, https://rucforsk.ruc.dk/ws/portalfiles/portal/66250330/Social_enterprises_and_their_ecosystems_in_Europe._Updated_country_report_Denmark.pdf.

enterprises' efforts in helping to solve societal challenges.[2] The idea was to enhance responsible conduct and thus create a positive brand for Danish enterprises worldwide. To achieve this, the government encouraged Danish enterprises to act responsibly but also took a number of other initiatives to promote this agenda. The key initiative was the introduction of a non-financial reporting system that was more comprehensive than any system in existence at the time.[3] The plan did not mention social enterprises.

In 2012, the Danish government introduced a new action plan for enterprises' social responsibility, where it confirmed its intention of promoting this agenda.[4] Again, the action plan did not mention social enterprises, but later in that year a committee on social enterprises was established with the task of analysing the potential barriers to establishing and developing social enterprises and proposing legislation for the introduction of a new corporate form for social enterprises.[5]

The committee published its report in September 2013. The committee defined social enterprises as being enterprises privately held that promote a specific social objective through their business and profit. More specifically, social enterprises had to fulfil five conditions:[6]

- the enterprise must have a social purpose, that is, it pursues a social, occupational, health-related, environmental and/or cultural purpose, and also promotes active citizenship;
- it must have a significant commercial activity, through the sale of either services or products;
- it must be independent from the public sector, meaning that it must be registered in the Central Business Register (CBR)[7] and must be outside significant public influence;

[2] See the report from the Danish government entitled *Handlingsplan for virksomheders samfundsansvar*, May 2008, https://docplayer.dk/675869-Handlingsplan-for-virksomheders-samfundsansvar.html.

[3] The Danish reporting rules were introduced with Act no. 395 of 25 May 2009, which added a new §99a to the Danish Accounting Act. The provisions have been changed subsequently, inter alia to incorporate the directive on non-financial reporting, Directive 2014/95/EU. The directive was clearly inspired by the Danish rules. For a comparison of the two reporting regimes see D. Szabo and K.E. Sørensen, 'New EU Directive on the disclosure of non-financial information (CSR)' (2015) 12 *European Company and Financial Law Review* 307.

[4] See the report *Ansvarlig vækst – Handlingsplan for virksomheders samfundsansvar 2012–2015*, March 2012, https://www.regeringen.dk/media/1259/ansvarlig_vaekst_-_handlingsplan_for_virksomheders_samfundsansvar_2012–2015.pdf.

[5] See the document prepared by the Ministry of Business and Growth entitled *Kommissorium for Udvalget for socialøkonomiske virksomheder*, September 2013, https://em.dk/media/12157/kommissorium-udvalg-om-socialoekonomiske-virksomheder-06-02-13.pdf.

[6] Ibid., p. 13.

[7] The Danish abbreviation is CVR, but here the English abbreviation is used.

- it must use its profits primarily to promote its social purpose, or to reinvest in its own business or that of other social enterprises; and
- it must be subject to responsible and inclusive corporate governance.

Using this definition, the committee made a survey of the existing social enterprises in Denmark and was able to identify 292 social enterprises as at 1 June 2013. It was also clear that these social enterprises made use of many different corporate forms (see also section 2 below).[8] This seems to be one of the main reasons why the committee did not propose a new corporate form, as suggested in the terms of references set out for the committee (see above), but chose instead to propose a registration scheme for social enterprises. According to the committee, such a scheme was more flexible as it allowed all existing social enterprises to join and furthermore allowed social enterprises to change corporate form according to their needs and development.[9]

In 2014, the government adopted the Act on Registered Social Enterprises (RSE Act).[10] Registration under the new Act is voluntary for those enterprises that fulfil the criteria. A registration will, however, allow a social enterprise to demonstrate its social characteristics to authorities, business partners and customers as they are allowed to publicise the fact that they are a registered social enterprise. The legislators foresaw that social enterprises could help some of the challenges that society will face in the future, such as low economic growth, an increasing number of persons on the margins of the labour market, global environmental problems, and the pressure on the health sector. Social enterprises may contribute to solving these problems both by their own conduct and by inspiring other private and public actors.[11]

The new Act had a slow start, and in 2018 less than 300 enterprises were registered. A search in the Central Business Register (CBR) shows that by 23 July 2023 there were 938 social enterprises registered.[12] So even though the number of social enterprises has increased, it hardly justifies being called successful. It must be remembered that social enterprises need not register and given that the advantages of registering are limited (see further below), it must

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8 See the overview of the different forms used in 2013, Ministry of Business and Growth, *Kommissorium for Udvalget for socialøkonomiske virksomheder*, September 2013, p. 25, figure 8, https://em.dk/media/12157/kommissorium-udvalg-om-socialoekonomiske-virksomheder-06-02-13.pdf.

9 For a discussion of the pros and cons of registration schemes and new corporate forms see K.E. Sørensen and M. Neville, 'Social Enterprises: How Should Company Law Balance Flexibility and Credibility?' (2014) *European Business Organization Law Review* 267.

10 See Act no. 711 of 25 June 2014.

11 See the comments to the proposed Act submitted on 26 February 2014, p. 4. In the following, the comments in the proposal will be referred to as the *travaux préparatoires*.

12 The search was made to cover those registered under the RSE Act and having the status of either 'normal' or 'active'.

be assumed that not all social enterprises have registered.[13] Even so, the new Act was intended to be the core legislation of promoting and regulating social enterprises in Denmark, and therefore the Act will be the focus of the following account.

Most of the social enterprises registered are small. Only just over 6% of them have 10 or more employees and only six out of 938 have 100 employees or more. They are engaged in different branches but more than 70% are engaged either in culture and leisure or in teaching and health.[14]

2. FORMS OF ORGANISATION FOR SOCIAL ENTERPRISES

As mentioned, social enterprises may use many different forms to organise themselves. Danish law allows for the formation of many different corporate forms. Many corporate forms are not regulated by any legislation, or only regulated partly by regulation, and as a consequence they will often be very flexible. This is why most corporate forms can be moulded to suit a social enterprise.

The RSE Act allows for most corporate forms to be registered. According to §4(1) of the Act, all legal persons that are registered in the CBR and resident either in Denmark or in another EU/EEA country may register.[15] According to §4(2), personally owned businesses (sole proprietorship) and businesses established by co-ownership of assets may not register.

To register under the RSE Act, a number of conditions must be fulfilled. These include that the legal person must have a social purpose, be commercially operated and accept a partial asset lock. These requirements are explained in more detail below in section 3.1, but it should be noted that legal persons that register will normally not have to fulfil these conditions under the rules that are

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[13] Thus, a survey of Danish social enterprises published in 2018 showed that in June 2017, there were 637 social enterprises but only 264 of those were registered under the RSE Act. Of course, it may be that now all of those existing in 2017 (and a few more) are now registered, but more likely the figure may mean that also today less than half of the social enterprises register. See the survey by A.B. Lund (ed.) and K.I. Sørensen, 'Komparative analyser af dansk socialøkonomi: Sorgfrit udkomme & Timeligt velfærd', 2018, p. 41, https://static1.squarespace.com/static/5b7c3a93266c073142e2df2f/t/5bb5f1abec212d48c3ac4dc6/1538650541842/Baggrundsrapport-SORGFRIT-UDKOMME-OG-TIMELIGT-VELV%C3%86REv2+Kapitel+1.pdf.

[14] At least this was the situation in 2018 according to the evaluation prepared by the Danish Business Authority, *Evaluering af lov om registrerede socialøkonomiske virksomheder*, December 2018, https://erhvervsstyrelsen.dk/evaluering-af-lov-om-registrerede-socialokonomiskevirksomheder.

[15] According to the *travaux préparatoires*, a company will be a resident in Denmark or another EU/EEA country if the majority of the members of the board of directors and the main office of the company is situated in one of these countries.

applicable to them, and it is only when they choose to register that they come under a duty to comply with these.[16]

The 938 social enterprises registered as such by July 2023 used the following forms of organisations:

- voluntary associations: 675;
- private limited companies: 92;
- associations: 75;
- enterprise foundations: 35;
- other forms of organisations: 20;
- foundations and other self-owned institutions: 16;
- public limited companies: 8;
- institutions belonging to the church: 4;
- cooperatives (with and without limited liability): 4;
- partnerships: 4;
- other companies with limited liability: 2;
- association with limited liability: 2; and
- foreign corporate form: 1.[17]

The list confirms that many different types of organisations may be tailored to fit the registration scheme. The list is so long that it does not make sense to go through them all, but it is worth commenting on a few of these.

2.1. ASSOCIATIONS

Associations make up the bulk of registered social enterprises. This is a corporate form that is very flexible and takes many forms. There is no legislation covering associations, and they are regulated by principles developed through case law and legal doctrine. Associations do not have owners or shareholders, but instead members. Members are not entitled to any profit from the association, which is why these are, by definition, non-profit organisations. In addition, the members are normally not entitled to any of the association's assets when it is dissolved.[18] Thus, associations are already under a partial asset lock.

[16] The only exception is the partial asset locks where some restrictions already apply to associations and enterprise foundations, see below sections 2.1 and 2.3.

[17] The company in question uses the abbreviation R/H, which is not an abbreviation known to the rapporteur.

[18] See O. Hasselbalch, *Foreningsret*, DJØF Publishing, Copenhagen 1997, pp. 69–71.

Associations may have economic activities, but most do not. Associations form the bulk of what is often referred to as the voluntary non-profit sector.[19] Associations do not need to register in the CBR unless they employ people, have a VAT number or receive public funding. A total of 118,435 were registered in the CBR database as of 23 July 2023, but the actual number of associations may be twice that.[20] Therefore, it is still a relatively small part of the total population that have opted for registration as a social enterprise.

2.2. PRIVATE LIMITED COMPANIES

This company form is the limited liability company form most widely used in Denmark for for-profit activities. Even though profit is normally distributed among the shareholders in these companies, it is possible in the articles of association to modify this in order to allow the company to register as a social enterprise.[21] Even though the activities of a private limited company are by definition commercial, there is nothing to prevent the company from adopting an overall social purpose and therefore qualifying for registration under the RSE Act.[22]

The company form shares many features with private limited companies found in other continental European countries. Private limited companies allow for employee representation on the board of directors. If the company has 35 employees, the employees have the right to elect one-third of the members of the board.[23]

2.3. ENTERPRISE FOUNDATIONS

Enterprise foundations and other foundations are also used for social enterprises. Here the enterprise foundation is of particular interest, since this is a form of

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19 The members are not entitled to any profit or assets in the associations, which is why these by definition are non-profit organisations. The same is normally true when the association is dissolved, see O. Hasselbalch, *Foreningsret*, DJØF Publishing, Copenhagen 1997 pp. 69–71.

20 A survey of associations conducted in 2004 showed that at that time only 45% of all associations were registered in the CBR, see T.P. Boye and B. Ibsen, *Frivillighed og nonprofit i Danmark*, Socialforskningsinstitutet, Copenhagen 2006, p. 172.

21 K.E. Sørensen and M. Neville, 'Social Enterprises: How Should Company Law Balance Flexibility and Credibility?' (2014) *European Business Organization Law Review* 281. As discussed on p. 286 of the article, a transition from normal profit allocation to an allocation benefiting other stakeholders or a social purpose will require a majority of nine-tenths of the shareholders.

22 It may be questioned whether the management may pursue the social purpose to the extent that it threatens the existence of the company and its business, see the discussion by H. Mollerup and Y.F.B. Akbatani, 'Benefit Corporation – en mulig selskabsform under dansk selskabsret?' (2021) *Revision og Regnskabsvæsen* 70. But even if that is the case this evidently does not prevent companies from committing to a social purpose.

23 See the Danish Companies Act, Act no. 1952 of 11 November 2021, §140.

organisation that has been designed for conducting commercial activities. Since the nature of the foundation is that it has no owners or shareholders, it is also likely to fulfil the other conditions for becoming a social enterprise.

Foundations have existed in Denmark for centuries, but foundations used for conducting enterprises only appeared in the late 19th century.[24] It was not until 1984 that legislation was adopted to regulate enterprise foundations.[25] The legislators pointed out that enterprise foundations could help solve difficult transfers of a business to the next generation. Not only are there tax benefits,[26] but it would also ensure a continuation of the business where the alternative would be splitting the business between several heirs. Additionally, using an enterprise foundation may ensure that part of the profits of the business is reinvested in the business, and may furthermore protect the business against hostile takeovers.[27]

In recent years, the number of enterprise foundations has increased to approximately 1,300. Of these, around 200 foundations can be termed 'industrial foundations', i.e. foundations that own a controlling interest in a private company.[28] These industrial foundations control some of the largest companies in Denmark (Novo Nordisk, A.P. Møller-Maersk, Lundbeck, Carlsberg, Lego), and it has been estimated that industrial foundations account for 8% of private Danish employment, and 18% of private value added.[29]

To become an enterprise foundation, a number of requirements must be fulfilled. This includes a minimum capital of DKK 300,000 (approximately €40,000), a requirement of a commercial activity which should raise a profit of at least DKK 250,000 and amount to more than 10% of the annual profit of the foundation. This commercial activity can be conducted in the foundation or in another entity controlled by the foundation.

A key element is that the foundation should be separated from the founder (and other major contributors to the foundation). To ensure this, there are

24 See the historical account in the government report 970/1982, p. 23. One of the first enterprise foundations was the Carlsberg Foundation established in 1876.

25 The current Act on Enterprise Foundations is Act no. 984 of 20 September 2019. In addition to the Act, there are guidelines on the governance of foundations, the latest dating back to June 2020, available in English at https://godfondsledelse.dk/sites/default/files/media/recommendations_on_foundation_governance_2020.pdf.

26 An enterprise foundation will pay taxes on the profit it makes, but is allowed to deduct any donation it makes for charitable purposes. Therefore, it will only pay taxes on the part of the profit it distributes to non-charitable purposes or not distribute at all.

27 See report 970/1982, p. 29. Indeed, it seems that businesses run by enterprise foundations on average survive for longer than 'normal' businesses, see S. Thomsen, *The Danish Industrial Foundation*, DJØF Publishing, Copenhagen 2017, p. 165.

28 See S. Thomsen, *The Danish Industrial Foundation*, DJØF Publishing, Copenhagen 2017, p. 20.

29 Ibid., p. 112. The enterprise foundations registered under the RSE Act also tend to be larger than other registered social enterprises. If the size is evaluated based on the number of employees, 13 out of 35 enterprise foundations have more than 10 employees (37.14%), whereas only 57 out of 938 of all social enterprises have that number of employees (6.01%).

additional requirements as to the purpose of the enterprise foundation and its management, and finally asset locks that must be observed.

The charter of the enterprise foundation must list its purpose (activity purpose) and how it will distribute funds (distribution purpose) – see §27(1) of the Act on Enterprise Foundations. The activity purpose specifies how the foundation will make profit for distribution. As pointed out above, a substantial part of the profit must come from commercial activities, and the charter specifies which activity it is, or it may specify that the purpose is to control and exercise influence on a particular company. This must be done carefully as the charter can subsequently only be changed with the agreement of the foundation authority, and normally it will be very difficult to get such agreement.

The distribution purpose should be to benefit either certain persons, a specific sector, an activity or a social purpose. Consequently, the founder is relatively free to formulate this purpose, except for two distinct restrictions set in the law. According to §28 of the Act on Enterprise Foundations, if members of certain families are granted preference in distributions, it may only cover those persons living at the time the foundation is formed, and one unborn generation. According to §87 of the Act, distribution may not be made to the founder, any member of the management of the foundation or its accountant. However, usual remuneration is allowed. Consequently, a founder cannot favour himself and can only favour his or her family for a foreseeable time span.

Even before the first Act on Enterprise Foundations was introduced, it was pointed out that the major problem when dealing with enterprise foundations was associated with the management. Since there are no owners or shareholders, foundations are self-governing, and there is a risk that the management may become static.[30]

Management of an enterprise foundation must consist of a board of at least three directors.[31] The board of directors should be appointed according to the rules set out in the charter of the enterprise foundation. Consequently, the founder may choose different solutions, but there are some restrictions. The most important are as follows:

- The founder (and his or her close relatives) must not constitute the majority of the board.[32]
- To ensure the foundation's independence, it is required that at least one of the three board members should be independent of the founder (and family).

[30] Report 970/82, p. 29.

[31] See §37(1). Additionally, there must be representatives of the employees on the board if the number of employees exceeds 35 persons, see §64.

[32] See §40. If the foundation is formed by a business, the same applies to the person who directly or indirectly owns more than half the votes or shares in the company.

If there are more than three members of the board, more members should be independent.[33]

- The board members must not be appointed by the management of the company controlled by the foundation, and normally the chairman and vice-chairman of the board must not be a director of the controlled company (see §37(4)–(5) of the Act on Enterprise Foundations).
- An indirect limitation may operate when the distribution purpose includes a member of the family or specific persons since no distribution must be made to anyone serving in the management of the foundation. Therefore, persons entitled to distributions according to the charter will have to forego distributions if they enter management (see §87 of the Act).

The first board is normally stipulated by the founder (subject to approval by the foundation authority), but additional members are often appointed by the board itself or by outside persons, organisations or public authorities. However, the charter may also set up a committee that may appoint up to half of the board's members.

Even so, it appears that the board in its composition may not be fully independent of the founder. However, the independence of the foundation is ensured by a number of additional requirements. First of all, the law stresses that the board of directors has a duty to promote the interests and purpose of the foundation (see §38 of the Act on Enterprise Foundations). It is also made clear by the foundation authorities that the board must not take instructions from anyone outside the board, including, of course, the founder (and family).[34] Finally, independence is ensured by the fact that only the foundation authority may dismiss a board member.[35]

The board has overall responsibility for running the foundation, but it may appoint one or more managing director(s) to handle the day-to-day business (see §37 of the Act). In running the business, the board has more or less the same duties as those of boards in public limited companies. Additionally, the board of directors is responsible for distributing funds. Funds can only be distributed to the extent that a distribution is responsible given the financial position of the foundation, and any distribution should comply with the distribution purpose.

33 This requirement is not found in the Act but is deduced from the definition of foundations by the Danish Business Authority, see *Vejledning om Ledelsen i de erhvervsdrivende fonde*, https://erhvervsstyrelsen.dk/vejledning-ledelsen-i-de-erhvervsdrivende-fonde.

34 See *Vejledning om Opmærksomhedspunkter for bestyrelsesmedlemmer i erhvervsdrivende fonde*, https://erhvervsstyrelsen.dk/vejledning-opmaerksomhedspunkter-bestyrelsesmedlemmer-i-erhvervsdrivende-fonde.

35 See §45 of the Act on Enterprise Foundations. Board members should resign if they become seriously ill, go bankrupt or prove to be 'unworthy', see §44. If they do not do so, they may be dismissed by the foundation authority.

There is no duty to distribute a specific part of the annual profit as, according to §77, the board is allowed to make reasonable reserves for future needs. However, if the capital of the foundation is clearly unbalanced with its distributions, the foundation authority may request or even require additional distributions to be made (see §79 of the Act on Enterprise Foundations).

Distribution from enterprise foundations is also intensively regulated. First, it is only possible to distribute the year's profits or profits from earlier years (see §78(2)). Next, it is only possible to make distributions according to the distribution purpose specified in the charter. This restriction applies to all distribution disregarding the form. As mentioned, no distribution to the founders and management is allowed (apart from remuneration), and it is stipulated that this may prevent the foundation from offering any loan or providing security for loans to the founders and management (see §87(2)–(3)).

The remuneration of the board must not exceed what is customary given the amount of work and the financial position of the foundation (see §49 of the Act). The intention is to prevent excessive remuneration.

In addition to the annual report, an enterprise foundation must comply with a number of additional reporting requirements. It must submit to the foundation authority a list of the persons that have received distribution from the foundation (see §80). Moreover, an enterprise foundation must disclose the remuneration its management has received collectively from the foundation itself and any other entity in the group. The obligation to report on related party transactions is also expanded to encompass all transactions, including those that take place at arms-length conditions.[36] Finally, management has to report on a comply-or-explain basis on the recommendation for foundation governance.[37]

Finally, it is worth noting that only 35 out of the 1,300 enterprise foundations have chosen to register as a social enterprise. The reasons for this are not clear. It may be because the foundations do not fulfil the social purpose required to register, or it may be because there is simply nothing to be gained from being registered. The main advantage of being registered is the benefit of being able to claim the status of a social enterprise, and most enterprise foundations may not find this that important. It must be kept in mind that the business carried out by the enterprise will often be in a separate entity controlled by the foundation, and even if the foundation is allowed to use the designation *Registreret Socialøkonomisk Virksomhed* (RSV), the entity conducting the commercial activity may not use it.

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36 See the Annual Accounting Act, §69.

37 See §60 of the Act on Enterprise Foundations. See the reference to the recommendation above.

2.4. COOPERATIVES

Cooperatives have played an important role in the development of the Danish economy. Cooperatives started to be formed from the mid-19th century onward. Many of these organised consumers, for instance the Foreningen af danske Brugsforeninger (FDB), which still today runs one of the largest groups of grocery stores in Denmark under the name COOP. Other cooperatives organised producers – for instance, a large number of dairies and a slaughterhouse were formed as cooperatives. Today most of these have merged into bigger units that have formed large cooperative entities that act as multinational enterprises. Thus, Denmark's largest dairy (Arla Foods amba) and largest slaughterhouse (Danish Crown amba) are owned by cooperatives.

Cooperatives are a democratic type of organisation, since each member has one vote.[38] Profit is normally distributed according to the turnover each member has with the cooperative. The fact that they distribute dividends in this way does not, however, make it likely that they will fulfil the condition for registering under the RSE Act. Normally, a cooperative will not have a social purpose as is required to register as a social enterprise. In total 1,593 cooperatives were registered in the CBR database by 23 July 2023. Of these, only four were registered as social enterprises, showing that even though cooperatives have a very important role as a democratic corporate form that will often allow smaller businesses or consumers to collaborate, they will normally not be registered social enterprises.

3. LIFECYCLE OF A REGISTERED SOCIAL ENTERPRISE

To register as a social enterprise under the RSE Act, a number of conditions must be fulfilled. These conditions supplement the conditions that are needed for the company that put in for registration. Furthermore, a social enterprise, once registered, must comply with a range of requirements that aim to ensure that the enterprise fulfils its purpose. Finally, there are rules regulating how to deregister under the RSE Act.

[38] There is no Act governing cooperatives, although for those cooperatives that have limited liability a few rules are found in the Act on Certain Commercial Enterprises, Act no. 249 of 1 February 2021. Cooperatives are subject to a special tax regime, see the Corporate Tax Act, Act no. 251 of 22 February 2021, §§14–16A, if the cooperative fulfils the conditions listed in §1(1)(3) of the Act.

3.1. FORMATION

To register, the enterprise must fulfil the following conditions (see §5 of the RSE Act):

1. it must have a social purpose;
2. it must be commercially operated;
3. it must be independent from the public sector;
4. it must act inclusively and responsibly in its activities; and
5. it must have a social handling of its profits; the term covers a partial asset lock that applies to social enterprises.

Each of these conditions will be briefly discussed in turn.

The text of the Act does not specify how to comply with the requirement of the *social purpose*, but some clarification can be found in the preparatory documents of the Act.[39] First, it is stated that 'social purpose' is to be understood as a requirement that the undertaking has social, employment, health, environmental or cultural aims. The preparatory documents also indicate that a registered social enterprise could be working either *for* a specific target group or cause, or *with* a specific target group or cause. The first would be the case if an enterprise worked to improve the conditions for a group (e.g. drug abusers) or cause (e.g. the environment) by, for instance, making products that benefit drug abusers or the environment, by running the business in a special way, or by using part of the profit for the benefit of the target group or cause. Working with a group or cause could, for example, involve employing or educating persons with a specific disability. The social purpose would normally be adopted in the articles of association or similar founding documents of the entity.

The condition that it is *commercially operated* should ensure that it is indeed an enterprise. This does not mean that the majority of the entity's income must derive from commercial activities, but it is required that the commercial activities should be a significant element. Thus, even though an enterprise receives public funding or donations from different sources, it may still qualify for registration if it has profit raised from commercial activities that amounts to at least 10% of all profit raised. Normally, the fulfilment of this condition is documented by submitting the latest annual report,

[39] In Danish law, preparatory documents that are added to a proposed Act are regarded as a very important source for interpreting the Act once adopted, in particular when no other sources such as case law are available. As for the RSE Act, the only alternative source is the little administrative practice communicated by the Danish Business Authority and, consequently, the preparatory work becomes one of the most important sources available.

but if such a report is not available (for instance because the enterprise has been recently formed) a budget for the coming three to five years may be used.[40]

The condition that the enterprise should be *independent from the public sector* means that the public should not influence the management of the company. Thus, for instance, if the public appoints the majority of the management, the conditions will not be fulfilled. If the enterprise receives a large part of its income from the public, it may also de facto be controlled by the public and therefore cannot register.[41]

The requirement to *act inclusively and responsibly* in its activities is interpreted as a requirement that the entity involves stakeholders as well as incorporates the social purpose in its business strategy and activities. In order to be registered, the entity should explain how it will be inclusive and responsible in its activities, and this description should be updated in the annual report (see below).

Finally, the requirement that the entity should use its *profits primarily for social purposes* indicates that it should only allow for a limited dividend to the shareholders/owners, as will be discussed in more detail below. Instead, profits may be used either to reinvest in the social enterprise, to invest in other registered social enterprises, or by donating the profit to other organisations which are committed to a social purpose (see §5(1)(5) of the RSE Act).

According to §6 of the RSE Act, it is up to the enterprise that is applying for registration to document the fulfilment of the above conditions. The Danish Business Authority is responsible for registering and should ensure that the conditions are fulfilled on registration.

3.2. MAINTENANCE

During registration, the management of the social enterprise will be subject to a number of special duties, which include observing the partial asset lock as well as reporting requirements.

The Act contains several provisions on the duties of management. These duties are imposed on the central management body of the company. This term is well defined for the types of companies that are covered by the Danish Companies

[40] The Danish Business Authority has made guidelines for the registration under the RSE Act, and this guideline outlines how to document the different conditions, see *Vejledning om Registrering som registeret socialøkonomisk virksomhed*, 8 August 2019, https://erhvervsstyrelsen.dk/vejledning-registrering-som-registreret-socialoekonomisk-virksomhed.

[41] Ibid.

Act (e.g. mainly public and private limited companies),[42] but for other types of organisations with a different type of management structure it may prove more difficult to decide who constitutes the central management body. The RSE Act does not stipulate how management is composed, as this will be determined by the rules governing the corporate entity.

First, the RSE Act emphasises that the central management body is responsible for the information given on registration and for the subsequent annual reporting (see below). Next, there is an obligation to deregister an entity which no longer meets the conditions for registration.[43] The effect of these provisions is that management is always under an obligation to pursue the social purpose adopted by the social enterprise.

There are no rules limiting the influence of the owners, members or shareholders of the entity. Their influence will be regulated by the rules applicable to the legal entity, and for companies covered by the Danish Companies Act shareholders can decide on most issues related to running the company. However, if the shareholders in a registered social enterprise either adopt a decision that infringes its social purpose or decide to distribute a larger dividend than allowed under the Act, management is no longer in compliance and must deregister.[44]

The Act provides that owners, members or shareholders of a registered social enterprise should only be permitted to receive a total return corresponding to their original investment plus a reasonable annual return on the investment. Evidently, this is open to interpretation, but the Act introduces two upper limits to indicate what constitutes a reasonable annual return.[45] The annual return can be no higher than 15% above the base rate,[46] and no more than 35% of the annual profit may be paid out as dividends in a single year. If dividends are not paid in one year, the amount payable can be carried forward and used in the distribution of profit in the following year. In addition to these requirements, the

42 According to §5(1)(4) of the Companies Act, for companies that only have one management organ – the executive directors – these will be the central management organ. For companies with a two-tier structure, it differs what model the company uses. If it uses the traditional structure where the board of directors, while appointing the executive managers, are still involved in making managing decisions, the board of directors will be the central management organ. If the company uses the newer – German-inspired – two-tier system with a supervisory board and a body with executive managers, the latter will be the central management organ.

43 See §7 of the RSE Act.

44 After deregistration, the entity may act outside the social purpose (if the articles of association are changed), but there will still be asset locks in place which will prevent the distribution of large dividends, see below.

45 See §5(2) of the RSE Act. As acknowledged in the *travaux préparatoires*, this solution is inspired by the solution adopted at the time for community interest companies in the UK.

46 The base rate is a rate set by the Danish National Bank.

RSV also has to comply with the restrictions on distribution of dividends found in the rules governing the entity.

To prevent circumvention of these restrictions, a number of additional limitations are imposed on registered social enterprises. First, the cap set for distributions applies to any form of profit distribution. This includes loans where the payment of interest is profit-dependent. Any capital reductions must observe the caps. Second, management fees may not exceed what is customary given the nature and extent of the work carried out and what may be regarded as reasonable in relation to the entity's social purposes.[47] There is little guidance on determining what customary and reasonable fees are. The *travaux préparatoires* indicate that one should compare with the fees paid in enterprises where management undertakes a similar amount of work as in the social enterprise. But it is also indicated that having a similar level of salary to comparable enterprises may not be justified when the special social purpose is taken into account. A similar (high) fee may take money away from the social purpose. This suggests that management in registered social enterprises may have to accept lower salaries than those in other enterprises.[48] The rules governing deregistration also aim to prevent circumvention, as discussed further below.

Finally, the registered social enterprise must make an annual report which, inter alia, ensures that stakeholders and the Danish Business Authority are able to keep an eye on the enterprise. The following should be reported (see §8 of the RSE Act):[49]

- the total fees, etc., paid to existing and former members of management, and any payments made to promoters of the registered social enterprise;
- agreements entered into by the registered social enterprise with closely related parties;
- cash holdings and other assets that are distributed or paid out of the company's assets;

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47 See §9 of the Act. It is not only the formal salary that should be within the boundaries set by the Act, but also any other type of fee, see also the reporting requirement in §8 outlined below. The same broad view on the regulation of fees is taken in the restrictions applicable in enterprise foundations where fees are restricted under §19, see J.H. Mikkelsen and L. Bunch, *Erhvervsdrivende fonde – en lovkommentar*, DJØF Publishing, Copenhagen 2009, p. 448.

48 The Danish Business Authority has not issued any guidance on how this condition should be fulfilled. For enterprise foundations there is a requirement that fees for management should not be more than what is customary and reasonable given the financial position of the foundation. Here there is no indication that the distribution purpose of the foundation could affect the size of the fee.

49 According to §8(1) of the Act, a registered entity must prepare an annual account according to the rules applicable for class B, whether or not the entity is required to make such a report under the rules applicable to the entity.

- how the registered social enterprise has fulfilled its social purposes; and
- the total dividends received by the owners/members/shareholders.

There is no requirement for the report to be audited. According to the *travaux préparatoires*, if a company chooses to include information in its management report and the company is subject to auditing, this information will need to be audited together with the rest of the management report. However, since a company can just omit this information from its management report and include it in a separate report submitted to the Danish Business Authority, it can easily avoid audit, since such a separate report need not be audited.

The management report of the company will be publicly available and if the information listed in §8 is incorporated in this report, it is will also be publicly available. If the enterprise chooses to make a separate report, this will still be available to the public but only on request from the Business Authority.

The Danish Business Authority has the obligation to monitor compliance with these requirements.[50] Whereas 10% of enterprises that apply for registration are subjected to a review, there are only a few ongoing reviews of enterprises that are already registered. The most common transgression of the rules is that the registered social enterprise does not submit the annual report as required under §8. According to the evaluation conducted by the Danish Business Authority in 2016, only 21% of all registered social enterprises complied with §8 and 32% partly complied. Consequently, just under half failed to comply.[51] Usually, the sanction will be that the Danish Business Authority will deregister the enterprise, as the power to impose fines is seldom used.[52]

Potentially other stakeholders could also monitor the registered social enterprise, for instance by requesting copies of the annual report. However, according to information received via telephone from the Danish Business Authority, there have been few requests for access to these reports. Perhaps stakeholders use other tools to question management about the activities of the social enterprise. For example, shareholders and members may have the right to ask questions under the rules applicable to the entity.[53]

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50 Foundations are also subject to supervision by the foundations authorities, but they will focus on the fulfilment of the requirement under the two laws applicable to enterprise foundations and other foundations.

51 See *Evaluering af lov om registrerede socialøkonomiske virksomheder*, December 2018, https://erhvervsstyrelsen.dk/evaluering-af-lov-om-registrerede-socialokonomiske-virksomheder.

52 This information was made available to the rapporteur during a telephone interview conducted on 29 September 2020 with one of the employees of the Danish Business Authority. The Business Authority has the power to impose a fine if a registered social enterprise does not handle its profits according to the restrictions imposed on them. There is no power to impose fines for enterprises that do not fulfil the reporting requirements under §8.

53 For instance, in private and public limited companies any shareholder has the right to ask questions of the management, see the Danish Companies Act §102. In associations and foundations, stakeholders will normally not have any formal right to ask questions of the management.

3.3. EXIT

The enterprise is free to deregister at any time. Additionally, management will have a duty to deregister if they conclude that the enterprise no longer fulfils the conditions of registration (and the failure cannot be corrected). Finally, deregistration may be triggered by the Danish Business Authority. In case of deregistration, the caps applicable during registration must still be observed for the profit made during the time the entity was operating under the scheme.[54] For deregistered enterprises, this means that the profit accumulated during registration cannot be used afterwards for distributions exceeding the caps and must still be used to serve the social purpose. Any profit accumulated before registration or after deregistration is not subject to these restrictions.

Any violation of the restrictions on distribution of profits after deregistration is punishable by a fine.[55] However, the Act does not stipulate how the Danish Business Authority will identify violations. After deregistration, the enterprise no longer has to report on how it uses its profit. Consequently, the Business Authority would need to engage in very substantial outreach work to detect violation of these rules. Thus far, the Business Authority has not made any efforts to enforce these rules.[56]

A social enterprise may also be liquidated, for instance through a bankruptcy. In the event that there is any profit left after paying off creditors this, profit should be used within the limits set by the rules requiring a social handling of the profit.[57]

4. STATE/PRIVATE CERTIFICATIONS AND METRICS

Social enterprises that are registered under the RSE Act are entitled to use the designation RSV, including a special logo designed for these enterprises. In fact, they are the only ones entitled to use this particular designation, as anyone else using it may be fined according to §17(2) of the RSE Act.

In recent years it has also been possible to be certified as a B Corporation in Denmark. According to the information provided by B Lab, 256 Danish enterprises have chosen to make use of this opportunity.[58] To be certified, the company must change its articles of association to specify that one of the

[54] See §10(3) of the RSE Act.
[55] See §17(4) of the RSE Act.
[56] Again, this information was obtained during the interview with a representative from the Business Authority in September 2020.
[57] See §10(1) of the RSE Act.
[58] This is the number of companies certified in Denmark as of 23 July 2023 according to the webpage of the Danish branch, see https://www.bcorporation.net/en-us/find-a-b-corp/?refinement%5Bcountries%5D%5B0%5D=Denmark.

purposes of the company is to have a significant positive impact on society and the environment. In addition, the articles must specify that the management has a duty when making a decision to consider the interest of its employees, suppliers, customers, the local as well as global environment, and both short-term and long-term interests.[59] Additionally, the company must undergo a certification process where different elements of the company and its activities are evaluated to verify that it meets the required score for certification based on B Lab's sustainability parameters.

The Danish Standard DS49001 is the Danish implementation of ISO26000 focusing on sustainable management. So far only a limited number of enterprises have been certified according to this standard.[60]

Several municipalities in Denmark have a scheme where they issue 'CSR certificates' to local companies that act socially responsibly.

5. SUBSIDIES/BENEFITS

The government does not provide any subsidies or special tax advantages for social enterprises, whether or not they are registered under the RSE Act. There are tax benefits for certain non-profit charitable organisations, but most registered social enterprises will not qualify for these benefits.[61]

The Danish Public Procurement Act[62] has implemented the rules benefiting certain social economic enterprises found in Directive 2014/24/EU on public

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59 See the requirement specified at https://assets.ctfassets.net/l575jm7617lt/5QomJkRDulKzjDfUMllmXv/17ad7b6f8ddc2f850e9ba7fe9f3df3dc/B_Lab_Legal_Framework_Denmark.pdf. The rapporteur was informed by a representative from B Corp that it had not proven difficult to register these changes to the articles of association in Denmark.

60 There is no register of those which have been certified, but an estimate given to the rapporteur by the Danish Standardisation Institute (Dansk Standard) points to 20 enterprises. However, the number of copies of the standard sold is larger, so some enterprises may use the standard without being certified.

61 Tax law favours non-profit charitable organisations, by allowing taxpayers to deduct contributions up to just under €3,000 in their tax return. However, the conditions to qualify for this regime are strict and require inter alia that the organisation uses its funds to the benefit of a wide range of persons (the potential group of beneficiaries must be more than 35,000), and that it receives donations from more than 100 persons annually, see Ministerial Order no. 1656 from 29 December 2018. These rules are not designed for social enterprises, but it is not impossible that these may adjust their activity to fit the conditions. For foundations and certain associations, a special tax regime applies according to the Foundation Tax Law, Act no. 700 of 20 April 2021. This regime inter alia allows for the deduction of distributions for non-profit and charitable purposes. For a discussion of this concept, see H.S. Hansen, 'Begreberne almennyttige og almenvelgørende formål i skatteretten' (2016) *Revision og Regnskabsvæsen* 54. In addition, donations to foundations not designated for distribution are either tax free for the foundation or in the case of a family foundation taxed at 20%, which in a Danish context is a low rate of taxation.

62 Act no. 1564 from 15 December 2015.

procurement. Under these authorities, most types of procurements may favour sheltered workshops and economic operators whose main aim is the social and professional integration of disabled or disadvantaged persons or who employ at least 30% disabled or disadvantaged workers.[63] It is possible to favour some social enterprises for a range of specific types of services.[64] The Danish implementation of the Directive stresses that not all registered social enterprises will qualify for this priority, but only those that fulfil the conditions set out in the Directive and the Danish Act.[65] Many of these conditions will be fulfilled by registered social enterprises, such as the requirement to have a public service mission and that there should be restrictions on the distribution of profits, but may not fulfil the condition that the structure of management or ownership are based on employee ownership or participatory principles.

For public procurements not regulated by the EU procurement rules, it may be easier to favour social enterprises. However, this will mostly relate to minor tenders.[66]

Although these public procurements only allow prioritisation of social enterprises within some very specific boundaries, several municipalities in Denmark have adopted strategies to favour social enterprises in other ways. For instance, some municipalities encourage and assist with the establishment of social enterprises (or attracting such enterprises from elsewhere) and collaborate with them.[67]

There are various, mainly publicly funded, schemes that may benefit social enterprises. This includes the Social Capital Fund, but there are also private initiatives such as the Merkur Cooperative Bank, which provides financial capital to social enterprises in Denmark.[68]

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63 See Article 20 of Directive 2014/24/EU and §20 of the Danish Public Procurement Act.

64 See Article 77 of the Directive and §190 of the Danish Public Procurement Act. The types of services where it is possible to favour social enterprises are listed in Annex XIV of the Directive.

65 See the conditions set in Article 77(2) of the Directive and §190 of the Danish Public Procurement Act.

66 It seems that this question has not drawn much attention in Danish law, most likely because very few (and less important) procurements are not covered by the directives. However, given there is a cross-border interest in such procurements, EU law still requires that the fundamental principles of non-discrimination, transparency and proportionality are observed. But still, it would be possible to favour social enterprises to some extent, see also the case law of the Court of Justice of the European Union, in particular Case C-113/13, *Spezzino* and Case C-70/95, *Sodemare*.

67 See for example the strategy for social enterprises adopted by Kolding municipality, https://www.kolding.dk/media/mejpqpwa/socialoekonomi_er_totaloekonomi.pdf. For an overview of this strategy see L. Hulgård and L.M. Chodorkoff, *Social enterprises and their ecosystems in Europe. Country report: Denmark*, European Commission, 2019, pp. 52–55, https://rucforsk.ruc.dk/ws/portalfiles/portal/66250330/Social_enterprises_and_their_ecosystems_in_Europe._Updated_country_report_Denmark.pdf.

68 For more information about these schemes and actors see the report prepared for the Commission, L. Hulgård and L.M. Chodorkoff, *Social enterprises and their ecosystems in*

6. PRIVATE CAPITAL

Some of the social enterprises interviewed in connection with the evaluation of the RSE Act conducted by the Danish Business Authority in 2018 complained that the cap on dividends would make it more difficult to attract investors.[69] No registered social enterprise has so far attempted to become listed on Nasdaq Copenhagen A/S.

A registered social enterprise may procure loans like all other enterprises. However, the asset locks mean that a loan where the 'interest' depends on the profit of the enterprise cannot be accepted.[70]

7. OTHER CONSTITUENCIES

The requirement that registered social enterprises should be inclusive mandates that the enterprise somehow involve its stakeholders in its governance. However, it is not clear how this should be carried out, and consequently the enterprise will have considerable room to manoeuvre in fulfilling this condition.

The RSE Act does not require worker participation in the management of the social enterprise, but such involvement may be required by the rules regulating the corporate entity housing the social enterprise.

The reports required under the RSE Act are accessible to the public upon request (or if the report is incorporated in the management report, it will be publicly available as being part of the annual report), and consequently may be read by different stakeholders. If they find that the social enterprise does not comply with the rules of the RSE Act, however, there is no official place to register a complaint as is the case for UK community interest companies. They may, however, point out the deficiencies to the Danish Business Authority, which may use the information as it sees fit.

Europe. Country report: Denmark, European Commission, 2019, pp. 52–54, https://rucforsk.ruc.dk/ws/portalfiles/portal/66250330/Social_enterprises_and_their_ecosystems_in_Europe._Updated_country_report_Denmark.pdf.

69 See p. 17 of the evaluation prepared by the Danish Business Authority, *Evaluering af lov om registrerede socialøkonomiske virksomheder*, December 2018, https://erhvervsstyrelsen.dk/evaluering-af-lov-om-registrerede-socialokonomiske-virksomheder. It seems possible for a social enterprise to get around the effect of the asset locks by conducting part of its activities in a private limited company where investors are invited to become shareholders in the later company.

70 This would be a circumvention of the restriction in §5(1)(5)(b) of the RSE Act. This is stated expressly in the *travaux préparatoires* for the provision.

8. PROSPECTIVE CHANGES IN LAW

The evaluation of the RSE Act conducted in 2018 showed that social enterprises found it difficult to register and in particular found it hard to comply with the Act's reporting requirements.[71]

Several respondents also complained that there were very few benefits associated with registration as a social enterprise. Some mentioned that it was very complicated for a municipality to favour social enterprises in public procurement, and consequently this seldom happened. In effect, registration under the RSE Act does not entail any specific advantages apart from the ability to use the special designation as a registered social enterprise.[72] Since the government had done little in recent years to promote the scheme, the potential benefit from using the designation was also seen as limited.

Despite these reservations, the majority of respondents recommended that the registration scheme be continued, as they expressed hope that in the future it may generate more advantages for those registered. This also seems to be the conclusion drawn by the Danish Business Authority, as it maintained the RSE Act and so far has not proposed any amendments or other initiatives to support registered social enterprises. It seems that in recent years the Danish government has become less interested in promoting social enterprises.[73]

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71 See the evaluation prepared by the Danish Business Authority, *Evaluering af lov om registrerede socialøkonomiske virksomheder*, December 2018, https://erhvervsstyrelsen.dk/evaluering-af-lov-om-registrerede-socialokonomiske-virksomheder.

72 Similarly, companies registered as B Corporations will not enjoy any other advantages than what flows from the special B Corp designation.

73 See also the discussion in L. Hulgård and L.M. Chodorkoff, *Social enterprises and their ecosystems in Europe. Country report: Denmark*, European Commission, 2019, pp. 68–72, https://rucforsk.ruc.dk/ws/portalfiles/portal/66250330/Social_enterprises_and_their_ecosystems_in_Europe._Updated_country_report_Denmark.pdf.

LES ENTREPRISES SOCIALES EN FRANCE

Jérôme Chacornac*

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L'expression « entreprise sociale » se présente d'emblée, pour le juriste français, comme porteuse de nombreuses équivoques d'un point de vue théorique, équivoques qu'il est indispensable de lever pour justifier le choix des règles à étudier. La locution apparaît comme une traduction littérale du concept de « *social enterprise* » promu

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par la Harvard Business School au cours des années 1990. Elle expose ainsi ledit concept à un certain risque d'acculturation[1] par rapport aux courants de pensée nombreux et riches et proprement français par lesquels s'est développée la réflexion sur les finalités « extracapitalistiques » de l'entreprise, dans le cadre des mouvements associatifs, mutualistes[2] et coopératifs, et selon les perspectives de l'économie sociale, de l'économie solidaire, puis de l'économie sociale et solidaire.[3]

Pour éviter les faux amis, on soulignera d'abord que, selon une approche purement lexicale, l'entreprise sociale est une commodité d'expression parfois utilisée pour faire référence à l'entreprise exploitée en société, civile ou commerciale.[4] Le terme « entreprise », pris isolément, renvoie cependant à une réalité bien moins commode à identifier en droit[5] et indifférente au choix de la

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1 J. Defourny et M. Nyssens, « Approches européennes et américaines de l'entreprise sociale : une perspective comparative », *Revue internationale de l'économie sociale*, 2011, n° 319.

2 Le mouvement mutualiste a promu une forme d'association fondée sur la réciprocité de l'engagement des membres dans la prise en charge d'un risque ou l'accès à un financement. À cet égard, la réciprocité des engagements pris s'est historiquement matérialisée dans des structures de groupement classiques, comme les sociétés et associations, avant de conduire à l'avènement de groupements spécifiques (voy. *Rép. Dalloz Sociétés*, V° Société et mutuelle d'assurance, par V. Nicolas, n° 17). Ses secteurs d'élection demeurent la banque et l'assurance et sont élargis à la prévoyance et à la retraite. Ce mouvement a donné lieu à l'avènement de formes spécifiques de groupement de droit privé, dotées de la personnalité morale, appelées « mutuelles, unions et fédérations » et régies par un code particulier, à savoir le Code de la mutualité. Ces organismes coexistent avec des sociétés d'assurance mutuelle ou des sociétés mutuelles d'assurance, lesquelles fonctionnent selon la technique de la mutualité, qui permet une couverture des risques par répartition entre un ensemble d'adhérents ou membres du groupement (pour une analyse concluant que le concept de « mutualité » revient fondamentalement à une technique financière de couverture des risques, voy. *Rép. Dalloz civ.*, V° Assurances : Généralités, par L. Mayaux, n° 31). Aux termes de l'article L 110-1 du Code de la mutualité :

> Les mutuelles, unions et fédérations sont des personnes morales de droit privé à but non lucratif.
>
> Elles sont régies par leurs statuts qui définissent leur objet social, leur champ d'activité, et leurs modalités de fonctionnement conformément aux dispositions du présent code. Les statuts peuvent préciser une raison d'être, constituée des principes dont la mutuelle, union ou fédération se dote et pour le respect desquels elle entend affecter des moyens dans la réalisation de son activité.
>
> Elles exercent leur activité dans le respect du principe de solidarité et mettent en place une gouvernance démocratique, fixée par les statuts, prévoyant la participation des membres.

3 Pour un aperçu synthétique de cette très riche évolution dans le contexte spécifiquement français, voy. G. Lacroix et R. Slitine, *L'économie sociale et solidaire – Que sais-je ?*, Puf, 2019 ; M. Dreyfus, *Histoire de l'économie sociale – De la grande guerre à nos jours*, Presses universitaires de Rennes, 2017.

4 P.ex. *RTD. com.* 2010, p. 738, obs. C. Champaud et D. Danet, sous l'arrêt Com. 18 mai 2010, pourvoi n° 09-14.838, arrêt n° 543 F-D. Le recours à cette expression par ces auteurs n'est pas fortuit. Il reflète un choix intellectuel sur l'analyse même de ce qu'est une société, en tant que structure de l'entreprise dans les pas de « l'école de l'entreprise » : voy. M. Cozian, A. Viandier et F. Deboissy, *Droit des sociétés*, 34e éd., LexisNexis, 2021, n° 10, p. 3.

5 En dernier lieu, inventoriant la multiplicité des approches proposées de cette notion en droit français, et tirant une nouvelle fois le constat de l'absence de définition générale :

société comme structure de l'entreprise. Sans s'y attarder, la notion d'« entreprise » est utilisée avec des enjeux différents en droit du travail, pour désigner la collectivité formée par les salariés et employeurs ; en droit commercial, pour évoquer l'entreprise individuelle selon diverses modalités d'exploitation[6] ; ou plus spécifiquement encore en droit de la concurrence, pour identifier l'activité économique exercée sur un marché concurrentiel.

En droit positif, elle ne correspond en revanche à aucune structure juridique particulière d'exploitation d'une entreprise, non plus qu'à aucun type d'activité bien défini. Par son indétermination, l'expression « entreprise sociale » est ainsi susceptible de renvoyer tant à l'identification de certaines activités orientées vers leurs résultats socialement bénéfiques, qu'à l'aménagement du fonctionnement ou de la structure de l'entreprise dans la réalisation de finalités sociales. C'est au niveau européen qu'une réflexion a été conduite sur une définition possible de l'« entreprise sociale », sans aboutir cependant. Dans une communication du 25 octobre 2011,[7] en partie inspirée du rapport Hewitt de 2002,[8] la Commission européenne visait, par l'expression « entreprises sociales », les entreprises « pour lesquelles l'objectif social ou sociétal d'intérêt commun est la raison d'être de l'action commerciale …, dont les bénéfices sont principalement réinvestis dans la réalisation de cet objet …, et dont le mode d'organisation ou le système de propriété reflète la mission, s'appuyant sur des principes démocratiques ou participatifs, ou visant à la justice sociale ».[9] En dépit de cette identification générique, la Commission avait toutefois rejeté l'idée d'adopter toute définition normative, pour préférer une approche selon des « principes communs » aux États membres, de façon à « respecter la diversité des choix politiques, économiques et sociaux, ainsi que la capacité d'innovation des entrepreneurs sociaux ». C'est dire que le refus d'une définition juridique procédait d'un choix politique en faveur de la

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voy. C. Hannoun, « L'impossible définition de l'entreprise », in *Mélanges en l'honneur d'Alain Couret*, Éditions Francis Lefebvre-Dalloz, 2020, p. 25.

[6] À l'entreprise individuelle, qui désigne l'activité professionnelle conduite à titre individuel sans structure particulière, il faut adjoindre l'entreprise individuelle à responsabilité limitée (EIRL), reposant sur la technique du patrimoine d'affectation, mais aussi certaines sociétés dans une variante unipersonnelle : les entreprises unipersonnelles à responsabilité limitée (EURL) et les entreprises agricoles à responsabilité limitée (EARL), dans lesquelles l'activité de l'entreprise est conduite par une personne morale distincte de la personne de l'entrepreneur, lequel est associé unique. L'hypothèse se rencontre également dans le champ des sociétés par actions, avec la société par actions simplifiée unipersonnelle (SASU).

[7] Communication au Parlement européen, au Conseil, au Comité économique et social européen et au Comité des régions – Initiative pour l'entrepreneuriat social – Construire un écosystème pour promouvoir les entreprises sociales au cœur de l'économie et de l'innovation sociales, COM(2011)682 final du 25 octobre 2011.

[8] « Social Enterprise : A Strategy for Success », Department of Trade and Industry, Great Britain, 2002.

[9] Ibid. ; sur cette communication, voy. E. Fatôme, « Office public de l'habitat, entreprise sociale ? », *AJDA*, 2013, p. 100.

souplesse et de la liberté des législateurs nationaux. De façon indirecte, l'entreprise sociale a néanmoins reçu une définition qui ne vaut que dans le cadre spécifique de l'investissement socialement responsable, sous la dénomination d'« entreprise de portefeuille éligible », à l'article 3, §1er, d), du règlement (UE) n° 346/2013.[10] S'il a son importance, ce règlement a un champ d'application limité, qui exclut ainsi de conférer une portée générale à la définition de l'« entreprise » qu'il renferme. On en laissera donc l'étude hors du champ du présent rapport national.[11]

Plus techniquement, dans le contexte législatif français, si l'entreprise sociale ne correspond à aucun ensemble normatif particulier, l'expression « entreprise sociale » peut évoquer deux réalités. Elle rappelle d'abord de manière incomplète le cadre mis en place par la loi n° 2014-856 du 31 juillet 2014 relative à l'économie sociale et solidaire[12] (ci-après « loi ESS »). L'entreprise sociale renverrait ainsi aux entreprises rentrant dans le champ d'application de cette loi et se soumettant aux principes de l'économie sociale et solidaire, ce qui invite par contrecoup à inclure dans la réflexion le droit coopératif. Si les sociétés coopératives sont d'une reconnaissance plus ancienne en droit français, par la loi n° 1947–1775 du 10 septembre 1947 portant statut de la coopération, elles ont été intégrées au champ de l'économie sociale et solidaire comme une technique privilégiée de respect de ses principes, de sorte que le droit coopératif dispose aujourd'hui d'un arrière-plan de principes plus vaste que celui qui le caractérisait à l'origine. Ensuite, de manière plus générale, l'expression « entreprise sociale » s'inscrit dans un mouvement doctrinal et législatif diffus, à savoir celui de la responsabilité sociale des entreprises ou RSE (équivalent en français de l'expression « *corporate social responsibility* »),[13] dont les contours sont toutefois mal définis. Il n'existe en effet en droit français aucun corpus législatif identifié, et encore moins de code adoptant une approche systématique de la question, mais plutôt quelques institutions et mécanismes spécifiques dont e.a. le devoir de vigilance, issu de la loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre,[14] ainsi que

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10 Règlement (UE) n° 346/2013 du Parlement européen et du Conseil du 17 avril 2013 relatif aux fonds d'entrepreneuriat social européens, JO L 115, 25 avril 2013, pp. 18–38.

11 Sur l'analyse de cette définition, voy. D. Hiez, « La perméabilité du droit des sociétés à l'ESS », *Juris Associations*, 2015, n° 522, p. 27.

12 Loi n° 2014-856 du 31 juillet 2014 relative à l'économie sociale et solidaire : JORF n° 0176 du 1er août 2014, complétée par le décret n° 2015-858 du 13 juillet 2015 relatif aux statuts des sociétés commerciales ayant la qualité d'entreprises de l'économie sociale et solidaire : JORF n° 0162 du 16 juillet 2015, et modifiée par la loi n° 2019-486 du 22 mai 2019 relative à la croissance et la transformation des entreprises : JORF n° 0119 du 23 mai 2019.

13 Pour un état des réflexions sur cette notion, voy. J.-P. Chanteau, K. Martin-Chenut et M. Capron (dir.), *Entreprise et responsabilité sociale en questions – Savoirs et controverses*, Classiques Garnier, 2017, et spéc. l'article de K. Martin-Chenut, « La RSE saisie par le droit et par les juristes », p. 205.

14 Loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre : JORF n° 0074 du 28 mars 2017.

les différentes innovations apportées par la loi dite « Pacte » du 22 mai 2019.[15] Cette dernière recèle en effet différentes dispositions, comme celle relative à la définition de l'« intérêt social » à l'article 1833, alinéa 2, du Code civil, et la création des sociétés à mission,[16] qui matérialisent, sinon une véritable entreprise sociale, du moins une certaine conception sociale de l'entreprise dans son fonctionnement quotidien,[17] celle-ci ayant été politiquement perçue comme un « objet d'intérêt collectif ».[18]

Ce dualisme de corpus législatif est également un dualisme d'approche que l'on a pu exposer en distinguant un modèle européen de l'entreprise sociale, exprimé par les règles de l'économie sociale et solidaire, et un modèle américain, centré sur le *social business*, soucieux d'intégrer des finalités sociales à une activité classiquement lucrative.[19]

En l'absence de définition formelle et unifiée de la notion d'« entreprise sociale », il apparaît nécessaire de traiter de cette double dimension de façon simultanée, en distinguant selon la question abordée, l'origine et le contexte de la règle qui sera étudiée.[20] En effet, ces deux ensembles de règles paraissent devoir être rapprochés, du fait qu'ils poursuivent, bien que dans des perspectives différentes, une finalité généralement commune, consistant à intégrer à l'activité de l'entreprise la réalisation d'un but, ou plus simplement la prise en compte d'intérêts qui dépassent leur seul but légal.[21] Seule cette approche compréhensive permet d'éviter au juriste de déterminer les contours d'une notion qui n'est pas intrinsèquement juridique, mais d'abord gestionnaire et politique, en tranchant arbitrairement entre de multiples conceptions et critères de l'entreprise

[15] Loi n° 2019-486 du 22 mai 2019 relative à la croissance et la transformation des entreprises : JORF n° 0119 du 23 mai 2019.

[16] Art. L 210-10 à L 210-12 du Code de commerce, et décret n° 2020-1 du 2 janvier 2020 relatif aux sociétés à mission : JORF n° 0002 du 3 janvier 2020, ayant créé un nouvel article R 210-21.

[17] Voy. *infra*, section 2.

[18] Les choix techniques opérés par la loi Pacte s'inscrivent dans le prolongement d'un important rapport du 9 mars 2018 remis aux ministres de la Transition écologique et solidaire, de la Justice, de l'Économie et des Finances, et du Travail, sous l'intitulé N. Notat, J.-D. Senard et J.-B. Barfety (dir.), *L'entreprise, objet d'intérêt collectif*. Un premier rapport d'évaluation des innovations de la loi Pacte a récemment été publié avec un bilan plutôt mitigé, à partir des travaux du groupe de travail présidé par M. Brice Rocher, *Rapport Rocher – Repenser la place des entreprises dans la société : bilan et perspectives deux ans après la loi Pacte*, rapport remis le 19 octobre 2021 à Bruno Le Maire, ministre de l'Économie, des Finances et de la Relance.

[19] Voy. N. Richez Battesti, « Entreprises sociales : entre capitalisme à finalité sociale et économie plurielle? », *Juris Associations*, 2010, n° 416, p. 13.

[20] Il ne rentre en revanche pas dans l'objet du présent rapport national de souligner en détail les jeux d'influence pourtant bien réels qui se sont exercés sur le droit français. On pense p.ex. au choix du législateur italien d'introduire les *società benefit* : L. 28 décembre 2015, n° 208, Commi 376–384.

[21] Sur les relations des innovations de la loi Pacte avec l'économie sociale et solidaire, voy. D. Hiez, « Loi Pacte, coopératives et économie sociale et solidaire », *RTD. com*. 2019, p. 929.

sociale – tant aux États-Unis qu'en Europe[22] – dont il est pourtant observable qu'ils se manifestent en droit français de diverses manières qu'il ne faut pas réduire de manière dogmatique.

Après s'être ainsi attaché dans cette introduction à éclairer l'indétermination de la notion d'« entreprise sociale » en droit français, il faut identifier les différentes structures susceptibles de suivre les buts caractéristiques d'une entreprise dite « sociale » (section 1), pour exposer ensuite les conditions de fonctionnement particulières qui peuvent résulter de la poursuite de buts plus généraux par une entreprise (section 2).

1. LES STRUCTURES DE L'ENTREPRISE SOCIALE

Largement entendue, l'entreprise sociale transcende, en droit français, les distinctions entre groupements, que celles-ci soient fondées sur leur but lucratif ou désintéressé, sur leur dimension coopérative ou mutualiste, ou encore sur l'adjonction à l'activité dudit groupement d'une dimension d'intérêt général ou d'utilité sociale.[23] En d'autres termes, ainsi qu'on l'a précisé dès l'introduction, l'entreprise sociale en droit français ne repose pas sur une forme de groupement spécifique. Elle correspond à l'aménagement des règles relatives à de multiples groupements, pourvu qu'ils agissent dans le respect de certains principes ou finalités. Davantage qu'à une forme, elle correspond à un statut[24] qui peut leur être reconnu ou retiré selon des modalités diverses. C'est dire que l'identification de l'entreprise sociale suppose la réunion de critères de qualification matériels, liés à l'activité conduite par le groupement (section 1.1), et formels, permettant la reconnaissance d'un statut particulier (section 1.2).

1.1. DIMENSION MATÉRIELLE

Selon les choix exposés en introduction, l'entreprise sociale largement entendue invite à évoquer en droit français deux types de structure procédant de deux logiques : les entreprises de l'économie sociale et solidaire d'une part (section 1.1.1), et les entreprises à mission, instituées en droit français selon la logique de la responsabilité sociale des entreprises, d'autre part (section 1.1.2).

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[22] Sur l'ensemble des courants de pensée et critères proposés, voy. l'exposé synthétique et la riche bibliographie jointe à l'article de J. Defourny et M. Nyssens, « Approches européennes et américaines de l'entreprise sociale : une perspective comparative », *Revue internationale de l'économie sociale*, 2011, n° 319.

[23] Les formes juridiques évoquées dépassent, en d'autres termes, la distinction du *non-profit* et du *not-for-profit*.

[24] Que l'on peut traduire comme « *legal status* ».

1.1.1. *Les entreprises de l'économie sociale et solidaire*

La loi ESS embrasse, dans le secteur de l'économie sociale et solidaire, une très grande variété de formes de groupement dont, assurément, tous n'ont pas une vocation commerciale. L'approche de l'économie sociale et solidaire suivie par le législateur ne se fonde pas sur la structure de l'entreprise, mais sur les conditions de conduite des activités.[25] La loi ESS est ainsi un travail de généralisation au nombre le plus étendu possible de certains principes de fonctionnement initialement limités à des formes spécifiques pour des activités qui peuvent être, au sens de l'article 1er, II, de cette loi ESS, « des activités de production, de transformation, de distribution, d'échange et de consommation de biens ou de services ». Ainsi largement entendue, la même disposition identifie les structures de l'économie sociale et solidaire en deux temps. Le 1° de l'article 1er, II mentionne ainsi :

> les personnes morales de droit privé constituées sous la forme de coopératives, de mutuelles ou d'unions relevant du code de la mutualité ou de sociétés d'assurance mutuelles relevant du code des assurances, de fondations ou d'associations régies par la loi du 1er juillet 1901 relative au contrat d'association ou, le cas échéant, par le code civil local applicable aux départements du Bas-Rhin, du Haut-Rhin et de la Moselle.

L'économie sociale et solidaire se présente ainsi, dans la tradition juridique française, comme un point de rencontre entre les mouvements associatifs, coopératifs et mutualistes au sein du « troisième secteur ».[26] Le 2° de la même disposition poursuit pour englober les sociétés commerciales. Implicitement, peuvent appartenir à l'économie sociale et solidaire des sociétés commerciales ne relevant pas de la loi sur les sociétés coopératives, celles-ci ayant déjà été mentionnées au 1°. À cet égard, à défaut de toute distinction, sont ainsi concernées toutes les sociétés commerciales qu'on appellera « de droit commun », c.-à-d. celles visées au livre II du Code de commerce. Explicitement, ne seront concernées que les sociétés commerciales qui, aux termes de leurs statuts, remplissent un certain nombre de conditions énumérées au 2° de l'article 1er, II.

Au sein de l'économie sociale et solidaire, la différence majeure entre les sociétés commerciales et les autres personnes morales de droit privé tient ainsi en ce que les premières n'y sont pas intégrées *de iure*. Les exigences légales tendent à assurer la conformité des modalités d'exploitation de l'entreprise commerciale par la forme que sont les sociétés commerciales au cadre spécifique

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[25] Pour une évocation comparative de l'ampleur et du niveau de détail de cette loi par rapport aux législations étrangères, voy. D. Hiez, « La richesse de la loi Économie sociale et solidaire », *Revue des sociétés*, 2015, p. 147.

[26] Expression d'usage courant pour désigner la troisième voie ouvrant l'alternative rigide entre secteur public et secteur privé à but lucratif.

de l'économie sociale et solidaire, par la réunion de plusieurs conditions. À ce titre, l'article 1er, II, 2°, de la loi ESS établit trois critères, dont le premier tient au respect par les sociétés des conditions cumulatives listées au I pour identifier l'économie sociale et solidaire. La société doit ainsi avoir un but autre que le partage des bénéfices, mais aussi avoir une gouvernance démocratique et se conformer à des principes de gestion sur lesquels nous reviendrons dans la partie suivante. Le deuxième critère tient à la recherche d'« une utilité sociale au sens de l'article 2 de la présente loi », cette dernière notion étant entendue comme la conformité de l'objet social de l'entreprise à l'un des quatre objectifs énumérés par ledit article 2. De manière synthétique, ces objectifs sont constitués par le soutien aux personnes en situation de fragilité, la contribution à la préservation et au développement du lien social, ou au maintien et au renforcement de la cohésion territoriale, la contribution à l'éducation à la citoyenneté aux fins de la réduction des inégalités sociales et culturelles et, enfin, l'objectif de concourir au développement durable, à la transition énergétique, à la promotion culturelle ou à la solidarité internationale.

Au-delà de ces objectifs, le critère de la recherche d'utilité sociale constitue une extension, par la loi ESS, du critère distinctif des types de société coopérative les plus récemment reconnus par le législateur avant son adoption. Ainsi, c'est une loi du 17 juillet 2001[27] qui a créé les sociétés coopératives d'intérêt collectif, régies aux articles 19 *quinquies* à 19 *sexdecies* A de la loi du 10 septembre 1947 portant statut de la coopération.[28] Ces sociétés ont, les premières, reçu comme critère de définition « la production ou la fourniture de biens et de services d'intérêt collectif, qui présentent un caractère d'utilité sociale », à l'alinéa 2 de l'article 19 *quinquies*. La doctrine spécialisée n'a toutefois pas manqué de souligner que le critère d'utilité sociale porte alors sur les biens et services d'intérêt collectif, et non sur les conditions de production, à la différence de l'exigence résultant de la loi sur l'économie sociale et solidaire.[29] Si l'exigence est formulée de manière similaire, elle ne s'applique ainsi pas à la même réalité.

Le troisième et dernier critère permettant d'inscrire une société commerciale dans le champ de l'économie sociale et solidaire mentionné par l'article 1er, II, 2°, de la loi ESS tient au respect de certaines exigences de gestion tenant à l'affectation d'une fraction d'au moins 20 % du bénéfice de l'exercice à la constitution

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[27] Loi n° 2001-624 du 17 juillet 2001 portant diverses dispositions d'ordre social, éducatif et culturel.

[28] La loi ESS elle-même a encore introduit une nouvelle forme de coopérative, la coopérative d'activité et d'emploi, par la création d'une nouvelle disposition au sein de la loi du 10 septembre 1947 portant statut de la coopération : « Les coopératives d'activité et d'emploi ont pour objet principal l'appui à la création et au développement d'activités économiques par des entrepreneurs personnes physiques » (loi n° 47-1775, 10 septembre 1947, art. 26-41, al. 1er).

[29] *Rép. sociétés Dalloz*, V° Sociétés coopératives d'intérêt collectif, par D. Hiez, n° 11.

d'une réserve obligatoire n'excédant pas le capital social, appelée « fonds de développement », ainsi qu'à différentes contraintes en matière d'opération sur le capital social. Est ainsi posé un principe d'interdiction d'amortissement du capital et de réduction de celui-ci non motivée par des pertes, sauf nécessité pour la continuité de son activité, tout comme se trouvent soumises aux règles applicables aux sociétés anonymes les opérations de rachat des actions ou parts sociales.

En résumé, la loi spécifie, à travers des exigences de gouvernance et de détermination du but poursuivi, les stipulations statutaires permettant d'intégrer les sociétés commerciales parmi les entreprises de l'économie sociale et solidaire. L'obstacle est surmonté, pour ces structures à but lucratif, en établissant de manière institutionnelle, par des critères légaux, la conformité des sociétés aux finalités plus larges de l'économie sociale et solidaire. En d'autres termes, tandis que l'appartenance des autres personnes morales de droit privé à l'économie sociale et solidaire est postulée par leur nature juridique dès qu'elles se livrent à des activités productives, cette appartenance doit être articulée avec des aménagements spécifiques du fonctionnement d'une société commerciale, dont elle n'est pas l'essence.

1.1.2. L'influence de la responsabilité sociale des entreprises : les entreprises à mission

Les entreprises à mission sont une innovation opérée par la loi Pacte du 22 mai 2019 et se situent formellement en dehors du cadre de l'économie sociale et solidaire et du droit coopératif.[30] La qualité d'« entreprise à mission » n'a pas le même champ que les entreprises de l'économie sociale et solidaire, puisqu'elle peut être reconnue aux coopératives,[31] aux mutuelles,[32] aux sociétés d'assurance mutuelle[33] et aux sociétés commerciales,[34] *à l'exclusion des organismes de prévoyance*.

La qualité d'« entreprise à mission » repose sur une nécessité technique qui est une autre innovation plus générale de la loi Pacte, relative à la nécessité d'inscrire aux statuts une « raison d'être », notion générique dont la définition se trouve de manière significative au sein des règles générales relatives aux sociétés à l'article 1835 du Code civil, auquel une phrase a été rajoutée : « Les statuts peuvent préciser une raison d'être, constituée des principes dont la société se dote

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30 Sur l'articulation entre les innovations de la loi Pacte et le cadre de l'économie sociale et solidaire, voy. D. Hiez, « Loi Pacte, coopératives et économie sociale et solidaire », *RTD. com.* 2019, p. 929.

31 Art. 7, al. 2, de la loi du 10 septembre 1947.

32 Art. L 110-1-1 à L 110-1-3 du Code de la mutualité.

33 Art. L 322-26-4-1 du Code des assurances.

34 Art. L 210-10 à L 210-12 du Code de commerce, complété par le décret n° 2020-1 du 2 janvier 2020 relatif aux sociétés à mission : JORF n° 0002 du 3 janvier 2020.

et pour le respect desquels elle entend affecter des moyens dans la réalisation de son activité ». Cette exigence d'une raison d'être, énumérée en premier parmi toutes les conditions permettant de faire état publiquement de la qualité de « société à mission », est en réalité de faible portée à l'égard des personnes morales relevant déjà du secteur de l'économie sociale et solidaire, qui, d'emblée, n'ont pas une visée exclusivement capitaliste. Ainsi que l'on a pu l'analyser, à leur égard, la raison d'être « ne peut donc être qu'une façon d'approfondir les principes, d'individualiser les objectifs en insistant davantage sur l'un ou sur l'autre aspect, notamment sur la question environnementale dont il reste discuté qu'elle soit dans l'ADN de l'économie sociale et solidaire ».[35] Il est ainsi de faible portée que l'inscription d'une raison d'être soit autorisée, au-delà de la possibilité d'être reconnue comme entreprise à mission pour les institutions de prévoyance et les sociétés de groupe assurantiel de protection sociale.[36]

La véritable évolution apportée par la raison d'être elle-même se situe à l'égard des sociétés, en permettant précisément d'assurer la conciliation des fins lucratives avec la poursuite d'objectifs sociaux et environnementaux. De manière sous-jacente, l'inspiration procède donc bien davantage de la responsabilité sociale des entreprises, et l'on peut le déduire des autres conditions à la reconnaissance de la qualité d'« entreprise à mission ». Aux côtés de la raison d'être, les statuts doivent préciser d'abord « un ou plusieurs objectifs sociaux et environnementaux que la société se donne pour mission de poursuivre dans le cadre de son activité », selon les termes de l'article L 210-10, 2°, du Code de commerce, ce que l'on retrouve décliné dans le Code de la mutualité et des assurances pour les autres groupements. Ensuite, la qualité d'« entreprise à mission » suppose la présence, dans le groupement en cause, de modalités de suivi d'exécution de la mission, dont, en particulier, la présence d'un comité de mission, distinct des organes légaux – et donc, pour les sociétés, distinct des organes de direction et de l'assemblée des associés. Enfin, il est nécessaire, dans tout groupement se prévalant de la qualité d'« entreprise à mission », de faire procéder à une vérification de l'« exécution des objectifs » par un organisme tiers indépendant.

Demeure une exigence additionnelle pour les seules sociétés, à l'exclusion des sociétés d'assurance mutuelle, exigence fixée à l'article L 210-10, 5°, du Code de commerce et sur laquelle nous reviendrons, qui consiste en une déclaration de leur qualité de « société à mission » au greffier du Tribunal de commerce.

La société à mission et ses déclinaisons aux univers mutualistes n'ont pas été la seule innovation majeure introduite dans la loi dite « Pacte » du 22 mai 2019, déjà citée. L'ajout de l'article 1833, alinéa 2, du Code civil a également une grande importance, qui se situe toutefois à la périphérie du thème de l'entreprise sociale comme « nouvelle forme d'entreprise commerciale » qu'il nous faut traiter.

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35 D. Hiez, « Loi Pacte, coopératives et économie sociale et solidaire », *RTD. com.* 2019, p. 929.

36 Art. L 931-1-2 et L 931-2-3 du Code de la sécurité sociale.

Depuis la loi Pacte, ce nouvel alinéa de l'article 1833 du Code civil dispose que « la société est gérée dans son intérêt social, en prenant en considération les enjeux sociaux et environnementaux de son activité ». Par sa place dans le droit commun français des sociétés, cette disposition s'applique à toute société, quelle qu'en soit la forme, de sorte qu'elle n'institue aucune nouvelle forme d'entreprise au sens légal du terme. Ce nouvel alinéa participe toutefois du mouvement plus général de basculement de la RSE vers des règles juridiques contraignantes. Il n'a encore reçu aucune application par les juridictions, et sa portée demeure toutefois discutée tant au titre de la détermination des obligations qu'il renferme que des débiteurs de ses obligations, ainsi que des sanctions qu'il peut générer. Si le législateur a exclu que sa violation puisse entraîner la nullité d'une décision sociale,[37] les études les plus approfondies de ce texte concluent,[38] sans certitude, qu'il ne saurait concerner que des décisions prises par les organes de gestion et se résoudrait en une obligation de moyens consistant à pondérer l'opportunité commerciale des décisions sociales avec leurs conséquences probables.

Il s'agit donc d'une nouvelle règle de responsabilité, dont les conditions de mise en œuvre sont rendues bien délicates à apprécier compte tenu de la formulation du texte, qui ne confère pas un statut véritablement renouvelé aux sociétés dans leur ensemble. On ne saurait donc, en l'absence d'un tel statut, placer cette règle applicable à l'ensemble des sociétés aux côtés des entreprises de l'économie sociale et solidaire et des sociétés à mission qui, elles, font l'objet d'une reconnaissance formelle, ainsi qu'il va être exposé.

1.2. DIMENSION FORMELLE : RECONNAISSANCE ET RETRAIT DE LA QUALITÉ D'« ENTREPRISE SOCIALE »

Formellement, le droit français autorise le rapprochement entre la loi ESS et les entreprises à mission, par leur soumission commune à un formalisme aux fins de l'obtention d'un certain statut. Si les enjeux entre entreprises de l'économie sociale et solidaire et sociétés à mission ne sont pas exactement les mêmes (section 1.2.1), ces deux formes présentent des similarités quant à la nécessité et aux modalités du bénéfice du statut particulier auquel elles prétendent (section 1.2.2). Bien que n'étant au détail pas identiques, ces formalités reposent

[37] Art. 1844-10, al. 1er, du Code civil et art. L 235-1, al. 2, du Code de commerce. Certains auteurs envisagent toutefois que le risque d'annulation ne soit pas exclu, du fait de l'application des règles de droit commun relatives à la capacité des personnes morales : voy. F.-X. Lucas et D. Poracchia, « La prise en considération des enjeux sociaux et environnementaux de l'activité de la société », in *Mélanges en l'honneur d'Alain Couret*, Éditions Francis Lefebvre-Dalloz, 2020, p. 89, spéc. pp. 91–92.

[38] D. Poracchia, « De l'intérêt social à la raison d'être des sociétés », *Bulletin Joly Sociétés*, 2019, n° 6, p. 40.

sur l'idée commune que le bénéfice d'un statut légal particulier n'est pas acquis de plein droit aux sociétés.

1.2.1. Enjeux

Avant d'envisager les enjeux propres au statut d'entreprise de l'économie sociale et solidaire (section 1.2.1.1), puis d'entreprise à mission (section 1.2.1.2), précisons à titre liminaire que ces statuts sont intrinsèquement dépourvus d'incitation et, plus généralement, de toute dimension fiscale : chaque groupement continue à relever du régime fiscal qui lui est propre. S'agissant ainsi d'une société, c'est en fonction de sa forme et, le cas échéant, des options ouvertes par le droit fiscal interne que son régime fiscal sera déterminé. En d'autres termes, la reconnaissance comme entreprise de l'économie sociale et solidaire ou comme entreprise à mission n'a pas d'incidence en ce qui concerne la soumission à l'impôt sur la société ou le taux de cet impôt.[39] Ce n'est pas dire que le législateur fiscal n'ait pas progressivement fait en sorte de rendre attractive la fiscalité des libéralités[40] aux fins de favoriser la constitution et le fonctionnement d'un certain nombre de groupements comme les associations, ou qu'il n'ait pas ponctuellement établi un régime spécifique pour une forme spécifique de société,[41] mais le législateur fiscal n'a alors pas suivi une approche d'ensemble liée au statut de l'ESS, ou plus généralement fondée sur la notion d'« entreprise sociale ».

1.2.1.1. L'enjeu du statut d'entreprise de l'économie sociale et solidaire

Ainsi qu'il a déjà été précisé, il faut distinguer, au sein des entreprises de l'économie sociale et solidaire, celles qui en font partie de manière statutaire et sont visées à l'article 1er, II, 1°, de la loi ESS, et les sociétés commerciales qui ne bénéficient de ce statut qu'aux conditions qui ont été rappelées. L'objectif ainsi recherché consiste précisément à limiter l'approche purement statutaire, liée à la nature juridique du groupement, dans la délimitation du champ de l'économie sociale et solidaire. Depuis la loi ESS, les statistiques n'ont cependant pas été établies sur le nombre de sociétés d'utilité sociale, faute pour ces dernières de l'avoir déclaré aux répertoires statistiques de l'Insee. La doctrine spécialisée

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39 V. O. Negrin, « Quelle fiscalité pour les entreprises et sociétés labellisées ESS ? », *Juris Associations*, 2016, n° 534, p. 34.

40 Voy. loi n° 2003-709 du 1er août 2003, dite « loi Aillagon ».

41 P.ex., pour les SCOP – sociétés coopératives de production – dites « d'amorçage », Régime fiscal des « SCOP d'amorçage » (art. 16 de la loi n° 2013–1279 du 29 décembre 2013 de finances rectificative pour 2013). L'expression « SCOP d'amorçage » désigne des SCOP issues de la transformation de sociétés existantes, et pour lesquelles l'ensemble des associés non coopérateurs s'engage à céder ou à obtenir le remboursement d'un nombre de titres suffisant pour permettre aux associés coopérateurs de détenir au moins 50 % du capital de la société au plus tard le 31 décembre de la septième année suivant celle de la transformation en SCOP.

n'avait cependant pas manqué de relever le caractère faiblement attractif, pour les sociétés commerciales, de s'inscrire dans le champ de l'ESS, du fait des diverses conditions imposées par l'article 1er,[42] II, dont celle que nous n'avons pas encore mentionnée, consistant en la nécessité à prélever une fraction d'au moins 50 % du bénéfice distribuable affecté au report bénéficiaire et aux réserves obligatoires, un bénéfice sur lequel s'imputent, de surcroît, les pertes antérieures. En d'autres termes, c'est là rendre impartageables dans une large proportion les bénéfices réalisés. Certes, l'affectation sera différente. Tandis que, à hauteur de 20 %, le bénéfice sera affecté à *une réserve statutaire obligatoire* appelée « fonds de développement », jusqu'au seuil du cinquième du capital social,[43] il est en toute hypothèse requis, en vertu de cette autre condition, de prélever la moitié du bénéfice pour l'affecter aux réserves obligatoires, légales et statutaires ou au report.[44] S'il faut considérer que, jusqu'au seuil du cinquième du capital envisagé sur le premier prélèvement, le second y contribue, ce second prélèvement continue d'avoir lieu pour constituer les réserves légales ou statutaires non encore constituées ou donner lieu à un report. C'est dire que, après plusieurs années d'existence, une société souhaitant demeurer une entreprise de l'ESS doit reporter la moitié de son bénéfice annuellement. L'attractivité éventuelle pour une société d'utilité sociale résulte de la possibilité de solliciter un agrément comme « entreprise solidaire d'utilité sociale », résultant de l'article 11 de la loi ESS ayant modifié l'article L 3332-17-1 du Code du travail.

De manière plus générale, le développement de l'activité des entreprises de l'économie sociale et solidaire repose essentiellement sur deux piliers. Un pilier institutionnel lié à l'organisation du secteur résulte de l'articulation entre plusieurs acteurs. Au niveau national, un Conseil supérieur de l'économie sociale et solidaire, placé auprès du Premier ministre et présidé par le ministre chargé de l'économie sociale et solidaire et l'association ESS France, assure au plan national la représentation et la promotion de l'économie sociale et solidaire, tandis que cette promotion est assurée au niveau local par des chambres régionales de l'économie sociale et solidaire, constituées des entreprises de l'économie sociale et solidaire ayant leur siège social ou un établissement situé dans leur ressort, ainsi que des organisations professionnelles régionales, qui viennent en appui au développement des entreprises et à la formation de leurs dirigeants et salariés.

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[42] D. Hiez, « La richesse de la loi Économie sociale et solidaire », *Revue des sociétés*, 2015, p. 147, spéc. n° 16.

[43] Art. 1er de l'arrêté du 3 août 2015, pris en application de l'art. 1er de la loi n° 2014-856 du 31 juillet 2014 relative à l'économie sociale et solidaire fixant la fraction des bénéfices affectée au report bénéficiaire et aux réserves obligatoires.

[44] Art. 2 de l'arrêté du 3 août 2015, pris en application de l'article 1er de la loi n° 2014-856 du 31 juillet 2014 relative à l'économie sociale et solidaire fixant la fraction des bénéfices affectée au report bénéficiaire et aux réserves obligatoires.

Le second pilier repose sur le soutien public et privé apporté au développement des entreprises. Le soutien public en particulier résulte du renvoi, dans le Code monétaire et financier, au règlement sur les fonds européens d'entrepreneuriat social,[45] à la possibilité d'institution de fonds territoriaux associatifs,[46] ainsi qu'à la possibilité pour les pouvoirs publics – collectivités territoriales, leurs groupements et établissements publics territoriaux – de détenir ensemble jusqu'à 50 % du capital de chacune des sociétés coopératives d'intérêt collectif. Le soutien privé s'appuie quant à lui e.a. sur la possibilité ouverte aux coopératives de constituer un fonds de développement coopératif. Les besoins de financement ont également conduit à la reconnaissance de nouveaux types d'instrument de financement, parmi lesquels, pour les mutuelles et sociétés mutuelles d'assurance, les certificats mutualistes,[47] et pour les institutions de prévoyance, les certificats paritaires.[48] De façon plus générale, les entreprises de l'ESS peuvent prétendre dans leur ensemble à des financements spécifiques, comme les prêts participatifs de la Banque publique d'investissement ou de l'État, via la Caisse de dépôts et consignations dans le cadre de projets d'investissement d'avenir, ou encore l'accès à des plateformes de *crowdfunding* pour la souscription du capital.

1.2.1.2. L'enjeu du statut d'entreprise à mission

Le statut d'entreprise à mission s'inscrit, ainsi qu'il a été évoqué, dans le contexte de l'influence du mouvement de la RSE sur le droit français. À titre liminaire sur le terrain des innovations réalisées en matière de RSE, on a déjà pu exposer, dans la partie précédente, les incertitudes entourant la portée de l'exigence de gestion de la société conformément à son intérêt social selon la formule gazeuse de l'article 1833, alinéa 2, du Code civil. Règle générale du droit des sociétés, et non forme sociale, il s'agit d'un fondement de responsabilité civile, dont les conditions d'application seront l'œuvre d'un activisme judiciaire favorable à l'application du texte, qui restera, autrement, lettre morte. Notre conviction est que cet activisme aura lieu, mais il ne s'agit là que d'une opinion qu'il n'est pas nécessaire de détailler.

L'enjeu de la qualification d'« entreprise à mission » est bien davantage précisé dans les textes : il s'agit d'autoriser les personnes morales de droit privé qui répondent aux conditions à pouvoir se prévaloir de la qualité de « mutuelle »[49]

[45] Art. L 214-153-1 du Code monétaire et financier renvoyant au règlement (UE) n° 346/2013 du Parlement européen et du Conseil du 17 avril 2013 relatif aux fonds d'entrepreneuriat social européens.
[46] Art. 68 de la loi ESS.
[47] Art. L 322-26-8 du Code des assurances et art. L 221-19 du Code de la mutualité, instruments nécessairement étrangers au capital social pour les mutuelles qui n'en disposent pas.
[48] Art. L 931-15-1 du Code de la sécurité sociale.
[49] Voy. *supra*, note 2.

ou de « société mutuelle d'assurance », ou encore de « société à mission », selon les cas. Le statut coïncide, en somme, avec la possibilité d'en faire état publiquement, et il n'est assorti d'aucune autre conséquence juridique non plus que spécifiquement fiscale. Cette observation explique la sanction prescrite par le législateur en cas de défaillance d'une ou plusieurs des conditions fixées par lui. Selon les termes de l'article L 210-11 du Code de commerce, « le ministère public ou toute personne intéressée peut saisir le président du tribunal statuant en référé aux fins d'enjoindre, le cas échéant sous astreinte, au représentant légal de la société de supprimer la mention "société à mission" de tous les actes, documents ou supports électroniques émanant de la société ». Cette solution est déclinée aux sociétés mutuelles d'assurance et aux mutuelles.

Il en résulte que l'entreprise à mission n'est pas une nouvelle forme sociale, mais bien un « simple label »,[50] qui n'en rencontre pas moins un certain public. Depuis l'entrée en vigueur du décret d'application sur les seules sociétés à mission, 261 ont fait état d'une mission auprès du greffe du Tribunal de commerce, parmi lesquelles on trouve des sociétés historiquement dotées d'une raison d'être antérieure même à la loi Pacte, comme la Camif, différentes sociétés cotées,[51] des groupes mutualistes et un certain nombre de secteurs récurrents, comme les cosmétiques, la formation, le prêt-à-porter, les incubateurs d'entreprise et sociétés de coworking, ou encore les entreprises de promotion et de gestion immobilière.

1.2.2. Modalités

Avant de les envisager séparément, il existe un élément commun aux sociétés d'utilité sociale et aux sociétés à mission, qui tient à la nécessité de déclarer cette qualité lors de la demande d'immatriculation présentée au greffe.[52] Les sociétés sont ainsi distinctes d'autres types de groupement qui sont, de droit, entreprises de l'ESS ou entreprises à mission. Envisageons successivement les deux situations.

1.2.2.1. Modalités d'accès à la qualité d'« entreprise de l'économie sociale et solidaire »

La qualité d'« entreprise de l'économie sociale et solidaire » étant de droit pour les coopératives, associations et fondations, c'est uniquement aux sociétés commerciales désireuses d'être reconnues comme sociétés d'utilité sociale qu'un formalisme est imposé. Aux termes de l'article 1er, III, de la loi ESS, les sociétés

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50 M. Cozian, A. Viandier et F. Deboissy, *Droit des sociétés*, 34e éd., LexisNexis, 2021, n° 87, p. 28.

51 P.ex. Atos, Danone.

52 Art. R 123-53 du Code de commerce.

commerciales peuvent faire publiquement état de leur qualité d'« entreprise de l'économie sociale et solidaire » et bénéficier des droits qui s'y attachent, lorsqu'elles sont immatriculées, sous réserve de la conformité de leurs statuts, au registre du commerce et des sociétés, avec la mention de la qualité d'« entreprise de l'économie sociale et solidaire ». En l'absence de toute précision dans la loi, il y a lieu d'estimer avec d'autres[53] que c'est au greffier qu'il appartiendra de vérifier la conformité des mentions statutaires aux exigences légales.

Demeurent les modalités d'accès au bénéfice, par une société d'utilité sociale, de l'agrément comme « entreprise solidaire d'utilité sociale ».[54] Sans rentrer dans le détail des conditions de fond qui résultent de l'article L 3332-17-1 du Code du travail et tiennent à l'absence de cotation des titres en bourse, au caractère principal de l'objectif d'utilité sociale, à la charge induite par cet objectif en termes de rentabilité et aux contraintes en matière de politique de rémunération, l'agrément est délivré par le préfet du département où l'entreprise a son siège social ou, lorsque son siège est à l'étranger, son principal établissement.[55] Cet agrément fait alors l'objet d'une publication au recueil des actes administratifs de la préfecture de département, pour donner lieu à l'établissement d'une liste nationale des entreprises bénéficiant de l'agrément,[56] mise à la disposition du public à l'initiative du ministre chargé de l'économie sociale et solidaire.

1.2.2.2. Modalités d'accès à la qualité d'« entreprise à mission »

Pour les entreprises à mission autres que les sociétés commerciales, la qualité d'« entreprise à mission » est de droit dans le seul respect des conditions de fond rappelées précédemment. Ce n'est donc qu'aux sociétés commerciales qu'est imposé, par l'article L 210-11, 5°, du Code de commerce, de déclarer leur qualité de « société à mission » au greffier du Tribunal de commerce, qui la publie, sous réserve de la conformité de ses statuts aux conditions mentionnées aux 1° à 3°, au registre du commerce et des sociétés, dans des conditions précisées par décret en Conseil d'État. De manière plus explicite que les sociétés d'utilité sociale, il résulte ici nettement du texte que c'est bien au greffe que doit être vérifiée la conformité des statuts aux conditions de fond qui ont été rappelées.

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53 D. Hiez, « La richesse de la loi Économie sociale et solidaire », *Revue des sociétés*, 2015, p. 147.

54 Cet agrément étant de droit pour des entreprises de l'ESS autres que les sociétés : entreprises d'insertion ou de travail temporaire d'insertion, associations intermédiaires, ateliers et chantiers d'insertion, organismes d'insertion sociale, services de l'Aide sociale à l'enfance, centres d'hébergement et de réinsertion sociale, etc.

55 L'ensemble des modalités sont décrites par le décret n° 2015-719 du 23 juin 2015 relatif à l'agrément « entreprise solidaire d'utilité sociale », régi par l'article L 3332-17-1 du Code du travail : JORF n° 0145 du 25 juin 2015.

56 Actuellement établie par la direction du Trésor et consultable via le lien suivant : https://www.tresor.economie.gouv.fr/banque-assurance-finance/finance-sociale-et-solidaire/liste-nationale-agrements-esus.

2. LE FONCTIONNEMENT DE L'ENTREPRISE SOCIALE

Il résulte de la première partie du présent rapport que ni les entreprises de l'économie sociale et solidaire, ni les entreprises à mission ne correspondent à des formes juridiques spécifiquement identifiées par le législateur. En fonction des situations, elles continuent donc de relever des régimes qui leur sont propres. S'agissant des sociétés plus particulièrement, l'appartenance à l'une ou l'autre catégorie n'ajoute pas aux conditions de transmission ou de cession de parts sociales (qui relèveront du droit coopératif[57] ou du droit des sociétés commerciales), ni n'emporte de motifs spécifiques de dissolution, dérogatoires au droit commun dont ces sociétés continuent de relever. À cet égard, le seul élément distinctif tient non à leur dissolution, mais à la perte de leur statut aux conditions évoquées dans la partie précédente.

Les conditions rappelées afin de se voir reconnaître le bénéfice de l'une ou l'autre qualité ont ainsi essentiellement une incidence en termes de gouvernance, dont on fera état (section 2.1) avant, pour être complet, de suggérer le développement de techniques qui, si elles sont étrangères aux statuts d'« entreprise de l'économie sociale et solidaire » ou d'« entreprise à mission », n'en conduisent pas moins à accentuer la promotion du rôle social des entreprises concernées (section 2.2).

2.1. LES SPÉCIFICITÉS DE LA GOUVERNANCE DE L'ENTREPRISE SOCIALE

On exposera d'abord les principales spécificités de gouvernance concernant les entreprises de l'économie sociale et solidaire (section 2.1.1), puis celles relatives aux entreprises à mission (section 2.2.2).

2.1.1. La gouvernance des entreprises de l'économie sociale et solidaire

Si, en termes de gouvernance, les entreprises de l'économie sociale et solidaire sont tenues, d'une manière générale, de respecter les règles qui s'appliquent à leur nature juridique spécifique, c'est avec une exigence supplémentaire qui constitue une condition de fond pour en déclarer la qualité. Aux termes de l'article 1er, I, 2°, de la loi ESS, les entreprises de l'économie sociale et solidaire doivent suivre « [u]ne gouvernance démocratique, définie et organisée par les statuts, prévoyant l'information et la participation, dont l'expression n'est pas seulement liée à leur apport en capital ou au montant de leur contribution financière, des associés, des salariés et des parties prenantes aux réalisations de l'entreprise ». Sans pouvoir

[57] D. Hiez, *Sociétés coopératives*, Dalloz référence, 2018, spéc. sur le droit de retrait, p. 175 et sur la dissolution, p. 314.

évoquer le détail des règles applicables aux entreprises de l'économie sociale et solidaire, en fonction de la multiplicité de leurs formes,[58] on peut souligner ici que ces règles emportent des ajustements pour l'ensemble des différents types de groupements concernés, à l'exception des sociétés commerciales. Pour ce qui a trait aux sociétés coopératives notamment, les modifications opérées par la loi ESS ont été importantes et ont conduit en particulier, à l'article 1er de la loi du 10 septembre 1947, à reformuler les principes d'adhésion volontaire et ouverte à tous, de gouvernance démocratique, de participation économique, de formation des membres et de collaboration avec les autres coopératives, outre la généralisation du principe « une personne une voix » pour les associés coopérateurs. Un alinéa 4 de la même disposition vient encore proclamer un principe de mise en réserve prioritaire des excédents de la coopérative, tempéré par la possibilité encadrée d'attribuer ces excédents sous la forme de subventions à d'autres coopératives ou unions de coopératives, et, par exception, d'incorporer ces excédents au capital sur décision de l'assemblée générale, en vertu de l'article 16. Les principaux impératifs en termes de gouvernance et de gestion résultent, d'une part, de la possibilité ouverte aux coopératives, encadrée à l'article 3, de permettre à des tiers non sociétaires de bénéficier de leur activité dans la limite de 20 %, restreignant ainsi le traditionnel principe d'exclusivisme, et, d'autre part, de l'affirmation de la gratuité des fonctions de direction, réserve faite du paiement de frais et du versement d'indemnités compensatrices, à l'article 6, alinéa 2.

L'interrogation majeure, à défaut de précision textuelle, concerne donc les sociétés commerciales qui souhaitent prétendre à la qualité de « société d'utilité sociale ». S'il demeure aisé d'inscrire, par voie de stipulation statutaire, les principes de gestion imposés par l'article 1er de la loi ESS concernant la constitution des réserves, leur caractère impartageable et les interdictions d'amortissement ou de réduction du capital non motivée par des pertes, ou encore la dévolution des bonis de liquidation, précisée à l'article 1er, I, 3°, b), la généralité des termes de « gouvernance démocratique » ou encore de « partie prenante » peut faire difficulté. À cette fin, un guide pratique renfermant des indicateurs non exhaustifs[59] a été élaboré pour servir de source d'inspiration aux entreprises, selon des règles complexes à articuler avec les dispositions spécifiques aux différentes formes de société commerciale. L'exigence de gouvernance démocratique ne saurait s'entendre comme une généralisation absolue aux sociétés commerciales de l'exigence « une personne une voix », non plus que comme une prohibition de rémunération des fonctions de dirigeant social, mais elle emporte *a minima* la prévision statutaire d'une information et

[58] D. Hiez, « La richesse de la loi Économie sociale et solidaire », *Revue des sociétés*, 2015, p. 147.

[59] *Guide définissant les conditions d'amélioration continue des bonnes pratiques des entreprises de l'économie sociale et solidaire*, établi par le Conseil supérieur de l'économie sociale et solidaire, 2017, spéc. le thème 1, consacré aux « modalités effectives de gouvernance démocratique ».

d'une participation des salariés ainsi que d'une décorrélation minimale de la participation au capital avec le pouvoir d'influence conféré. Tout est, en la matière, renvoyé à la rédaction des statuts, ainsi que le révèle le décret d'application de la loi ESS du 13 juillet 2015.[60] Les ambiguïtés demeurent car, si l'objectif est de favoriser, aux termes de ce texte, la participation des salariés et parties prenantes, il n'est pas question de la « participation aux décisions collectives », qui constitue le droit spécifique des associés dont est déduit le droit de vote, à l'article 1844, alinéa 1er, du Code civil. La décorrélation entre la participation au capital et le droit de vote *pour les associés* est différente de la reconnaissance de véritables droits politiques à des salariés ou parties prenantes non associés. Ce n'est là qu'un des problèmes d'interprétation à soulever en application du droit commun des sociétés.

Il s'en déduit que, si une certaine liberté statutaire est ainsi reconnue aux sociétés commerciales, en marge du strict respect des principes de gestion qui ont été rappelés, cette liberté statutaire « demeure difficile à traduire dans les faits ».[61] Cette considération explique le succès remporté par des formes flexibles en termes de rédaction des statuts, autorisant plus souplement la décorrélation du droit de vote et de la détention du capital, comme les sociétés par actions simplifiées.[62] Plus généralement, le caractère démocratique a vocation à se traduire par des dialogues internes avec des organes de l'entreprise, comme le Comité social et économique pour les instances représentatives du personnel, ainsi que par la création d'organes spécifiques fonctionnant aux côtés des organes de direction sur la base du principe « une personne une voix », remis à la liberté

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60 Décret n° 2015-858 du 13 juillet 2015 relatif aux statuts des sociétés commerciales ayant la qualité d'entreprises de l'économie sociale et solidaire, article 1er : « Les statuts des sociétés mentionnées au 2° du II de l'article 1er de la loi du 31 juillet 2014 susvisée qui font publiquement état de leur qualité d'entreprise de l'économie sociale et solidaire doivent contenir les mentions suivantes :

> 1° Une définition de l'objet social de la société répondant à titre principal à l'une au moins des trois conditions mentionnées à l'article 2 de la loi du 31 juillet 2014 précitée ;
> 2° Les stipulations relatives à la composition, au fonctionnement et aux pouvoirs des organes de la société pour assurer sa gouvernance démocratique, et notamment l'information et la participation des associés, dont l'expression n'est pas seulement liée à leur apport en capital ou au montant de leur participation, des salariés et des parties prenantes aux réalisations de l'entreprise ;
> 3° L'affectation majoritaire des bénéfices à l'objectif de maintien ou de développement de l'activité de la société ;
> 4° Le caractère impartageable et non distribuable des réserves obligatoires constituées ;
> 5° La mise en œuvre des principes de gestion définis au c du 2° du II de l'article 1er de la loi du 31 juillet 2014 précitée.

61 *Rapport de l'observatoire nationale de l'ESS – Les sociétés commerciales de l'économie sociale et solidaire : premiers éléments d'analyse*, établi par le Conseil national des chambres régionales de l'économie sociale et solidaire (CNCRESS), 2017.

62 Ibid.

statutaire, ce que la SAS autorise, là encore, plus souplement[63] que les autres formes de société commerciale.

2.1.2. La gouvernance des entreprises à mission

Si, comme nous venons de l'exposer, la qualité d'« entreprise de l'économie sociale et solidaire » présente des spécificités au titre des décisions collectives relevant habituellement des associés, la gouvernance des entreprises à mission n'emporte pas modification du fonctionnement de leurs organes légaux traditionnels. À titre d'exemples, les conditions de réunion et la composition de l'assemblée générale des actionnaires d'une société anonyme demeurent celles du droit commun qui leur est applicable.

Les spécificités en termes de gouvernance tiennent en vérité à deux éléments. Le premier est constitué par la présence d'un organe interne spécifique, distinct des organes sociaux, dénommé « comité de suivi » et chargé du suivi de l'exécution de la mission énoncée sous la forme d'objectifs sociaux et environnementaux. Ses dimensions ne sont pas précisées, sous la seule réserve d'un allégement, pour les entreprises employant, au cours de l'exercice, moins de 50 salariés permanents, qui peuvent se limiter à désigner un « référent de mission », lequel peut être un salarié disposant d'un emploi effectif ou une autre personne.[64] Hors cette hypothèse, le comité de suivi doit impérativement comprendre un salarié, sans autre exigence de composition, ce qui autorise à y intégrer des associés, des dirigeants, associés ou non, ainsi que des tiers. Ce comité a en charge l'élaboration d'un rapport joint au rapport de gestion destiné à l'assemblée chargée de l'approbation des comptes de l'entreprise, et pour lequel ce comité procède à toute vérification qu'il juge opportune et se fait communiquer tout document nécessaire au suivi de l'exécution de la mission.

Le second élément résulte de la présence d'un organisme tiers indépendant désigné parmi les organismes accrédités à cet effet par le Comité français d'accréditation[65] ou par tout autre organisme d'accréditation signataire de l'accord de reconnaissance multilatéral établi par la coordination européenne des organismes d'accréditation. Cet organisme est chargé de la vérification

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[63] Article L 227-5 du Code de commerce : « Les statuts fixent les conditions dans lesquelles la société est dirigée ». Sur la direction des sociétés par actions simplifiées et sur l'étendue et les limites de la liberté statutaire, voy. M. Cozian, A. Viandier et F. Deboissy, *Droit des sociétés*, 34e éd., LexisNexis, 2021, p. 567. Plus spécifiquement, la Cour de cassation a jugé que la possible dissociation entre la propriété des actions et l'expression des droits de vote en assemblée est une caractéristique propre au statut de « société par actions simplifiée », dans un arrêt rendu par la Chambre commerciale le 7 mai 2019 (pourvoi n° 17-14.438).

[64] Art. L 210-12 du Code de commerce.

[65] Défini par le décret n° 2008-1401 du 19 décembre 2008 relatif à l'accréditation et à l'évaluation de conformité, pris en application de l'article 137 de la loi n° 2008-776 du 4 août 2008 de modernisation de l'économie.

externe de l'exécution des objectifs, sous la forme d'un avis émis tous les deux ans,[66] le premier devant intervenir dans les 18 mois suivant la déclaration de société à mission. Aux termes de l'article R 210-21, II, du Code de commerce, « sauf clause contraire des statuts de la société, cet organisme est désigné par l'organe en charge de la gestion, pour une durée initiale qui ne peut excéder six exercices. Cette désignation est renouvelable, dans la limite d'une durée totale de douze exercices ». La même disposition précise encore la manière dont cet organisme effectue sa mission. Ainsi, il peut accéder à tous les documents de la société qu'il juge utiles pour l'élaboration de son avis et peut, plus généralement, procéder à toute vérification qu'il estime utile. L'avis devra alors faire état de l'ensemble des diligences effectuées et indiquer si la société respecte ou non les objectifs qu'elle s'est fixés, en mentionnant, le cas échéant, les raisons pour lesquelles ces objectifs n'ont pas été atteints.[67]

Il apparaît ainsi que le souffle de la responsabilité sociale des entreprises qui inspire les entreprises à mission consiste à adjoindre un nouveau paramètre de gestion qui, étranger à la finalité première de la forme juridique adoptée, suppose une appréciation autonome de sa réalisation par rapport à la gestion courante. Si l'enjeu, ainsi qu'il a été évoqué, consiste uniquement en un risque de remise en cause de la qualité d'« entreprise à mission » par le ministère public ou tout intéressé, c.-à-d., en définitive, en une sanction réputationnelle, l'effectivité du bénéfice de réputation attendu suppose un aménagement institutionnel. Sans constituer une forme d'entreprise nouvelle, cela implique l'aménagement d'un cadre de gouvernance particulier, qui conduit à faire de l'entreprise à mission une catégorie transversale qui transcende, comme telle, la diversité des formes juridiques des entreprises qui peuvent y prétendre.

2.2. LE DÉVELOPPEMENT DES TECHNIQUES COMPLÉMENTAIRES AU STATUT D'« ENTREPRISE SOCIALE »

La dimension sociale de l'activité des entreprises n'est plus aujourd'hui appréhendée exclusivement en termes de statuts spéciaux, ou à partir de formes juridiques déterminées. L'évolution contemporaine est ainsi au déplacement des grands mouvements du XIXe siècle, qui avait vu se concurrencer les mouvements

[66] Le délai peut être porté à trois ans sur demande de l'entreprise, lorsqu'elle compte moins de 50 salariés permanents au titre du dernier exercice comptable ayant fait l'objet de la dernière vérification, aux termes de l'article R 210-21, II, al. 4, du Code de commerce.

[67] Ces conditions ont été ultérieurement précisées par l'arrêté du 27 mai 2021 relatif aux modalités selon lesquelles l'organisme tiers indépendant, chargé de vérifier l'exécution, par les sociétés, mutuelles et unions à mission, de leurs objectifs sociaux et environnementaux, accomplit sa mission : JORF n° 0123 du 29 mai 2021.

coopératifs, mutualistes puis associatifs. L'époque est au développement de règles là où elles sont utiles, compte tenu des intérêts en présence et, plus spécifiquement, du risque particulier associé à la dimension des entreprises. Ainsi en va-t-il du développement de l'information extra-financière à la charge des sociétés cotées, qui, d'un point de vue français, est désormais de source européenne[68] et en passe de connaître d'importantes modifications.[69]

Il existe toutefois, comme caractéristique propre au droit français, deux ensembles de techniques qui méritent d'être mentionnés. Le premier procède du droit de la responsabilité civile et est constitué par la création du devoir de vigilance par la loi du 27 mars 2017 évoquée en introduction, consistant à imposer une responsabilité pour faute prouvée aux sociétés mères d'un groupe comportant au moins 5 000 salariés en France et 10 000 salariés au niveau mondial, pour n'avoir pas adopté un plan de vigilance ou avoir établi un plan de vigilance insuffisant à identifier, ou pour prévenir le risque associé à l'activité des filiales et des sous-traitants et fournisseurs. Cette innovation française, que l'on ne peut détailler ici,[70] a convaincu le Parlement européen d'inciter à l'adoption d'une directive européenne,[71] selon l'idée directrice de la prévention des risques associés à la grande entreprise, soit, en définitive, à l'intégration d'un paramètre de prévention du risque social à l'activité de la grande entreprise, selon le recours à la technique des seuils. C'est donc par intégration au droit commun, adapté à la taille des entreprises, que la dimension sociale de l'activité des entreprises est amenée à pénétrer l'activité des groupes nationaux et internationaux.

Aux côtés de cette évolution majeure, le droit français présente comme autre tendance celle de développer, dans de multiples directions, le rôle des salariés dans les sociétés de multiples manières, qu'il s'agisse de leur place dans

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68 Directive 2014/95/UE du Parlement européen et du Conseil du 22 octobre 2014, modifiant la directive 2013/34/UE en ce qui concerne la publication d'informations non financières et d'informations relatives à la diversité par certaines grandes entreprises et certains groupes : JO L 330, 15 novembre 2014, pp. 1–9.

69 Proposition de directive du Parlement européen et du Conseil, modifiant les directives 2013/34/UE, 2004/109/CE et 2006/43/CE ainsi que le règlement (UE) n° 537/2014 en ce qui concerne la publication d'informations en matière de durabilité par les entreprises : Bruxelles, le 21 avril 2021, COM(2021)189 final, 2021/0104(COD).

70 Pour un récent point d'étape de l'application de cette loi, voy. B. Teyssié, « Le plan de vigilance. Trois années d'application », *Recueil Dalloz*, 2021, p. 1823.

71 Résolution du Parlement européen du 10 mars 2021 contenant des recommandations à la Commission sur le devoir de vigilance et la responsabilité des entreprises, P9_TA-PROV(2021)0073, (2020/2129(INL)). Sur cette résolution, voy. B. Lecourt, « Vers une directive sur le devoir de vigilance des sociétés », *Revue de sociétés*, 2021, p. 335. Depuis, la Commission a établi une proposition de directive : Proposition de directive du Parlement européen et du Conseil sur le devoir de vigilance des entreprises en matière de durabilité, modifiant la directive (UE) 2019/1937, Bruxelles, 23 février 2022, COM(2022)71 final, 2022/0051(COD).

les instances dirigeantes ou de leur association au devenir et aux résultats de l'entreprise.[72] À ce titre, techniquement, la loi ESS a introduit dans le Code de commerce un dispositif permettant la transmission de l'entreprise aux salariés, par l'instauration d'une information leur permettant de présenter une offre en cas de vente des parts sociales, actions ou valeurs mobilières donnant accès à la majorité du capital,[73] tandis que, de façon plus spécifique, la loi Pacte a ouvert un mécanisme permettant le partage de la plus-value de cession aux salariés assis sur des règles de neutralité fiscale pour en assurer l'attractivité.[74]

3. CONCLUSION

Pour conclure ce rapport, seule l'indétermination de la notion d'« entreprise sociale » empêche de fournir une réponse catégorique à la question posée aux rapporteurs nationaux, consistant à savoir s'il faut y voir une nouvelle forme d'entreprise commerciale. Si l'entreprise sociale ne correspond, au pied de la lettre, à *aucune forme juridique légalement déterminée*, l'expression évoque un développement de statuts spécifiques pour nombre d'entreprises, indépendamment de la nature spécifiquement commerciale de leur activité. Avec le rapprochement qui a été proposé ici entre les règles relatives à l'économie sociale et solidaire et celles inspirées par le mouvement de responsabilité sociale des entreprises, ce qui se fait jour n'est pas tant une nouvelle forme d'entreprise commerciale que la généralisation de certaines techniques traditionnelles du secteur coopératif et le développement de nouvelles techniques de prise en compte de l'utilité sociale des entreprises.

Davantage qu'une nouvelle forme, la notion d'« entreprise sociale » permet, en droit français, l'émergence d'un nouveau mode d'organisation de l'activité et de nouveaux paramètres de gestion des entreprises, sans modification des structures traditionnelles, qu'il s'agisse de groupements à but lucratif ou non.

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72 Pour un exposé synthétique, voy. M. Cozian, A. Viandier et F. Deboissy, *Droit des sociétés*, 34e éd., LexisNexis, 2021, pp. 500–16.

73 Art. L 23-10-1 à L 23-10-12 du Code de commerce.

74 Art. L 23-11-1 à L 23-11-4 du Code de commerce : voy. J. Chacornac et G. Duchange, « Le contrat de partage de la plus-value », *Bulletin Joly Travail*, 2020, n° 7–8, p. 33.

SOCIAL ENTERPRISES IN GERMANY

Birgit Weitemeyer

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1. CONCEPT AND APPEARANCE

1.1. THE CONCEPT OF A SOCIAL ENTERPRISE IN GERMANY

In some countries, social enterprises are registered or organised in special legal forms, and thereby acquire a special status. This is not yet the case in Germany.[1] Increasingly, however, entrepreneurs and foundations in Germany are looking for ways to translate commercial activities directly into social projects.[2] The European Commission, through its Social Business Initiative, has defined a

[1] The lack of definition was also pointed out in Parliament by members of parliament from the Green party (small group question Bündnis 90/Die Grünen, BT-Drs. 19/6844).

[2] B. Weitemeyer, 'Alternative Organisationsformen im Trend – Unternehmensstiftung, gemeinnützige GmbH, Benefit Corporation' (2022) 4/5 *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 627; N. Gröler von Ravensburg, G. Mildenberger and G. Krlev, 'Social Enterprise in Germany' in J. Defourny and M. Nyssens (eds), *Social Enterprise in Western Europe*, Routledge, New York 2021, p. 85.

social enterprise as an undertaking '(i) whose primary objective is to achieve social impact rather than generating profit for owners and shareholders, (ii) which uses its surpluses mainly to achieve these social goals, [and] (iii) which is managed by social entrepreneurs in an accountable, transparent and innovative way, in particular by involving workers, customers and stakeholders affected by its business activity'.[3] Similarly, Social Entrepreneurship Netzwerk Deutschland (SEND e.V.) defines the 'primary goal of social entrepreneurship as solving social challenges. This is achieved through the sustained use of entrepreneurial means and results in new and innovative solutions.'[4]

1.2. CHARACTERISTICS AND INDUSTRIES

In Germany, the most pragmatic characteristic is a non-profit legal form where there is no distribution of profits (non-distribution constraint) and a strong focus on social welfare. Another criterion for distinguishing between social enterprises and traditional ventures is the degree of prominence of the business concept. Innovation can relate to products and services as well as to business models and organisational forms. Approaches that are more in line with economic principles often focus on providing capital and knowledge to promote self-help, or they apply strict ethical or ecological criteria in the production process (such as fair trade, alternative energies, and so on).[5] Social enterprises pursue goals like workshops for disabled people (WISE), with the aim of integrating people with disabilities into working life, although they are traditionally less innovative and tend to assign employees simple tasks.

A third distinguishing criterion is the generation of earned income. In Germany, this also applies if fixed rates are agreed for certain services, such as in the case of the health or care sectors.[6] The definition of a social enterprise does not apply to projects that are based exclusively on donations or subsidies. The distinction between social business (often referred to as the 'social economy' or 'third sector') is not without ambiguity. In some cases, a social business is considered to be a

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3 Regulation (EU) No. 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds, OJ L 115/18 of 25.04.2013.

4 N. Ryland, 'Deutschland hat endlich eine Definition für Social Entrepreneurship!', 09.10.2019, https://www.tbd.community/de/a/deutschland-hat-endlich-eine-definition-fuer-social-entrepreneurship; K. Osbelt, 'Social Entrepreneurship – Entstehung und Bedeutung', *Social Entrepreneurship Netzwerk Deutschland (SEND e.V.)*, 2019, https://www.send-ev.de/wp-content/uploads/2021/03/definition_socialentrepreneurship.pdf.

5 T. Scheuerle, G. Glänzel, R. Knust and V. Then, *Social Entrepreneurship in Deutschland: Potentiale und Wachstumsproblematiken*, CSI University of Heidelberg, Heidelberg 2013, p. 10.

6 T. Scheuerle, G. Glänzel, R. Knust and V. Then, *Social Entrepreneurship in Deutschland: Potentiale und Wachstumsproblematiken*, CSI University of Heidelberg, Heidelberg 2013, p. 11.

special form of social enterprise.[7] Mostly, however, a social business is in the ownership of traditional charities and welfare organisations that generate revenues by charging for social services that they themselves or their subsidiaries generate and generally also operate in a less innovative manner.[8] Nevertheless, traditional welfare organisations are setting up social enterprises themselves with the help of subsidiaries.[9] Thus, the term 'social economy' is used as an umbrella term for classic third-sector organisations and social entrepreneurs.[10]

According to the third German Social Entrepreneurship Monitor, social enterprises are most frequently represented in the care and education sectors (21.5%), as well as the health and social services areas of the economy (17.5%). In third place is information and communication (16.6%).[11]

1.3. FACTS AND FIGURES

The phenomenon of social enterprises as such is 'nothing new', but the underlying strategies of these enterprises have changed.[12] The founders of the cooperative movement, Friedrich Wilhelm Raiffeisen and Hermann Schulze-Delitzsch, for example, were already acting as social entrepreneurs in the mid-19th century. However, due to the rapidly developing German social welfare state with government-subsidised welfare institutions, the idea of social enterprise spread much less quickly in Germany than in developing and emerging markets, as well as in the Anglo-Saxon industrialised countries, where social security systems are often based on inadequate or largely private provision of social services.

As there is no standard legal form for social enterprises in Germany, it is not possible to give an exact figure. The German development bank KfW collected the most recent data in 2018, indicating that 108,000 social enterprises were founded between 2012 and 2017.[13] SEND e.V. interest group has been active

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7 T. Lorenz, *Social Entrepreneurs at the Base of the Pyramid*, Metropolis, Weimar 2012.

8 T. Scheuerle, G. Glänzel, R. Knust and V. Then, *Social Entrepreneurship in Deutschland: Potentiale und Wachstumsproblematiken*, CSI University of Heidelberg, Heidelberg 2013, p. 21.

9 L. Nock, G. Krlev and G. Mildenberger, *Soziale Innovationen in den Spitzenverbänden der Freien Wohlfahrtspflege – Strukturen, Prozesse und Zukunftsperspektiven*, Bundesarbeitsgemeinschaft der Freien Wohlfahrtspflege, CSI University of Heidelberg, Berlin 2013.

10 T. Scheuerle, G. Glänzel, R. Knust and V. Then, *Social Entrepreneurship in Deutschland: Potentiale und Wachstumsproblematiken*, CSI University of Heidelberg, Heidelberg 2013, p. 9.

11 P. Hoffmann, K. Scharpe and M. Wunsch, '3. Deutscher Social Entrepreneurship Monitor 2020/2021', *Social Entrepreneurship Netzwerk Deutschland (SEND e.V.)*, pp. 18–19, https://www.send-ev.de/wp-content/uploads/2021/03/DSEM-2020-21.pdf.

12 H. Hackenberg and S. Empter, *Social Entrepreneurship – Social Business: Für die Gesellschaft unternehmen*, VS Verlag, Wiesbaden 2011, pp. 11–14.

13 *KfW Research Nr. 238*, 2019, https://www.kfw.de/PDF/Download-Center/Konzernthemen/Research/PDF-Dokumente-Fokus-Volkswirtschaft/Fokus-2019/Fokus-Nr.-238-Januar-2019-Sozialunternehmer.pdf.

since 2017 and has around 450 members (as at 2020).[14] Besides the cooperatives already mentioned, the Federal Agency for Civic Education identifies the following enterprises as 'well-known' social enterprises: Ecosia (an ecological search engine) and Discovering Hands (early detection of breast cancer through palpation of the breasts by blind women).[15] Plainly, there are no well-known social enterprises in Germany that stand out from the rest.

1.4. CERTIFICATIONS AND METRICS

The EU has meanwhile enacted the third version of the Eco Management and Audit Scheme (EMAS) of 2009,[16] which provides for a detailed certification procedure for environmentally sound production. The certification by the US organisation B Lab requires companies to meet 80 out of 200 criteria, ranging from labour concerns to environmental issues that are particularly oriented towards the common good, to attain the status of a Certified B Corporation.[17] This is also available in Germany and is used by some companies. Furthermore, in Germany there is the audit of the international association Economy for the Common Good (Gemeinwohlökonomie e.V.). Phineo gAG, founded by the Bertelsmann Foundation and other actors, is seeking to create greater transparency through a social marketplace whereby non-profit organisations are examined using an impact analysis.[18] Private initiatives[19] such as Transparency International Deutschland, DZI[20] or Deutscher Spendenrat[21] monitor the spending of donations via their donation seals.

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14 S. Rabl, 'Social Entrepreneurs: Zwischen den Stühlen', 23.04.2019, https://www.diepresse.com/5614815/social-entrepreneurs-zwischen-den-stuehlen.

15 Y. Yahyaoui, 'Social Entrepreneurship. Herausforderungen und Bedeutung für die Gesellschaft', 26.03.2021, https://www.bpb.de/apuz/im-dienst-der-gesellschaft-2021/329330/social-entrepreneurship-herausforderungen-und-bedeutung-fuer-die-gesellschaft.

16 A. Schmidt-Räntsch, 'Die Novelle 2010 des Europäischen Umweltmanagements EMAS – Eine Partnerschaft mit Unternehmen als strategisches Konzept zur Erfüllung von Umweltzielen' (2010) 3 *Zeitschrift für Europäisches Umwelt- und Planungsrecht* 123.

17 F. Möslein, 'Zertifizierung nachhaltiger Kapitalgesellschaften: Regimevergleich und flankierende Maßnahmen' in M. Burgi and F. Möslein (eds), *Zertifizierung nachhaltiger Kapitalgesellschaften: "Good Companies" im Schnittfeld von Markt und Staat*, Mohr Siebeck, Tübingen 2021, pp. 3, 5–8.

18 I. Epkenhans, 'Transparenz über die Wirkungen gemeinnütziger Aktivitäten: Die Arbeit der PHINEO gAG' in J. Alvermann (ed.), *Bürokratieentlastung des Dritten Sektors und des bürgerschaftlichen Engagements: Notwendigkeit, Praxis und Perspektiven*, AWV-Verlag, Eschborn 2011, p. 271.

19 G.V. Krönes, 'Spendensiegel auf dem Prüfstand' in M. Gmür, R. Schauer and L. Theuvsen (eds), *Performance Management in Nonprofit-Organisationen. Theoretische Grundlagen, empirische Ergebnisse und Anwendungsbeispiele*, Haupt Verlag, Bern/Stuttgart/Vienna 2013, pp. 377–85.

20 https://www.dzi.de/.

21 https://www.spendenrat.de/.

Investors and stakeholders expect social entrepreneurs to demonstrate their success or their social impact – that is, the (positive) effects on their subject area – with the help of an impact analysis. The methods and standards of the private sector for measuring impact can hardly be used for social enterprises. There still exist no binding, uniform reporting standards for the reporting of social impact. The organisation Ashoka has developed the Social Reporting Standard, which proposes a framework for reporting. The method helps to document and communicate the impact chain of programmes, projects and organisations. A distinction is made between output (for example, the number of unemployed young people who are trained) and outcome (the number of young people who get a job).[22] The fragmentation of these initiatives is largely considered to be an obstacle to a broader public response.[23]

Nevertheless, a study by the University of Heidelberg's Research Centre for Social Investment and Innovation (CSI) concludes that the current accountability and transparency status in the third sector cannot be deemed visibly problematic. On the contrary, in Germany there is a greater reliance on state and regulatory monitoring and lesser reliance on the public interest.[24] According to German regulatory principles, the role of non-profit status for tax purposes is that of an overarching organisational statute providing for the recognition of eligible non-profit organisations. It acts like a state seal of approval, opens access to public or private funding and other benefits, ranging from fee reductions, for instance, for the broadcasting contribution, to the requirement of cooperation between social enterprises under social law as an exception from antitrust law, in that many laws contain provisions that are linked to non-profit organisations or purposes.[25] Government grants are often made dependent on the tax-exempt status of an organisation.[26]

1.5. FUNDING AND FINANCE

A recent comparative study by the Heidelberg CSI found that access to funding is the main challenge for social enterprises.[27] Due to the special financial status

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22 https://www.wirkung-lernen.de/.

23 H.K. Anheier, A. Beller and R. Haß, 'Accountability und Transparenz des Dritten Sektors in Deutschland: Ein Paradox?' (2011) 3 *Forschungsjournal Soziale Bewegungen* 96.

24 H.K. Anheier, A. Beller and R. Haß, 'Accountability und Transparenz des Dritten Sektors in Deutschland: Ein Paradox?' (2011) 3 *Forschungsjournal Soziale Bewegungen* 96.

25 O. Cremers, *Steuerliche Gemeinnützigkeit und allgemeine Rechtsordnung*, Nomos Verlag, Baden-Baden 2022.

26 S. Schauhoff in S. Schauhoff (ed.), *Handbuch der Gemeinnützigkeit*, 3rd ed., C.H. Beck, Munich 2010, Grundlegung Rn. 37.

27 G. Krlev, S. Sauer, K. Scharpe, G. Mildenberger, K. Elsemann and M. Sauerhammer, 'Finanzierung von Sozialen Innovationen – Internationale Vergleichsstudie', *Centrum für*

of social enterprises, their financing is very often a challenging task, because the return on investment for investors is limited due to the income models of social enterprises.[28] Typically, the sources of income vary. Income is generated through the sale of products, via donations, or from private or public funding.[29] Some 23.2% of social enterprises generate income exclusively through market activities, while 11.7% obtain income exclusively through non-market activities (and may therefore not be defined as social enterprises from a strict point of view). In the case of non-market activities, some 34.3% of the funding comes from public funding sources and another 27.3% from donations from private individuals.[30]

In 2010, the federal government adopted the promotion of social entrepreneurship as part of the National Engagement Strategy. KfW has had a financing programme for social entrepreneurship since 2012.[31] State funding through KfW requires a business model that should focus not only on social involvement, but also on generating profits. The KfW therefore used to impose requirements as to the legal form: only commercial enterprises could get a loan; non-profit companies were not supported. Since then, the KfW has changed its strategy, and supports non-profit organisations as well.[32] In the meantime, social enterprises are more strongly addressed in the federal government's funding and advisory services. These include, for example, loan, equity and mezzanine support (for example, ERP Start-up Loan – StartGeld, EXIST, Micromezzanine Fund, and ERP VC Fund Investments), the KfW programme IKU – Investment Loan for Municipal and Social Enterprises, and the project Generationsbrücke Deutschland (2014–2019), in which more

Soziale Investitionen und Innovationen (CSI University of Heidelberg and SEND e.V.), Social Entrepreneurship Netzwerk Deutschland (SEND e.V.), 26.10.2021, pp. 4, 11, https://www.send-ev.de/wp-content/uploads/2021/10/Finanzierung_Sozialer_Innovationen.pdf.

28 T. Scheuerle, G. Glänzel, R. Knust and V. Then, *Social Entrepreneurship in Deutschland: Potentiale und Wachstumsproblematiken*, CSI University of Heidelberg, Heidelberg 2013, pp. 65–84, https://www.kfw.de/PDF/Download-Center/Konzernthemen/Research/PDF-Dokumente-Studien-und-Materialien/Social-Entrepreneurship-in-Deutschland-LF.pdf.

29 P. Hoffmann, K. Scharpe and M. Wunsch, '3. Deutscher Social Entrepreneurship Monitor 2020/2021', *Social Entrepreneurship Netzwerk Deutschland (SEND e.V.)*, p. 42, https://www.send-ev.de/wp-content/uploads/2021/03/DSEM-2020-21.pdf.

30 P. Hoffmann, K. Scharpe and M. Wunsch, '3. Deutscher Social Entrepreneurship Monitor 2020/2021', *Social Entrepreneurship Netzwerk Deutschland (SEND e.V.)*, p. 43, https://www.send-ev.de/wp-content/uploads/2021/03/DSEM-2020-21.pdf.

31 Federal Ministry for Family Affairs and KfW present new instrument for financing the growth of social enterprises, 25.10.2011, https://www.bmfsfj.de/bmfsfj/aktuelles/alle-meldungen/bundesfamilienministerium-und-kfw-stellen-neues-instrument-zur-wachstumsfinanzierung-von-sozialunternehmen-vor-97002.

32 https://www.kfw.de/inlandsfoerderung/%C3%96ffentliche-Einrichtungen/Soziale-Organisationen-und-Vereine/F%C3%B6rderprodukte/Investitionskredit-(148)/.

than 200 cooperation partners (such as elderly care facilities, daycare centres and schools) are currently involved.[33]

Since 2003, there have been venture capitalists for social enterprises (e.g. the BonVenture Group) in Germany. Social venture capitalists do not expect a financial return (or only a small one), but they do expect a social return.[34] The Social Venture Fund finances social enterprises and invests in the areas of education, integration, life in old age, combating long-term unemployment, and health. Financiers are mostly high-net-worth individuals.[35] In order to activate private investment capital to promote social entrepreneurship in the EU, the European Social Entrepreneurship Fund (EuSEF) was created launched by the European Commission in 2011. The EuSEF is a label for private (investment) funds that must comply with certain uniform requirements that apply throughout the EU.[36] As in a normal fund, the diversification in the portfolio should help to reduce the overall risk of the social investment if an organisation or project proves not to be effective. The donors sign a contract with the GLS Bank, a cooperative bank, which collects the donations.

Foundations support social enterprises without any repayment obligation, such as the Siemens Foundation, the Vodafone Foundation, the Robert Bosch Foundation or the Haniel Foundation.[37] The Social Entrepreneurship Network Germany as a network association, as well as the Ashoka Foundation, ProjectTogether and Social Impact, offer practical help, advice and networking through various funding programmes.[38]

Numerous prizes and awards are given to support projects. In 2011, the Social Entrepreneurship Academy was founded, a cooperation project of the four Munich universities.[39] It awards annual prize money of €48,000

[33] Answer of the Federal Government to the small group question of the parliamentary group Bündnis 90/Die Grünen, BT-Drs. 19/7293.

[34] Bundesverband Deutscher Kapitalbeteiligungsgesellschaften e.V., https://web.archive.org/web/20140103141935/http:/www.bvkap.de/privateequity.php/cat/137/aid/380/title/Beispiel:_BonVenture_-_Portrait.

[35] V. Ege, C.-T. Klaiber and R. Prügl, 'Impact Investments – Generierung einer wirkungsorientierten sozialen und finanziellen Rendite als neuer Investmentansatz für Family Offices und Stiftungen' (2021) 5 *Zeitschrift für Familienunternehmen und Strategie* 192.

[36] Regulation (EU) No. 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds.

[37] B. Sahlmüller, I. Nazlier and R. Antes, 'Mit Collective Impact und Social Entrepreneurship im Ökosystem wirken: 7 Impulse aus dem Projekt „Bildung als Chance"' in R. Berndt, P. Kreutter and S. Stolte (eds), *Zukunftsorientiertes Stiftungsmanagement: Herausforderungen, Lösungsansätze und Erfolgsbeispiele*, Springer Gabler Verlag, Wiesbaden 2018, p. 251.

[38] Bundesministerium für Wirtschaft und Energie (ed.), *GründerZeiten 22 – Existenzgründungen im sozialen Bereich*, 2020, p. 12, https://www.bmwi.de/Redaktion/DE/Publikationen/Gruenderzeiten/infoletter-gruenderzeiten-nr-22-existensgruendung-im-sozialen-bereich.pdf?__blob=publicationFile&v=3.

[39] https://heldenrat.wordpress.com/2011/02/28/social-entrepreneurship-forschung-bildung/.

to the winners.[40] The Schwab Foundation for Social Entrepreneurship awards the international prize Social Entrepreneur of the Year.[41] Every year, the Startsocial competition honours 100 social organisations for their commitment.[42]

2. LACK OF SPECIALISED LEGAL FORMS FOR SOCIAL ENTERPRISES

Since all corporations and cooperatives are allowed to waive, in their articles of association, their right to make a profit and pursue social, ecological or other non-profit purposes, specific legal forms for social enterprises have not yet been developed.[43] Non-profit corporations, especially the flexible GmbH, have proven to be an important legal form for social enterprises. This is in stark contrast with other legal systems.[44] Swiss law has allowed the limited liability company to engage in non-commercial activities only since 2008.[45] In US corporate law, the corporation can be used for a variety of purposes,[46] but there the doctrine of shareholder value has contributed to legal uncertainty about the extent to which the 'normal' for-profit corporation may be used for social or mixed purposes, and has thus also led to the development of new legal forms oriented towards the common good.[47]

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40 M. Wunsch, '15 Wettbewerbe für Deine Idee', 12.07.2017, https://www.tbd.community/de/a/wettbewerbe-startup-social-nachhaltig.

41 M. Kasper-Claridge, 'The Schwab Foundation: 20 years of inspiring entrepreneurs', 24.09.2018, https://www.dw.com/en/the-schwab-foundation-20-years-of-inspiring-entrepreneurs/a-45615739.

42 C. Eipert, 'Gründen? Unbedingt! – Der Social Start-Up Guide', 08.03.2019, https://www.relaio.de/wissen/der-social-start-up-guide/.

43 F. Möslein, 'Zertifizierung nachhaltiger Kapitalgesellschaften: Regimevergleich und flankierende Maßnahmen' in M. Burgi and F. Möslein (eds), *Zertifizierung nachhaltiger Kapitalgesellschaften: "Good Companies" im Schnittfeld von Markt und Staat*, Mohr Siebeck, Tübingen 2021, pp. 3, 21–22.

44 B. Momberger, *Social Entrepreneurship – Im Spannungsfeld zwischen Gesellschafts- und Gemeinnützigkeitsrecht*, Bucerius Law School Press, Hamburg 2015, pp. 242–43; regarding France: H. Fleischer, 'Unternehmensinteresse und intérêt social: Schlüsselfiguren aktienrechtlichen Denkens in Deutschland und Frankreich' (2018) 5 *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 703, 728–31; regarding section 172(1) UK Companies Act 2006: H. Fleischer, 'Gesetzliche Unternehmenszielbestimmungen im Aktienrecht' (2017) 4 *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 411, 419–20.

45 Code of Obligations (law on limited liability companies as well as amendments to the law on shares, cooperatives, commercial register and company law), amendment of 16.12.2005, BBl. 2005, 7289.

46 H. Fleischer and S. Mock, 'Gesellschaftsverträge und Satzungen im Wandel der Zeit' (2020) 5 *Neue Zeitschrift für Gesellschaftsrecht* 161, 164.

47 F. Möslein and A.-C. Mittwoch, 'Soziales Unternehmertum im US-amerikanischen Gesellschaftsrecht – Benefit Corporations und Certified B Corporations' (2016) 80 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 399, 401–06.

Therefore, traditional legal forms for business enterprises serving as legal forms for social enterprises are the limited liability company (GmbH), public limited company (*Aktiengesellschaft*, AG) and cooperative (*Genossenschaft*). Due to its prevalence among social enterprises, the primary legal form is the GmbH.[48] All permissible purposes – that is, those not prohibited by criminal law – may be chosen, whether non-profit, commercial or hybrid. It is estimated that there are around 25,300 non-profit GmbHs.[49] The new legal form 'entrepreneurial company with limited liability' (*Unternehmergesellschaft haftungsbeschränkt*, UG), which was created in 2008[50] and is a sub-form of the GmbH according to section 5a Limited Liability Company Act (GmbHG), is suitable for smaller social enterprises. Here it is possible to set up the company without capital, or with a minimum capital of only €1 per shareholder.

Public limited companies[51] and cooperatives are used by large social enterprises and commercially active self-help organisations with cooperative structures.[52] In the course of the amendment of the German Cooperative Societies Act (GenG)[53] in 2006 it was clarified that, in addition to promoting the economic interests of cooperatives, their social or cultural interests can also be promoted (section 1(1) GenG), which means that cooperatives can also be used as social enterprises. Village shops in the form of cooperatives guarantee local sustainability and create communal places to meet,[54] while energy cooperatives generate renewable energy.[55]

The advantage of the public limited company is that many interested parties can participate in the organisation as shareholders. One reason for this is that the executive board of an AG, unlike the managing director of a GmbH, is not subject to shareholder instructions (section 76 Public Limited Company Act, AktG) and can therefore administer the company independently in its day-to-day business according to entrepreneurial guidelines. Shareholders in a company (GmbH) are the owners of (at least) one share in the company. Shares in the company are in principle freely transferable (section 15(1) GmbHG). Both the assignment of the shares and the transaction on which the assignment is based (for example,

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[48] B. Momberger, *Social Entrepreneurship – Im Spannungsfeld zwischen Gesellschafts- und Gemeinnützigkeitsrecht*, Bucerius Law School Press, Hamburg 2015, pp. 87–95, 103.

[49] B. Weitemeyer, 'Fallstricke der gGmbH' (2021) 2 *GmbH-Rundschau* 57.

[50] Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) vom 23.10.2008, BGBl. I 2008, 2026.

[51] I.J. Weber, *Die gemeinnützige Aktiengesellschaft*, Bucerius Law School Press, Hamburg 2014.

[52] C. Picker, *Genossenschaft und Governance*, Mohr Siebeck, Tübingen 2019, p. 167.

[53] Gesetz zur Einführung der Europäischen Genossenschaft und zur Änderung des Genossenschaftsrechts v. 18.08.2006, BGBl. I, 1911.

[54] B. Bösche, 'Wirtschaftliche Vereine als kleine Genossenschaften' (2011) 3 *Zeitschrift für das Recht der Non Profit Organisationen* 82.

[55] B. Momberger, *Social Entrepreneurship – Im Spannungsfeld zwischen Gesellschafts- und Gemeinnützigkeitsrecht*, Bucerius Law School Press, Hamburg 2015, pp. 77–84.

a purchase agreement) require notarial certification (section 15(3) and (4) GmbHG). The articles of association may provide for restrictions on assignment (section 15(5) GmbHG (*Vinkulierung*)). For example, the effectiveness of the assignment can be linked to the consent of all shareholders or an affirmative majority resolution of the shareholders' meeting.[56] In the case of a public limited company, the transfer of membership can be made more simply and without a notary by merely handing over the share.

In the GmbH and AG, the investors as shareholders have all the normal shareholder rights. Their voting power is determined by the size of their shareholding. In a cooperative, the shares also generally grant only one vote to each shareholder (one person, one vote). Only members who particularly promote business operations can be granted more votes, but only up to three votes (section 43(3) GenG).[57] In the cooperative, therefore, the participation of the cooperative members is guaranteed irrespective of their financial commitment; the entity is not structured in a capitalist way. In fact, cooperatives are the legal form most suitable for the commercial activities of social enterprises. However, the approximately €1,500–3,000 in auditing fees that a cooperative must pay for the compulsory audit at an auditing association are unaffordable for smaller social enterprises.[58] Proposals to simplify the compulsory audit have not yet gained acceptance.[59]

For tax and business administration reasons, as well as the lack of special legal forms for social enterprises, a hybrid double structure consisting of a for-profit limited liability company and a non-profit supporting association, a holding foundation or a sponsoring limited liability company is often chosen. In this way, for example, a variety of interests can be bundled together in an association, and it can act in a non-profit capacity, while the subsidiary is liable for tax, generates income for the association and can conclude contracts with the outside world in a legally sound manner (section 37(2) GmbHG). In contrast to the standard association solution, additional costs are incurred due to the notarial certification requirements necessary of the limited liability company (GmbH), its obligatory entry in the commercial register and the accounting obligation.

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[56] C.H. Seibt in F. Scholz (founder), *Kommentar zum GmbH-Gesetz*, 12th ed., Verlag Dr. Otto Schmidt, Cologne 2018, § 15 Rn. 119–34.

[57] C. Picker, *Genossenschaft und Governance*, Mohr Siebeck, Tübingen 2019, pp. 445–48.

[58] R. Wolff, 'Ein passendes Rechtskleid für kleinkooperative Vereinigungen? – Zum Referentenentwurf eines Gesetzes zur Einführung der Kooperationsgesellschaft und zum weiteren Bürokratieabbau bei Genossenschaften' (2014) *Non Profit Law Yearbook 2013/2014* 19, 22.

[59] R. Wolff, 'Ein passendes Rechtskleid für kleinkooperative Vereinigungen? – Zum Referentenentwurf eines Gesetzes zur Einführung der Kooperationsgesellschaft und zum weiteren Bürokratieabbau bei Genossenschaften' (2014) *Non Profit Law Yearbook 2013/2014* 19.

3. STAKEHOLDER INTERESTS, PUBLIC BENEFIT AND ENFORCEMENT

The extent to which the interests of stakeholders may be considered in standard commercial businesses has been the subject of debate for 200 years.[60] Today, it is recognised that managers of German public limited companies are not primarily bound by shareholder value but must serve a broader corporate interest. They therefore enjoy greater discretion to consider the interests of stakeholders.[61] In the case of the limited liability company (GmbH), the shareholders directly determine the company's objectives, which can range from pure profit maximisation to total non-profit. Cooperatives are not aimed at profit maximisation from the outset, but rather promote the business activities of their members or their social or cultural interests through joint business operations.

Insofar as corporations are not-for-profit organisations, for tax purposes they must stipulate these requirements in the articles of association. Shareholders may then not receive in return more than the paid-in capital shares (cash contributions) plus the fair value of their contributions in kind, not even in the event of their withdrawal from the corporation or the dissolution of the corporation. The loss of the increase in value is not immoral according to section 138 BGB, as corresponding book value clauses are classified in the case of a significant disproportion between the nominal value and the settlement credit for for-profit companies, but is rather a logical consequence of the voluntarily entered tax exemption and is therefore also insolvency-proof.[62]

According to German regulation principles, non-profit status for tax purposes serves the function of an overarching organisational status for non-profit organisations that are eligible for funding. It functions like a seal of approval from the state.[63] At its core, this status is based on the non-distribution constraint. Public trust in non-profit organisations is also strengthened by the fact that the establishment of the non-profit purposes in the articles of association, as required by section 60 General Fiscal Tax Code Act (AO), documents the organisation's 'eligibility for promotion' to a certain extent to the outside world,

60 M. Habersack, 'Gemeinwohlbindung und Unternehmensrecht' (2020) 220 *Archiv für die civilistische Praxis* 594.

61 A.-C. Mittwoch, 'Zertifizierung als Mosaikstein unternehmensrechtlicher Nachhaltigkeit' in M. Burgi and F. Möslein (eds), *Zertifizierung nachhaltiger Kapitalgesellschaften: "Good Companies" im Schnittfeld von Markt und Staat*, Mohr Siebeck, Tübingen 2021, pp. 51, 67–69.

62 Most recently OLG Hamm, ZIP 2022, 1205; R. Seer in K. Tipke/H.W. Kruse, AO, 159. Lfg., 2020, §55 AO Rn. 21; J. Leisner-Egensperger, DStZ 2008, 292, 299.

63 S. Schauhoff in S. Schauhoff (eds), *Handbuch der Gemeinnützigkeit*, 3rd ed., C.H. Beck, Munich 2010, Grundlegung Rn. 37.

and the tax authorities monitor whether the non-profit status in the statutes also corresponds with the actual management of the organisation. This is in line with the hypothesis of the US economist and legal scholar Henry Hansmann, who ascribes the existence of non-profit organisations to a contractual failure because of a deficiency of information.[64]

Accordingly, the enforcement is undertaken solely by means of tax law. Should the articles of association comply with the legal requirements, but later it transpires that the management failed to comply with the provisions of the articles of association, this results in the non-profit enterprise not being tax-exempt for the entire past assessment period, and therefore liable for the payment of taxes in the ordinary way. Any tax savings from these periods must be refunded to the tax authorities.[65] The most severe contravention is when a non-profit corporation does not comply with the principle of asset retention – that is, for instance, by distributing profits to the executive board or members on account of excessive salaries, which violates section 55(1) no. 1 AO. In such cases, the tax benefit should be forfeited not only for the assessment period in which the violation occurred, but also for periods prior to that (section 61(3) AO).[66] The objective of this harsh penalty is to prevent organisations from collecting tax-privileged funds in one year and deciding to 'give up' their non-profit status the next year and distribute the state-subsidised funds to the board or members. The obligation to pay back taxes extends not only to the taxes that would have been incurred by the non-profit organisation itself (such as, in particular, corporate income tax and trade tax),[67] but also, where applicable, to taxes that its donors would otherwise have been obliged to pay, but which were exempted due to their donation to the supposedly non-profit organisation, pursuant to section 10b (4) of the German Income Tax Act (EStG). This is because the donor should be able to rely on a donation receipt once he has received it and can therefore claim his donation as income-reducing in any case without having to fear an obligation to pay tax arrears.[68] In addition, managers may be held personally liable for the payment of the tax arrears pursuant to section 10b (4) (2)–(4) EStG.

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64 H.B. Hansmann, 'The Role of Nonprofit Enterprise' (1989) 89 *The Yale Law Journal* 835.

65 E.-M. Gersch in F. Klein and G. Orlopp (founder), *Abgabenordnung*, 15th ed., C.H. Beck, Munich 2020, § 63 AO Rn. 2.

66 U. Koenig in U. Koenig (ed.), *Abgabenordnung*, 4th ed., C.H. Beck, Munich 2021, § 61 AO Rn. 7, § 63 AO Rn. 7.

67 H. Bott in S. Schauhoff (eds), *Handbuch der Gemeinnützigkeit*, 3rd ed., C.H. Beck, Munich 2010, §10 Rn. 90–92.

68 Sections 10b (4) sentence 1 EStG, 9(3) sentence 1 KStG, 9 no. 5 sentence 13 of the German Trade Tax Act (GewStG).

4. THE DEBATE ABOUT DISCLOSURE AND REPORTING

The non-profit GmbH (gGmbH) (or AG and cooperative) is already a formal trader according to its legal form, irrespective of its non-profit status, and is therefore obliged to register and keep accounts. According to section 325 German Commercial Code (HGB), the annual financial statements must be submitted to the electronic Federal Gazette and published. Anyone is permitted to inspect the commercial register (section 9 HGB). Legislators and standard-setting professional bodies have also created framework concepts for non-financial reporting, through which companies must disclose their corporate social responsibility (CSR) measures according to sections 289b and 289c or sections 315b and 315c HGB.[69] Due to the disclosure and auditing obligations (sections 336(2) and 339(3) HGB and section 53 GenG), which are also applicable, there is sufficient protection for legal transactions and section 1 GenG ensures that the cooperatives do not seek to maximise profits.

For a non-commercial association (*Idealverein*) there are only the somewhat simplified provisions of sections 27(3), 666, 259 and 260 of the German Civil Code (BGB), which only oblige associations to draw up an orderly list of their income and expenditure. As a rule, there is no obligation to publish the annual financial statements. Section 325 HGB only applies to corporations; for non-profit associations,[70] an obligation to publish can only arise from the Publicity Act (PublG) if the very stringent thresholds of section 1 are exceeded. It is only when non-commercial associations operate a commercial enterprise within the meaning of section 1 HGB (for example, where a football club has a commercial league division that is not outsourced to subsidiaries) that they are to be entered in the commercial register as traders pursuant to section 33 HGB. They are required to comply with the regulations for traders, such as the preparation of a commercial balance sheet pursuant to section 242 HGB.[71] But it is unclear when an economic activity of an association constitutes a commercial enterprise within the meaning of section 1 HGB, and a large

[69] Corporate Social Responsibility Directive of the EU, Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014, OJ L 330/1 of 15.11.2014; European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, 21.04.2021, COM(2021)189; G. Lanfermann and O. Scheid, 'Vorschlag der EU-Kommission zur Corporate Sustainability Reporting Directive (CSRD)' (2021) 23 *Der Betrieb* 1213. There are also private standard-setters, e.g. the Global Reporting Initiative and the International Integrated Reporting Council (IIRC), which merged on 09.06.2021 with SASB to form the Value Reporting Foundation.

[70] Section 3(1) no. 3 PublG.

[71] R. Hüttemann, 'Non Profit-Organisationen als Kaufleute' in *Privat- und Wirtschaftsrecht in Europa: Festschrift für W.-H. Roth zum 70. Geburtstag*, C.H. Beck, Munich 2015, p. 241.

number of associations are not registered under section 33 HGB despite meeting the requirements.

Non-profit organisations are accountable to the tax authorities, which examine their financial reporting according to the requirements of the non-profit tax law under sections 51 et seq. AO. However, due to tax confidentiality (section 30 AO), the financial authorities are required to maintain secrecy vis-à-vis the public. The existing external review of non-profit organisations in the legal forms of associations and foundations by the tax authorities is therefore widely considered to be insufficient, even by international standards.[72] Therefore, as of 1 January 2024, a register of beneficiaries will be introduced in which the status of the organisation as a non-profit organisation can be inspected.[73]

5. TAX EXEMPTION AND LIMITATION ON TRADING

The German state supports corporations whose activities are of particular value to society by granting them tax advantages. Non-profit corporations are exempt from income taxes provided they do not maintain a commercial business operation. Specifically, this includes exemption from the 15% corporate income tax (section 5(1) no. 9 of the German Corporate Income Tax Act, KStG) and from around 14–15% trade tax (section 3 no. 6 of the German Trade Tax Act, GewStG). In addition, there are tax exemptions for property tax (section 3(1) no. 3 lit. b of the German Property Tax Act, GrStG)[74] and the VAT rate for services provided by non-profit corporations[75] is reduced from 19% to 7% (section 12(2) no. 8 lit. a of the German Value Added Tax Act, UStG).[76] Furthermore, VAT law contains several special tax exemptions that are linked to non-profit status. Finally, charitable donations to non-profit entities can be received tax-free as non-taxable increases in assets (section 13(1) no. 16 lit. b, c and no. 17 of the German Inheritance and Gift Tax Act, ErbStG).

Insofar as the corporation is engaged in commercial activities, the tax concession depends on the type and scope of the commercial activity. Pure asset

72 B. Vogt, *Publizität im Stiftungsrecht. Analyse der geltenden Rechtslage und Vorschläge für eine umfassende Reform der stiftungsrechtlichen Publizität*, Bucerius Law School Press, Hamburg 2013.

73 Article 28 of the Annual Tax Act (JStG) 2020, section 60b AO-new.

74 Real estate of a non-profit corporation is exempt from property tax if it is used for beneficial purposes, J. Kühnold in O.-G. Lippross and W. Seibel (eds), *Basiskommentar Steuerrecht*, 129th ed., Verlag Dr. Otto Schmidt, Cologne 2022, § 3 GrStG Rn. 27.

75 These are usually sales from special-purpose operations or asset management.

76 A non-profit status does not automatically lead to exemption from VAT. The differentiation between VAT and non-profit law results from the fact that non-profit law is national law, whereas VAT law is strongly influenced by European law; R. Kohlhepp, 'Rechtsprechung zum Gemeinnützigkeitsrecht 2017/2018' (2019) 4 *Deutsches Steuerrecht* 129, 136 and comprehensively B. Weitemeyer, M. Achatz and S. Schauhoff (eds), *Umsatzsteuer für den Nonprofit-Sektor*, Verlag Dr. Otto Schmidt, Cologne 2019.

management – that is, the use of assets, for example through capital investment or leasing (section 14(3) AO) – is allowed if the funds are not withdrawn from the corporation's actual purpose in the long term.[77] If the activities of a non-profit corporation are limited to asset management, this area remains tax-exempt. This also holds true for spin-off for-profit GmbHs as subsidiaries of non-profit organisations. The collection of profits does not constitute a commercial business operation at the level of the non-profit organisation if the holding of the participation is limited to the usual exercise of shareholder rights.[78]

If, on the other hand, the corporation pursues an independent consistent activity through which income or other economic benefits are generated and which goes beyond the scope of asset management, then it maintains a (partially) taxable commercial business operation.[79] Due to the exclusivity requirement of section 56 AO, the commercial operation must at least indirectly serve the purpose of fulfilling the tax-privileged objectives, by regularly raising funds.[80] The partial tax liability results from the fact that the non-profit corporation on the one hand promotes the tax-privileged purpose, but on the other hand is in competition with taxable businesses of the same industry. For reasons of competition impartiality, the corporation is taxable (in other words, partially taxed) on the business operation but remains tax-exempt in all other respects.[81]

According to section 21 BGB, the non-commercial association pursues charitable purposes, but may also engage in commercial activities, provided these do not result in profits being distributed to individual members and are secondary to the main charitable purpose. However, even a primary purpose that involves exchanges for payment has been deemed permissible by the most recent so-called KiTa cases (*KinderTagesstätte* – childcare provider case) of the Federal Supreme Court,[82] provided it can be assumed that this activity serves only charitable purposes and is tax exempt. According to the KiTa cases of the Federal Supreme Court, an important indication for assessing whether the commercial business operation is secondary and subordinate to the main non-profit purpose and auxiliary to its pursuit is the recognition of the association as a non-profit organisation for tax purposes.[83] The altruism requirement ensures that the association does not primarily pursue its own

[77] In this respect, the requirement of timely application of funds is particularly relevant, section 55(1) no. 5 sentence 3 AO, R. Hüttemann, *Gemeinnützigkeits- und Spendenrecht*, 5th ed., Verlag Dr. Otto Schmidt, Cologne 2021, Rn. 6.40.

[78] BFH, Urt. v. 25.08.2010 – I R 97/09, BFH/NV 2010, 312.

[79] R. Hüttemann, *Gemeinnützigkeits- und Spendenrecht*, 5th ed., Verlag Dr. Otto Schmidt, Cologne 2021, Rn. 6.100.

[80] R. Hüttemann, *Gemeinnützigkeits- und Spendenrecht*, 5th ed., Verlag Dr. Otto Schmidt, Cologne 2021, Rn. 6.50.

[81] K. Blesinger in R. Kühn (founder) and A. von Wedelstädt (ed.), *Abgabenordnung und Finanzgerichtsordnung*, 22nd ed., Schäffer-Poeschel Verlag, Stuttgart 2018, § 64 AO Rn. 2.

[82] BGH, Beschl. v. 16.05.2017 – II ZB 7/16, NJW 2017, 1943.

[83] BGH, Beschl. v. 16.05.2017 – II ZB 7/16, NJW 2017, 1943 Rn. 22–27.

commercial goals.[84] Since the right to freedom of association guaranteed under Article 9(1) of the German Constitution (GG) grants persons the right to form associations, it is not necessary to use alternative corporate forms if the protection of creditors does not require this.

When commercial activities are further developed, associations often outsource these activities to wholly owned subsidiaries for business reasons (liability, governance, independence and gaining managing directors). However, if the association is not supposed to operate exclusively on a non-profit basis, the scope of the permitted commercial activities is still not conclusively clarified.[85] Unlike as is the case with an association, for the gGmbH it is irrelevant whether a commercial purpose or a non-profit purpose is pursued.[86]

If, however, social enterprises provide for even partial profit distribution, or profit distribution from the association's activities in a concealed manner by way of excessive salaries or other benefits, not only is the non-profit status at risk, but the indirect effect for the civil law right of association is also jeopardised. However, appropriate remuneration of members or board members on the basis of an employment relationship does not prevent the association from being registered as a non-profit organisation. Nevertheless, if one wants to avoid uncertainty with regard to appropriate salary payments, hybrid models are the better option.[87]

Provided, however, that the social enterprise predominantly serves the commercial purposes of its members – say, through the joint operation of a village shop, the procurement of energy or the purchase of ecologically produced food at reduced prices – the current case law on associations is of no assistance. The limited liability company is not suited to structures with a large number of committed members because of its notarial foundation and the time-consuming process associated with changing members. Some state administrations have started to revive the legal form of the commercial association (section 22 BGB) for village shops.[88] After the legislator gave up its intention to revive the commercial association in the course of the KiTa cases, however, the responsible authorities are probably also prevented from doing so administratively.[89] Cooperatives are also not

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[84] BGH, Beschl. v. 16.05.2017 – II ZB 7/16, NJW 2017, 1943 Rn. 25.

[85] L. Leuschner in F.J. Säcker, R. Rixecker, H. Oetker and B. Limperg (eds), *Münchener Kommentar zum Bürgerlichen Gesetzbuch*, 9th ed., C.H. Beck, Munich 2021, § 22 Rn. 43–50.

[86] C. Cramer in F. Scholz (founder), *Kommentar zum GmbH-Gesetz*, 12th ed., Verlag Dr. Otto Schmidt, Cologne 2018, § 1 Rn. 9–36.

[87] B. Momberger, *Social Entrepreneurship – Im Spannungsfeld zwischen Gesellschafts- und Gemeinnützigkeitsrecht*, Bucerius Law School Press, Hamburg 2015, pp. 224–25.

[88] B. Bösche, 'Wirtschaftliche Vereine als kleine Genossenschaften' (2011) 3 *Zeitschrift für das Recht der Non Profit Organisationen* 82.

[89] R. Wolff, 'Kein Gesetz zur Erleichterung unternehmerischer Initiativen aus bürgerschaftlichem Engagement? Die Tragödie der Dorfläden zwischen Kooperationsgesellschaft, wirtschaftlichem Verein und Kita-Rechtsprechung' (2018) *Non Profit Law Yearbook 2017* 99.

a viable alternative, especially for organisations in the low-profit sector, due to their considerable auditing costs.[90] The small cooperative with simplified organisational requirements is limited to a maximum of 20 members, according to section 24 GenG, which is again too few for a village shop or a citizens' energy cooperative.

The restrictions by tax law described for commercial operations do not apply to special-purpose operations (*Zweckbetrieb*) within the meaning of sections 64(1) and 65 AO. A special-purpose business is deemed to exist if the commercial business operation in its entirety serves to realise the charitable purpose of the corporation (for example, if it provides advice and networking to other non-profit organisations for a small fee). This tax concession results from the fact that the special-purpose business serves not only to raise funds but also to directly realise the statutory purposes.[91] Examples are non-profit enterprises in nursing or geriatric care, as well as the operation of educational institutions or youth hostels. The Federal Fiscal Court (Bundesfinanzhof, BFH) did not consider a catering business that served a non-profit corporation for the training of disadvantaged youths or disabled persons to be a special-purpose business. This was because the business had competed with other competitors more than was necessary. The decision is part of a larger context of several decisions through which the court has gained a reputation for being a 'competition guardian'.[92] Since the regulations on special-purpose operations, and specifically section 65 no. 3 AO, are intended to protect potential competition, so that no barriers to market entry can be erected by existing non-profit special-purpose operations,[93] the requirements for special-purpose operations are increasingly coming under scrutiny. This is because, technically, almost all the activities of social enterprises could also be offered by commercial providers, but they often do not do so because the profit margins are too low.

6. LIMITATIONS ON PROFIT DISTRIBUTIONS TO OWNERS

According to section 55(1) AO, the principle of altruism requires that the funds of the corporation be used only for objectives consistent with the statutes, and that the members, while holding membership, may not receive any benefits from the funds of the corporation (no. 1), and that the corporation may not favour

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90 R. Wolff, 'Ein passendes Rechtskleid für kleinkooperative Vereinigungen? – Zum Referentenentwurf eines Gesetzes zur Einführung der Kooperationsgesellschaft und zum weiteren Bürokratieabbau bei Genossenschaften' (2014) *Non Profit Law Yearbook 2013/2014* 19, 22.

91 R. Hüttemann, *Gemeinnützigkeits- und Spendenrecht*, 5th ed., Verlag Dr. Otto Schmidt, Cologne 2021, Rn. 6.2, 6.3.

92 R. Hüttemann and S. Schauhoff, 'Der BFH als Wettbewerbshüter' (2011) 6 *Der Betrieb* 319.

93 BFH, Beschl. v. 19.07.2010 – I B 203/09, BFH/NV 2011, 1; BFH, Urt. v. 18.08.2011 – V R 64/09, HFR 2012, 784.

any person by means of expenditure that is incompatible with the purpose of the corporation or by means of disproportionately high remuneration (no. 3). The importance of the principle of altruism is seen in 'protecting the resources of the non-profit corporation from [being accessed by] its decision-makers contrary to the statutes[,] and ensuring the most efficient possible use of resources for the tax-privileged statutory objectives of the corporation'.[94] This establishes a substantive link between the pursuit of charitable purposes by excluding investors from the distribution of profits,[95] thereby preventing 'a non-profit corporation from being misused by its members in the pursuit of their own commercial objectives'.[96]

Recently, courts have questioned what constitutes reasonable remuneration for the employees of a charitable organisation. According to the Federal Fiscal Court, the salaries of persons in comparable positions in the industry, and not only the usually lower salaries of non-profit organisations, are to be used to examine the appropriateness of remuneration under non-profit law.[97] This is because, while non-profit organisations may not place their employees in a better position than managing directors with the same position and qualifications in commercial enterprises, they are not required to place them in a worse position. However, overstepping the limits set out in this provision triggers a hidden distribution of profits (section 55(1) no. 3 AO), which can lead to the loss of the organisation's non-profit status on account of misappropriation of funds (sections 59 half-sentence 2, and 63 AO).[98] Nevertheless, some margin of appropriate remuneration conditions exist. In addition, there is a safety margin of up to 20%, which if exceeded does not lead to the loss of non-profit status for the entity in question. For reasons of proportionality, there is also a *de minimis* provision, which in the case in question was assumed to be €3,000.[99] However, there is a considerable restriction in relation to non-charitable limited liability companies, as they are only allowed to pay reasonable salaries to shareholder-directors and related persons, but are allowed to pay even outstanding salaries to outside directors.

In contrast to traditional non-profit organisations, which are not allowed to distribute profits, social enterprises, like non-profits, pursue public welfare

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94 T. von Holt in S. Winheller, S.J. Geibel and M. Jachmann-Michel (eds), *Gesamtes Gemeinnützigkeitsrecht*, 2nd ed., Nomos Verlag, Baden-Baden 2020, §55 AO Rn. 2.

95 R. Walz, 'Die Selbstlosigkeit gemeinnütziger Non-Profit-Organisationen im Dritten Sektor zwischen Staat und Markt' (2002) 6 *Juristenzeitung* 268, 270–71.

96 R. Seer in K. Tipke and H.W. Kruse (founder), *Abgabenordnung, Finanzgerichtsordnung*, 168th ed., Verlag Dr. Otto Schmidt, Cologne 2021, §55 AO Rn. 1.

97 BFH, Urt. v. 12.03.2020 – V R 5/17, npoR 2020, 303 with annotation by C. Kirchhain and M. Kampermann.

98 BFH, Urt. v. 12.03.2020 – V R 5/17, npoR 2020, 303; M. Kampermann, *Organvergütung in gemeinnützigen Körperschaften*, Bucerius Law School Press, Hamburg 2018, p. 254.

99 BFH, Urt. v. 12.03.2020 – V R 5/17, npoR 2020, 303.

goals, but they also want to be able to distribute profits to their shareholders or investors, even if profit maximisation is not the primary objective. According to section 56 AO, as well as section 5(1)(8)(1) KStG and section 12(2)(8) UStG, tax-exempt status requires the exclusive pursuit of non-profit objectives. There is no partial non-profit status.[100] The principle of exclusivity is intended to promote an organisational focus and to avoid conflicts of interest and misappropriation of funds.[101]

With reference to international models which, like the US low-profit limited liability company, in principle also permit profit distribution in full or,[102] as in the case of the UK legal form of the community interest company introduced in 2004, merely partially,[103] a relaxation of the ban on profit distribution is also called for in Germany.[104] The possibility provided for in the former German law of still assuming the non-profit status of an entity at returns of 5% (KStG 1925) or 4% (KStDV 1935),[105] and therefore below the interest rate prevailing in the market at the time, has also been raised.[106] A further possibility is the former non-profit housing association, which also allowed a return on equity of 4% (of the shareholders or cooperators).[107] However, in the case of the international models, the granting of a partial profit distribution is not usually accompanied by any tax relief.[108]

Hybrid structures are also somewhat challenging, as commercial enterprises are often accused of making hidden profit distributions if they make donations to charitable organisations within the maximum limits of section 9(1) no. 2 KStG. The consequence is that the donation deduction is not recognised and

[100] R. Hüttemann, *Gemeinnützigkeits- und Spendenrecht*, 5th ed., Verlag Dr. Otto Schmidt, Cologne 2021, Rn. 4.3.

[101] R. Hüttemann, 'Empfiehlt es sich, die rechtlichen Rahmenbedingungen für Gründung und Tätigkeit von Non-Profit-Organisationen übergreifend zu regeln?' (2018) 2 *Neue Juristische Wochenschrift-Beilage* 55, 56.

[102] F. Möslein and A.-C. Mittwoch, 'Soziales Unternehmertum im US-amerikanischen Gesellschaftsrecht – Benefit Corporations und Certified B Corporations' (2016) 80 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 399, 411–28.

[103] B. Momberger, *Social Entrepreneurship – Im Spannungsfeld zwischen Gesellschafts- und Gemeinnützigkeitsrecht*, Bucerius Law School Press, Hamburg 2015, pp. 254–65.

[104] www.goodimpact.org, Start Mitte Mai 2012, quoted according to P. Spiegel, 'Social Impact Business' (2012) 2 *Stiftung & Sponsoring* 30.

[105] German Corporate Tax Executive Order 1935.

[106] B. Momberger, 'Neue rechtliche Rahmenbedingungen für Social Entrepreneurs erforderlich?' (2017) *Non Profit Law Yearbook 2016/2017* 113, 148–50.

[107] J. Kuhnert and O. Leps, *Neue Wohnungsgemeinnützigkeit: Wege zu langfristig preiswertem und zukunftsgerechtem Wohnraum*, Springer Verlag, Wiesbaden 2017.

[108] F. Möslein, 'Zertifizierung nachhaltiger Kapitalgesellschaften: Regimevergleich und flankierende Maßnahmen' in M. Burgi and F. Möslein (eds), *Zertifizierung nachhaltiger Kapitalgesellschaften: "Good Companies" im Schnittfeld von Markt und Staat*, Mohr Siebeck, Tübingen 2021, p. 3.

the amount is added to the company's profit off-balance sheet.[109] In addition to the considerable uncertainty that therefore accompanies every act of corporate citizenship, the fact that every altruistic donation is motivated by idealism, which is influenced by the personal preferences of the entrepreneurs, at least in small and medium-sized companies, speaks against the classification of the donation as a hidden profit distribution.

7. EXIT

The principle of altruism does not prohibit the realisation of profits as such, but according to section 55(1) no. 2 AO it does prohibit the distribution of current or liquidation profits to non-charitable members or third parties. For social enterprises, therefore, contributions may be made to the nominal capital and may also be repaid in the event of the dissolution of the company or the withdrawal of a member. However, the amount is limited to the nominal amount, so that any increases in value remain in the company. Pursuant to section 55(1) no. 4 AO, the assets remaining after the return of capital shares and contributions in kind must continue to be used for charitable purposes after the termination of the charitable activity. Practically, this is achieved by including a clause in the articles of association stating that the funds fall to a specific beneficiary or to the public purse.[110] Therefore, an exit from non-profit status while retaining the assets is not possible unless all tax benefits of at least the last 10 years are refunded according to section 61 AO.[111]

8. CONCLUSION AND NEW PROPOSAL OF A GMBH-GEBV

The lack of specialised legal forms for social enterprises has often been criticised. The existing legal structures for social entrepreneurs and other sustainably operating enterprises between the market and the third sector, as well as the current non-profit law, are not sufficiently oriented towards their needs.[112]

[109] BFH, Beschl. v. 19.12.2007 – I R 83/06, BFH/NV 2008, 988; BFH, Beschl. v. 10.06.2008 – I B 19/08, BFH/NV 2008, 1704: donations to a foundation; BFH, Beschl. v. 13.07.2021 – I R 16/18: donations in kind of art works to a foundation.

[110] U. Koenig in U. Koenig (ed.), *Abgabenordnung*, 4th ed., C.H. Beck, Munich 2021, §55 AO Rn. 27.

[111] H. Fischer, *Ausstieg aus dem Dritten Sektor: juristische Probleme bei Beendigung der Gemeinnützigkeit*, Heymanns, Cologne 2005.

[112] Motion of the parliamentary group Bündnis 90/Die Grünen 'Strategische Förderung und Unterstützung von Social Entrepreneurship in Deutschland', BT-Drs. 19/8567; B. Momberger, *Social Entrepreneurship – Im Spannungsfeld zwischen Gesellschafts- und Gemeinnützigkeitsrecht*,

There is a demand for greater flexibility pursuing dual purposes (for-profit and not-for-profit), the possibility of partial profit distribution, as well as the measurability and visibility of their own social successes in relation to the public through further certifications and special legal structures.[113] Therefore, the current government coalition consisting of the SPD, FDP and the Greens has undertaken to improve the legal basis for social enterprises.[114]

For similar reasons, the Stiftung Verantwortungseigentum proposes a new alternative to the limited liability company (GmbH),[115] the *Gesellschaft mit gebundenem Vermögen mbH* (limited liability company with locked assets – GmbH-gebV).[116] In this legal structure, the assets and profits of the GmbH-gebV should permanently benefit the company alone. In addition, profit distributions to shareholders are excluded, as is the participation of shareholders in the increase in value of the company in the event of withdrawal from the company or in the event of liquidation (also known as the asset lock).[117] In the course of business, the shareholders should at most receive (reasonable) remuneration under separate legal relationships, such as a salary, interest on a loan, licence fees, rent or lease.[118]

The proposal has generated significant response.[119] The general criticism is that the GmbH-gebV is neither suitable nor necessary for the intended goals.[120]

Bucerius Law School Press, Hamburg 2015, pp. 61–132; B. Weitemeyer, 'Innovative Formen der Philanthropie – Ein Problemaufriss zu den Grenzen des geltenden Gemeinnützigkeits- und Zivilrechts' (2012) *Non Profit Law Yearbook 2011/2012* 91.

113 B. Momberger, *Social Entrepreneurship – Im Spannungsfeld zwischen Gesellschafts- und Gemeinnützigkeitsrecht*, Bucerius Law School Press, Hamburg 2015, pp. 43–52, 60.

114 Coalition Agreement 2021 between SPD, Bündnis 90/Die Grünen and FDP, 30, https://www.bundesregierung.de/resource/blob/974430/1990812/04221173eef9a6720059cc353d759a2b/2021-12-10-koav2021-data.pdf?download=1.

115 A. Sanders, S. Kempny, B. Dauner-Lieb, A. von Freeden, F. Möslein and R. Veil, *Entwurf eines Gesetzes für die Gesellschaft mit beschränkter Haftung in Verantwortungseigentum mit steuerlichen Begleitänderungen*, 2020; A. Sanders, 'Eine Gesellschaft in Verantwortungseigentum im GmbHG' (2020) 5 *Zeitschrift für Rechtspolitik* 140.

116 A. Sanders, S. Kempny, A. von Freeden, F. Möslein and R. Veil, *Entwurf eines Gesetzes für die Gesellschaft mit beschränkter Haftung mit gebundenem Vermögen*, 2021, pp. 7, 11–12, 24, https://www.gesellschaft-in-verantwortungseigentum.de/der-gesetzesentwurf.

117 Sections 77b, 77c, 77e, 77f (2), 77g, 77i, 77j, 77k, 77l (2) GmbHG-gebV(E), A. Sanders, S. Kempny, A. von Freeden, F. Möslein and R. Veil, *Entwurf eines Gesetzes für die Gesellschaft mit beschränkter Haftung mit gebundenem Vermögen*, 2021, pp. 7, 11–12, 24, https://www.gesellschaft-in-verantwortungseigentum.de/der-gesetzesentwurf.

118 A. Sanders, S. Kempny, A. von Freeden, F. Möslein and R. Veil, *Entwurf eines Gesetzes für die Gesellschaft mit beschränkter Haftung mit gebundenem Vermögen*, 2021, p. 8, https://www.gesellschaft-in-verantwortungseigentum.de/der-gesetzesentwurf.

119 M. Beise, 'Das Ende der Patriarchen', *Süddeutsche Zeitung*, 05.05.2021, p. 15; F. Gehm, 'Zeiss als Vorbild', *Die Welt*, 30.11.2019, p. 16; J. Tönnesmann, 'Glücklich enteignet', *Die Zeit*, 06.08.2020; M. Winkelmann, 'Gier? Nein, Danke', *stern* 28.03.2019, p. 59.

120 A. Arnold, U. Burgard, G. Roth and B. Weitemeyer, 'Die GmbH im Verantwortungseigentum – eine Kritik' (2020) 34 *Neue Zeitschrift für Gesellschaftsrecht* 1321; J. Croon-Gestefeld, 'Verantwortungseigentum als Instrument gegen soziale Ungleichheit' (2020) 4 *Critical*

This is because all the arrangements associated with the legal form can already be implemented voluntarily today.[121] Therefore, the GmbH-gebV would only restrict the freedom of the shareholders, but above all that of subsequent generations. It also leads to frictions with the applicable corporate, foundation, inheritance, family and tax law,[122] and with the European freedom of establishment.[123]

Weighty microeconomic and macroeconomic considerations also speak against the proposal.[124] The concept of responsible ownership and the distribution constraint suggest an orientation towards the common good and a corporate management that does not focus on profit maximisation but on preserving the company, jobs and the environment. In fact, the draft does not live up to these expectations. Unlike for social enterprises, it does not contain any requirements for the GmbH-gebV to act in a particularly sustainable and responsible manner.[125] The protection against takeovers intended by the proposed financial constitution can easily be circumvented by clever design because the assets of the company can be freely sold. It is true that the shares in the company can only be sold at a profit to natural persons, other GmbH-gebV, foundations or partnerships consisting of natural persons (section 77a (2) sentences 1 and 2 Draft Law on Limited Liability Companies with Capital Lock (GmbHG-gebV-E). However, it is expressly provided that shareholders and potential purchasers can partially undermine the asset commitment, as management and consultancy agreements, loans, leasing and renting of assets, business splitting and licence agreements, etc. are permissible. The proposal

Quarterly for Legislation and Law 351; M. Habersack, '"Gesellschaft mit beschränkter Haftung in Verantwortungseigentum" – ein Fremdkörper im Recht der Körperschaften' (2020) 18 *Die GmbH-Rundschau* 992; B. Grunewald and J. Hennrichs, 'Die GmbH in Verantwortungseigentum, wäre das ein Fortschritt?' (2020) 31 *Neue Zeitschrift für Gesellschaftsrecht* 1201; R. Hüttemann, P. Rawert and B. Weitemeyer, 'Zauberwort "Verantwortungseigentum". Mit Verve fordern Lobbyisten eine neue Eigentumsform für Unternehmen' (2020) 6 *Zeitschrift für das Recht der Non Profit Organisationen* 296; L. Henn, 'Gesellschaft mit beschränkter Haftung mit gebundenem Vermögen (GmbH-gebV) – Ein Überblick' (2021) 7 *Zeitschrift für die notarielle Beratungs- und Beurkundungspraxis* 241; M. Habersack, P. Horváth and R. Kirchdörfer, *Frankfurter Allgemeine Zeitung*, 19.03.2021, p. 16; K.-G. Loritz and P.S. Weinmann, 'Die GmbH mit gebundenem Vermögen – Kreative Idee oder Legitimation zum Betreiben eines Unternehmens ohne typische Unternehmerpflichten?' (2021) *Deutsches Steuerrecht* 2205.

121 B. Westermann, 'Nachhaltigkeit im Recht der Gesellschaft mit beschränkter Haftung' (2020) *GmbH-Rundschau* 1061.

122 R. Hüttemann and W. Schön, 'Die "GmbH mit gebundenem Vermögen" – ein Steuersparmodell' (2021) *Der Betrieb* 1356; C. Watrin and F. Riegler, '"Gesellschaft mit beschränkter Haftung mit gebundenem Vermögen" – Würdigung der vorgeschlagenen Anpassungen des KStG und des ErbStG' (2021) *Finanzrundschau* 350.

123 A. Engel and D. Haubner, 'Die GmbH mit gebundenem Vermögen und das Europarecht' (2022) *Deutsches Steuerrecht* 844.

124 B. Weitemeyer, B. Weißenberger and G.T. Wiese, 'Eine GmbH mit ewigem Gewinnausschüttungsverbot' (2021) *GmbH-Rundschau* 1069.

125 A.-C. Mittwoch, *Nachhaltigkeit und Unternehmensrecht*, Mohr Siebeck, Tübingen 2022, p. 258.

suffers from a contradiction in this respect because the shareholders participate in the economic success of the company only through appropriate performance remuneration ('work instead of capital').[126] Nevertheless, equity-like debt financing should remain possible[127] to provide financing incentives for start-ups and SMEs in particular. However, in addition to the profit-free minimum share capital of €25,000, this would allow a much higher level of mezzanine financing to be achieved through silent participations by the shareholders, via which (proportionately quite appropriate) substantial profits could be distributed. The criticism to this effect was responded to in the revision of the draft by permitting silent participations only by third parties, but not by shareholders or persons associated with them (section 77i (2), (3) GmbHG-gebV-E). However, this opens up the obvious path for shareholders to act like employed managers and for atypical silent partners with co-management rights and profit entitlements to be the actual masters of the company. A similar result can be achieved through a business split: the GmbH-gebV is founded as a mere operating company whose operating resources, such as industrial property rights, databases, factories or real estate, are rented or leased to it by a normal GmbH, a partnership with an identical group of partners or the partners.

Apart from the fact that companies such as Apple and Amazon have shown how it is possible to shift all profits from one company to another (in a low-tax country) even by means of market-driven licensing agreements on trademark rights, the permissible relationships under the law of obligations between the company and the shareholder harbour the further risk of excessive consideration (hidden profit distributions) through licence fees, salaries, interest, rents, etc. that are not in line with the market. This risk is to be countered by a civil liability of shareholders and managing directors (section 77g GmbHG-gebV-E). In practice, however, such claims are only asserted by the insolvency administrator or discovered by the tax authorities in the course of the tax audit. Section 77h GmbH-gebV-E did not contain any mandatory requirements in this respect in the first version, but merely issued the shareholders with the regulatory mandate to provide for appropriate precautions for compliance with asset retention and for the assertion of claims for reimbursement of prohibited payments. However, the possible reporting obligation of the managing directors to the shareholders or the optional establishment of a supervisory board are insufficient and do not

126 A. Sanders, S. Kempny, A. von Freeden, F. Möslein and R. Veil, *Entwurf eines Gesetzes für die Gesellschaft mit beschränkter Haftung mit gebundenem Vermögen*, 2021, p. 22, https://www.gesellschaft-in-verantwortungseigentum.de/der-gesetzesentwurf.

127 A. Sanders, S. Kempny, A. von Freeden, F. Möslein and R. Veil, *Entwurf eines Gesetzes für die Gesellschaft mit beschränkter Haftung mit gebundenem Vermögen*, 2021, p. 22, https://www.gesellschaft-in-verantwortungseigentum.de/der-gesetzesentwurf.

help in the case of shareholders and managing directors being the same people or the appointment of related persons to the supervisory board, as the explanatory memorandum to the draft itself states ('family and friends').[128]

Other governance instruments, such as a mandatory audit of the report on safeguarding the asset commitment by auditors, as now proposed in section 77j GmbHG-gebV-E, are only partially effective, as the scandal surrounding Wirecard has shown. In order to further effectuate the control, the audited report on the compliance with the asset commitment pursuant to section 77j (4) GmbHG-gebV-E Proposal 1 shall be published on the homepage of the company and forwarded to an independent institution to be determined, which may also sue for dissolution (section 77j (3) GmbHG-gebV-E). Alternatively, the GmbH-gebV is to submit to a membership-based auditing association like a cooperative (section 77j GmbHG-gebV-E, Proposal 2). With each of these elements, however, the legal form becomes more bureaucratic and approaches the form of a foundation or cooperative, so that the added value of the proposal is hardly recognisable.

On the other hand, there is to be no foundation supervision, because in relation to the foundation, which pursues a purpose that is basically unchangeable at the time of formation, the shareholders of the GmbH-gebV are at risk with their contribution and pursue changeable purposes.[129] However, this fails to recognise the function of foundation supervision, which is building on the principal-agent theory that the separation of ownership and control in publicly traded companies can result in inadequate governance due to 'rational apathy', particularly in the case of shareholders who have only a very small or no share in profits.[130] Today, the supervision of foundations is justified by the need to protect the foundation against plundering by its organs and related persons.[131] The foundation bodies make decisions about third-party assets without owners or members with ownership interests standing behind the foundation. The fact that foundations – unlike associations of persons – require ongoing external supervision after their

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[128] A. Sanders, S. Kempny, A. von Freeden, F. Möslein and R. Veil, *Entwurf eines Gesetzes für die Gesellschaft mit beschränkter Haftung mit gebundenem Vermögen*, 2021, p. 80, https://www.gesellschaft-in-verantwortungseigentum.de/der-gesetzesentwurf.

[129] A. Sanders, S. Kempny, A. von Freeden, F. Möslein and R. Veil, *Entwurf eines Gesetzes für die Gesellschaft mit beschränkter Haftung mit gebundenem Vermögen*, 2021, pp. 23, 80–81, https://www.gesellschaft-in-verantwortungseigentum.de/der-gesetzesentwurf.

[130] A. Berle and G. Means, *The Modern Corporation and Private Property*, Harcourt, Brace & World, New York 1932, p. 66.

[131] BGH, Urt. v. 22.01.1987 – III ZR 26/85, BGHZ 99, 344; BVerwG, Beschl. v. 29.11.1990 – 7 B 155/90, StiftRspr. IV 151; R. Hüttemann and P. Rawert in Staudinger (founder) 2017, Vorbemerkung zu §§ 80–88 BGB Rz. 123–29; P. Rawert, 'Vom Umgang des öffentlichen Rechts mit der Stiftung des BGB' (2017) 65 *Jahrbuch des öffentlichen Recht der Gegenwart. Neue Folge* 179; R. Tischer, *Über die Notwendigkeit strenger gesetzlicher Regelungen von Aufsicht und Kontrolle über privatrechtliche Stiftungen*, Dr. Kovač, Hamburg 2012, pp. 20–58.

establishment is therefore undisputed internationally.[132] Although the draft correctly states that the gGmbH is also not subject to foundation supervision, in Germany the financial supervisory authority has the function of controlling all non-profit organisations independent of their legal form.[133]

In contrast to social enterprises like the US benefit corporation or the community interest company introduced in Great Britain in 2005, the GmbH-gebV does not require any social purpose. For good reasons, all authoritative legal systems provide for a mandatory prohibition of profit distribution at the expense of the shareholders only under the special conditions of non-profit status and only for certain purposes oriented towards the common good. The ostensible waiver of profit distributions is not sufficient for this purpose. On the contrary, it would have opposite effects: what these new legal forms have in common is that the prospect of private profit-making results in a more effective and innovative pursuit of the social and ecological goals pursued at the same time than is considered possible with traditional non-profit organisations without their own private profit interest. Moreover, there are strict limits to any efforts to 'lock in' an asset and thus remove it from the economic cycle. For these reasons, most recently, the Scientific Advisory Board at the German Federal Ministry of Finance took up the arguments of the critics and issued a negative opinion.[134]

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132 B. Weitemeyer 'Gemeinsame Wurzeln und Wiederannäherung des Stiftungsrechts – Rechtsvergleichender Generalbericht der Stiftungsrechtsordnungen Deutschlands, der Schweiz, der USA, Frankreichs und Chinas' in *Stärkung des Stiftungswesens, 35. Tagung für Rechtsvergleichung „Religion, Werte und Recht"*, Mohr Siebeck, Tübingen 2017, pp. 127–33; D. Brakman Reiser and S. Miller, 'Foundation Law in the United States' in *Stärkung des Stiftungswesens, 35. Tagung für Rechtsvergleichung „Religion, Werte und Recht"*, Mohr Siebeck, Tübingen 2017, p. 32; J. Fishman 'Nonprofit organizations in the United States' in *Comparative Corporate Governance of Non-Profit-Organisations*, Cambridge University Press, Cambridge 2010, pp. 131–32; T. v. Hippel, *Grundprobleme von Nonprofit-Organisationen*, Mohr Siebeck, Tübingen 2007, pp. 14–47.

133 H.-K. Anheier, A. Beller and R. Haß, 'Accountability und Transparenz des Dritten Sektors in Deutschland: Ein Paradox?' (2011) 3 *Forschungsjournal Soziale Bewegungen* 96.

134 https://www.bundesfinanzministerium.de/Content/DE/Downloads/Ministerium/Wissenschaftlicher-Beirat/Gutachten/gmbh-mit-gebundenem-vermoegen.html.

SOCIAL ENTERPRISES IN HUNGARY

István Sándor

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1. THE CONCEPT OF SOCIAL ENTERPRISE

1.1. THE NOTION OF SOCIAL ENTERPRISE IN HUNGARIAN LAW

The concept of social enterprise was used as early as the 1960s.[1] The terms social enterprise as a business, social entrepreneurship as an activity, and social entrepreneur should be distinguished.

The US concept of social enterprise is a broader one based on the diversity of enterprises and their role in market life, as part of the market economy. In terms of the European model, the social cooperative played a pioneering role, first appearing in Italy and then spreading around the continent.[2] In comparison, other legal constructions have emerged over time at legislative level, such as the 'social purpose company' in Belgium. Another important difference is that in the US, the private sector is the main source of funding, while in Europe it is the public sector.[3]

In international literature we find different approaches to the perception of social enterprises. There is a view that sees them explicitly as non-profit organisations following the principles of business life. Another approach is that these are non-profit organisations that base their funding on income-generating activities in addition to traditional fundraising.[4] The European Commission describes social enterprises as serving the social, societal and environmental interests of the community and not seeking to maximise profits. Through their products or services, or the production or organisational methods they use, social enterprises tend to be innovative in nature. They often provide employment opportunities for the most excluded members of society and thus contribute to social cohesion, employment and the reduction of inequalities.[5]

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1 K. Szegedi and Á. Bereczk, 'A társadalmi vállalkozások finanszírozási lehetőségei, jogi szervezeti formái és beágyazódása a szociális gazdaság rendszerébe' [Funding opportunities, legal forms of social enterprises and their integration into the social economy system] [2017] *Vállalkozásfejlesztés a 21. században* 602, 602–03, http://kgk.uni-obuda.hu/sites/default/files/41_SzegediKrisztina_BereczkAdam.pdf.

2 J. Hajdú, 'The Hungarian social co-operative as special social enterprise' in K. Gellén (ed.), *Honori et virtuti: ünnepi tanulmányok Bobvos Pál 65. születésnapjára* [Honori et virtuti: festive studies for the 65th birthday of Paul Bobvos], Pólay Elemér Alapítvány, Iurisperitus Kiadó, Szeged 2017, p. 102, http://acta.bibl.u-szeged.hu/69121/1/polay_064_100-115.pdf.

3 T. Buchko, 'Social Entrepreneurship and Its Implications for Hungary' (2018) 26(1) *Periodica Polytechnica Social and Management Sciences* 38, 40, https://pp.bme.hu/so/article/view/9376/7778.

4 Zs. Péter, 'A társadalmi vállalkozások és tevékenységeik ismertsége, illetve az előttük álló feladatok egy kérdőíves felmérés eredményei alapján' [Visibility of social enterprises and their activities and duties based on the results of a questionnaire] (2018) 11(2) *Közép-európai közlemények* 124, 125, http://real.mtak.hu/92300/1/3.Atarsadalmivallalkozasokestevekenysegeikismertsegeilletveazelottukallofeladatokegykerdoivesfelmereseredmenyeialapjan1.pdf.

5 European Commission, *Communication from the Commission to the European Parliament, the Council, the European and Social Committee and the Committee of the Regions. Social*

Some schools of thought make a distinction between several approaches. The business model approach views social enterprises as seeking to achieve social goals on the basis of the business models or business processes used by businesses. By comparison, the entrepreneurship competence approach, which is related to competency and resource-based theories, argues that the key to achieving the social objective lies in the use of entrepreneurial characteristics, competences and skills such as innovativeness, risk-taking and proactivity. The double-bottom-line approach emphasises the financial/profitability factor.[6] Related to this is the approach that views the principle of profit reinvestment as one of the most important characteristics of social enterprises. On the one hand, those who take this approach consciously refer to the criterion of the non-profit (or so-called hybrid) enterprise, while on the other hand they implicitly link the concept to theories of satisfactory profit as opposed to profit-maximising models. A social enterprise is a business entity organised along the lines of a given strategy or business model typical of business enterprises, based on business competences (innovation, risk-taking),[7] and at the same time one that primarily does not aim to maximise profits but to achieve given social goals.[8]

Social enterprise in Hungary does not operate as a specific legal category. Social enterprise is generally translated as *társadalmi vállalkozás*, which refers to the connection to society (*társadalom*). The term *szociális vállalkozás* (social enterprise)[9] previously used in Hungary had a narrower meaning, and therefore fell into disuse.[10] A familiar approach to social enterprise found in Hungarian literature is 'a consciously planned entrepreneurial activity created to solve

Business Initiative. Creating a favourable climate for social enterprises, key stakeholders in the social economy and innovation, Social Business Initiative, Brussels, 25.10.2011, COM(2011) 682 final, pp. 2–4, https://ec.europa.eu/transparency/documents-register/detail?ref=COM(2011)682&lang=en.

6 K. Szegedi and Á. Bereczk, 'A társadalmi vállalkozások finanszírozási lehetőségei, jogi szervezeti formái és beágyazódása a szociális gazdaság rendszerébe' [Funding opportunities, legal forms of social enterprises and their integration into the social economy system] [2017] *Vállalkozásfejlesztés a 21. században* 602, 603, http://kgk.uni-obuda.hu/sites/default/files/41_SzegediKrisztina_BereczkAdam.pdf.

7 Z. Bartha and Á Bereczk, 'A társadalmi vállalkozások sikertényezői, erősségei és gyengeségei' [Success factors, strengths and weaknesses of social enterprises] [2018] *Vállalkozásfejlesztés a XXI. században* 6, 7–8, http://kgk.uni-obuda.hu/sites/default/files/6_VF2018_VF_2018_2.pdf.

8 K. Szegedi and Á. Bereczk, 'A társadalmi vállalkozások finanszírozási lehetőségei, jogi szervezeti formái és beágyazódása a szociális gazdaság rendszerébe' [Funding opportunities, legal forms of social enterprises and their integration into the social economy system] [2017] *Vállalkozásfejlesztés a 21. században* 602, 604, http://kgk.uni-obuda.hu/sites/default/files/41_SzegediKrisztina_BereczkAdam.pdf.

9 *Szociális* means 'social'.

10 É.G. Fekete, L. Hubai, J. Kiss and M. Mihály, 'Social enterprise in Hungary', ICSEM Working Papers No. 47, The International Comparative Social Enterprise Models (ICSEM) Project, Liège 2017, pp. 7–8, https://www.academia.edu/35937094/Social_Enterprise_in_Hungary_ICSEM_Working_Papers_No_47.

social problems in an innovative way. Social enterprises can be non-profit organisations that use business models to achieve their core mission, or they can be businesses that seek to achieve significant social impact alongside their business objectives.'[11] Under the new Hungarian Partnership Agreement for the 2014–2020 Programme Period, we can find an official – even if not statutory – definition for the first time as 'those non-profit and civil society organisations that have viable economic goals in addition to their social objectives; the profit of their business activities is reinvested for social objectives; and they implement the principle of participatory decision-making in their budgets and organisational functioning'.[12] The aim of social enterprises is therefore to reconcile the benefits of business and the non-profit sector, to create real value by providing competitive services and goods in response to real market needs, while creating social value (e.g. employment of people with disabilities).[13]

Social enterprise is distinct from corporate social responsibility.[14] An organisation primarily with an economic/business activity is an organisation for which 60% or more of its total annual income comes from its economic/business activity.[15]

Social and environmental objectives not only play a complementary role in the case of social enterprises, they are also integrated into their business

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11 L. Tóth, É. Varga and P. Varga, *A társadalmi vállalkozások helyzete Magyarországon* [The situation of social enterprises in Hungary], NESsT Europe Nonprofit Kft., Veszprém 2011, p. 5, https://tarsadalmivallalkozasoknapja.files.wordpress.com/2011/05/2011-nesst-country-assessment-hungary-hu.pdf; Zs. Péter, 'A társadalmi vállalkozások és tevékenységeik ismertsége, illetve az előttük álló feladatok egy kérdőíves felmérés eredményei alapján' [Visibility of social enterprises and their activities and duties based on the results of a questionnaire] (2018) 11(2) *Közép-európai közlemények* 124, 125, http://real.mtak.hu/92300/1/3.Atarsadalmivallalkozasokestevekenysegeikismertsegeilletveazelottukallofeladatokegykerdoivesfelmereseredmenyeialapjan1.pdf.

12 Nemzetgazdasági Minisztérium [Ministry for National Economy], *Felhívás társadalmi vállalkozások ösztönzése – kiemelt projekt GINOP-5.1.2.* [Call for encouraging social enterprises – priority project GINOP-5.1.2.], https://www.palyazat.gov.hu/ginop-512-trsadalmi-cl-vllalkozsok-sztnzse; É.G. Fekete, L. Hubai, J. Kiss and M. Mihály, 'Social enterprise in Hungary', ICSEM Working Papers No. 47, The International Comparative Social Enterprise Models (ICSEM) Project, Liège 2017, p. 9, https://www.academia.edu/35937094/Social_Enterprise_in_Hungary_ICSEM_Working_Papers_No_47.

13 J. Dzurdženík, H. Kiraľvargová, M. Višňovská, G. Bartók, R. Filep, K. Hall, A. Lenártek, A. Mixtayné Kerekes, N. Nagy, A. Anzanello, K. Szeremeta and T. Bober, 'Hogyan alapítsunk és menedzseljünk társadalmi vállalkozásokat?' [How to start and manage social enterprises?], BORA94 Borsod-Abaúj-Zemplén Megyei Fejlesztési Ügynökség Nonprofit Kft., Miskolc 2019, pp. 4–6, https://bora94.hu/web_h/wp-content/uploads/2019/10/K%C3%A9zik%C3%B6nyv-t%C3%A1rsadalmi-v%C3%A1llalkoz%C3%A1sok-menedzsel%C3%A9s%C3%A9hez.pdf.

14 T. Buchko, 'Social Entrepreneurship and Its Implications for Hungary' (2018) 26(1) *Periodica Polytechnica Social and Management Sciences* 38, 40, https://pp.bme.hu/so/article/view/9376/7778.

15 Section 2(7) of Act CLXXV of 2011 on the right of association, the status of non-profit organisations and the operation and support of non-governmental organisations.

concept. And when social and business objectives conflict, social objectives take priority.[16]

The best way to describe a social enterprise in Hungary is based on the following characteristics. These are primarily non-profit organisations that seek to achieve social goals through their involvement in economic life. They have their own legal structure, which allows their assets to be used to benefit persons linked to the achievement of the intended social objectives. The structure is based on the cooperation and equal rights of its members and is often characterised by mutual cooperation with other organisations in the sector.[17] In Hungary, social enterprises can be organised as non-profit companies, foundations, associations or cooperatives, including social cooperatives in particular, provided that they meet the criteria set out above. The qualification as social enterprise is possible on an individual basis; there are currently no normative criteria in the Hungarian legal environment for this.

1.2. THE ROLE OF SOCIAL ENTERPRISES IN HUNGARIAN SOCIETY

In Hungary, the main areas of social enterprise are: social land schemes, agricultural cooperatives, non-profit employment schemes, marketing the products of local producers, building cashless local connections, and micro-credit objectives. According to a survey, 76% of social enterprises are mainly active in the following industries: health and social work; business activities; education; community activities; social and related services; and wholesale and retail.[18] The remainder were active primarily in personal service activities; agriculture, hunting, forestry and fishing; and manufacturing. 72% of social enterprises have their primary social activity in one of the following eight sectors: other educational activities; environment; employment and training; recreation and community clubs; business and professional associations; and nursing homes and other health services.[19] The potentially qualifying non-

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16 L. Tóth, É. Varga and P. Varga, *A társadalmi vállalkozások helyzete Magyarországon* [The situation of social enterprises in Hungary], NESsT Europe Nonprofit Kft., Veszprém 2011, p. 8, https://tarsadalmivallalkozasoknapja.files.wordpress.com/2011/05/2011-nesst-country-assessment-hungary-hu.pdf.

17 A.I. Petheo, 'A vállalati társadalmi felelősségen túl: a szociális vállalkozás' [Beyond Corporate Social Responsibility: the Social Enterprise], PhD thesis, Corvinus University of Budapest, 2009, p. 16, http://phd.lib.uni-corvinus.hu/398/1/petheo_attila.pdf.

18 European Commission, *A map of social enterprises and their eco-systems in Europe. Country report: Hungary*, Publications Office of the European Union, Luxembourg 2014, p. 15.

19 N. Etchart, A. Horváth, A. Rosandić and A. Spitálszky, 'The State of Social Entrepreneurship in Hungary. SEFORÏS Country Report', NeSsT, 2014, p. 1, https://www.researchgate.net/publication/332802667_Social_enterprises_and_their_ecosystems_in_Europe_Updated_country_report_Hungary.

profit organisations in the Hungarian Central Statistical Office's database (foundations, associations and non-profit companies with 25% of their revenue from sales), most commonly focus on activities like hobbies and leisure (25%), culture (19.3%) and sport (14.4%). Foundations tend to focus more on culture, education and social care; associations deal mainly with culture, sports, hobbies and leisure; and non-profit companies prioritise culture, education, social care, community development and economic development.[20]

1.3. NUMBER OF SOCIAL ENTERPRISES IN HUNGARY

According to the latest available data from the Central Statistical Office, there are more than 60,000 non-profit organisations in Hungary, of which nearly 20,000 operate as foundations.[21] They include the vast majority of social enterprises. Due to the lack of a proper legal definition, we can only estimate that there were around 300–400 social enterprises in Hungary in 2014, half of which can be were classified as small (1–10 employees) and only 12% of which had revenues above €1 million.[22] According to a 2016 figure, the total number of potential social enterprises is 2,980, but this only refers to potential social enterprises based on their legal form.[23] The actual number of social enterprises likely falls somewhere between the two estimates.

1.4. EXAMPLES OF SOCIAL ENTREPRENEURSHIP

Among the social enterprises created in Hungary, we would like to highlight the following.[24] A significant number of social enterprises operate in the form of foundations. For example, the Open Garden Foundation of Gödöllő (Nyitott Kert Alapítvány) was registered in 1999 with the aim of promoting sustainable

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20 J. Kiss and M. Mihály, *Social enterprises and their ecosystems in Europe*, Publications Office of the European Union, Luxembourg 2019, p. 52, https://ec.europa.eu/social/BlobServlet?docId=21131&langId=en.

21 https://www.ksh.hu/stadat_files/gsz/hu/gsz0012.html.

22 N. Etchart, A. Horváth, A. Rosandić and A. Spitálszky, 'The State of Social Entrepreneurship in Hungary. SEFORÏS Country Report', NeSsT, 2014, p. 1, https://www.researchgate.net/publication/332802667_Social_enterprises_and_their_ecosystems_in_Europe_Updated_country_report_Hungary.

23 J. Kiss and M. Mihály, *Social enterprises and their ecosystems in Europe*, Publications Office of the European Union, Luxembourg, 2019, p. 50, https://ec.europa.eu/social/BlobServlet?docId=21131&langId=en.

24 The examples are taken from the following analysis: L. Tóth, É. Varga and P. Varga, *A társadalmi vállalkozások helyzete Magyarországon* [The situation of social enterprises in Hungary], NESsT Europe Nonprofit Kft., Veszprém 2011, pp. 29–44, https://tarsadalmivallalkozasoknapja.files.wordpress.com/2011/05/2011-nesst-country-assessment-hungary-hu.pdf.

agriculture and community-supported local food networks. The Beautiful Present Foundation (Szép Jelen Alapítvány) was registered in 1991 with the aim of supporting people with disabilities or disadvantages, their families and professionals working with them. The Blue Bird Foundation (Kék Madár Alapítvány) in Szekszárd, which aims to help disadvantaged people on the labour market with counselling and training programmes – based on a Dutch example – launched its social enterprise, the Ízlelő (Taste) family-friendly restaurant in 2007. The aim of the Home Help Foundation (Otthon Segítünk Alapítvány) is to help parents in families with children under three years of age who have become isolated raising their children for two to three years find their way back to work.

The choice of association form is also typical, examples of which are the following. The Vigyázó Kéz Child Protection Public Benefit Association in Székesfehérvár works to improve the living conditions of 800 children and young people living in foster homes and residential homes instead of families. The aims of the Székesfehérvár Garden Friendly Association (Kertbarát Egyesület), which runs the Szárazrét Community Garden, include the further development of garden-friendly culture and the widespread dissemination of knowledge about it. The activities of the Green Circle Association (Zöld Kör Egyesület) in Hajdúböszörmény include the collection and resale of paper waste for recycling purposes, through which Green Circle generates additional financial resources to realise its social goals, in addition to the direct mission benefits. Over the years, they have gradually become involved in environmental and consumer protection, land development and ecotourism, as well as community and social participation activities.[25]

A similarly frequently used legal form is the social cooperative, examples of which are the following. Romani Design is a social enterprise in the form of a social cooperative. It designs, creates and sells high-quality clothing and accessories combining traditional Roma motifs with modern elements. Its aim is to reduce prejudices against Roma and the resulting social conflicts, and to familiarise Roma and non-Roma alike with the traditions and still-living motifs of Roma culture through the world of fashion. The Millennial Chestnut (Ezeréves Gesztenyés) Social Cooperative operates in Pécsbányatelep and its main activities are providing job opportunities for its members, who are unemployed or studying, and providing other services to its members to establish working conditions and improve their social situation. The Hetedhét Határ Social Cooperative in Gyulaj aims to stimulate the economy of the local community. The cooperative, which was set up by the local authority and the

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[25] L. Huszák, 'Másként vállalkozók? Társadalmi vállalkozások ma Magyarországon' [Entrepreneurs of another kind? Social enterprises in Hungary today] (2018) 179(3) *Magyar Tudomány* 342, 342–45, https://mersz.hu/dokumentum/matud__147.

Hungarian Charity Service of the Order of Malta, aims to produce good-quality, family-oriented food through local livestock and vegetable production.[26]

In addition to the above, we also find social enterprises operating in corporate and non-profit corporate form. The Káva Cultural Workshop, a highly professional and recognised drama education and theatre workshop, is the first and the largest theatre education company in Budapest, and indeed Hungary as a whole, and organises national and international programmes. The interesting thing about this organisation is that in addition to the limited liability company form, they also operate a foundation and an association for their activities, thus optimising the advantages of different types of legal personality. Fruit of Care, the first social brand in Hungary, is linked to the name of the artist Áron Jakab. The social enterprise offers quality handmade gifts developed by designers for companies and individual customers. This business operates as a non-profit limited liability company. The Six Dot (Hatpöttyös) Restaurant is also operated as a non-profit limited liability company. It was established in 2012 in Székesfehérvár as the second restaurant in Hungary (after the Ízlelő Restaurant run by the Blue Bird Foundation in Szekszárd) staffed by disadvantaged people and those with disabilities. The Integrated Employment and Housing Rehabilitation Center in Csömör (known as Összefogás) is a non-profit limited liability company that provides housing and employment opportunities for people with mental or physical disabilities, or autism. The aim is to improve the living conditions of people with disabilities and to create a family environment.[27] The aim of Napra Forgó Public Benefit Non-profit Ltd in Érd is to rehabilitate people with disabilities and reintegrate them into the labour market. This includes 4M programmes, IT mentor training, HR advisory services, etc.[28] 4M refers to 'Solutions for Employers and Employees with Changed Work Capability'. The aim of the 4M service is to promote the employability of persons with altered work ability or disabilities in order to find employment in the open labour market, as well as to create an accepting and inclusive social environment and attitude. The goal of the programme is to provide assistance to people with health problems to find permanent jobs on the open labour market, taking into account individual needs, abilities and opportunities. Route4U is a for-profit limited liability company with a social mission to make transport easier by developing an app to help you get from door to door. The app indicates

[26] J. Kiss and M. Mihály, *Social enterprises and their ecosystems in Europe*, Publications Office of the European Union, Luxembourg 2019, p. 22, https://ec.europa.eu/social/BlobServlet?docId=21131&langId=en.

[27] J. Kiss and M. Mihály, *Social enterprises and their ecosystems in Europe*, Publications Office of the European Union, Luxembourg 2019, p. 20, https://ec.europa.eu/social/BlobServlet?docId=21131&langId=en.

[28] J. Kiss and M. Mihály, *Social enterprises and their ecosystems in Europe*, Publications Office of the European Union, Luxembourg 2019, p. 24, https://ec.europa.eu/social/BlobServlet?docId=21131&langId=en.

pedestrian crossings, wheelchair access, etc. The creators of the app are working with local authorities and organisations to ensure that the service is as widely available as possible.

1.5. PRINCIPAL SOURCES OF FUNDING/FINANCE FOR SOCIAL ENTERPRISES IN HUNGARY

Social enterprises have great potential to support disadvantaged groups and areas in Hungary. In recent years, there have been many opportunities to help social enterprises financially, both via EU programmes and through social sector funding. These have been joined by CSR programmes that are increasingly targeting business initiatives with social objectives based on business logic, as they are seen as more sustainable than simple charitable actions.[29]

The income of social enterprises can come from public external sources, such as state and local authority grants (which can be normative – provided from the central budget, based on legislation, typically proportional to the number of employees and earmarked), central funds administered on the national level (e.g. the National Cultural Fund, Research and Technological Innovation Fund, Labour Market Fund, etc.). A public benefit organisation can get proceeds from the 1% donations of personal income tax of individuals, from the National Civil Fund Programme. In 1997, Hungary introduced a new source of funding for the non-profit sector: for the first time in the world, taxpayers could donate 1% of their personal income tax to non-profit, non-governmental organisations, a system later adopted by other countries such as Romania and Japan.[30] In addition, these organisations may receive private financial support and donations. The income from their core and public benefit activities, as well as their business management activities is also of decisive importance.[31]

Hungary's accession to the European Union in 2004 was a milestone for the non-profit sector. EU funding was also available prior to that, through the PHARE programme (Pologne-Hongrie Actions pour la Reconversion

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29 K. Szegedi and Á. Bereczk, 'A társadalmi vállalkozások finanszírozási lehetőségei, jogi szervezeti formái és beágyazódása a szociális gazdaság rendszerébe' [Funding opportunities, legal forms of social enterprises and their integration into the social economy system] [2017] *Vállalkozásfejlesztés a 21. században* 602, 610, http://kgk.uni-obuda.hu/sites/default/files/41_SzegediKrisztina_BereczkAdam.pdf.

30 L. Tóth, É. Varga and P. Varga, *A társadalmi vállalkozások helyzete Magyarországon* [The situation of social enterprises in Hungary], NESsT Europe Nonprofit Kft., Veszprém 2011, p. 18, https://tarsadalmivallalkozasoknapja.files.wordpress.com/2011/05/2011-nesst-country-assessment-hungary-hu.pdf.

31 L. Tóth, É. Varga and P. Varga, *A társadalmi vállalkozások helyzete Magyarországon* [The situation of social enterprises in Hungary], NESsT Europe Nonprofit Kft., Veszprém 2011, pp. 13–14, https://tarsadalmivallalkozasoknapja.files.wordpress.com/2011/05/2011-nesst-country-assessment-hungary-hu.pdf.

Economique) for example and subsequently through the European Structural Funds. After accession, the National Development Plan and its Human Resources Operational Programme (HEFOP) provided additional funding. This was followed by the New Hungary Development Plan and the Social Renewal Operational Programme. In the cooperative domain, the possibility of setting up social cooperatives and the related support programmes were of crucial importance.[32]

There are many other ways of financing the operations of a social enterprise aside from external resources, typically:

- collecting membership fees;
- charging a service fee;
- selling products;
- renting out tangible assets;
- selling and utilising intellectual property; and
- dividends on investments.[33]

2. LIFECYCLE OF A SOCIAL ENTERPRISE

Previously, we described the general rules that apply to legal entities that can be counted as social enterprises. By comparison, this section describes the specific rules that apply to non-profit organisations.

The Civil Act distinguishes between non-governmental organisations and public benefit organisations. These are not separate types of legal entity, but umbrella designations available to entities taking various legal forms.

2.1. NON-GOVERNMENTAL ORGANISATIONS

Hungarian-registered associations and foundations are automatically qualified by law as civil societies and considered to be non-governmental organisations (NGOs). An NGO is established upon registration at a court of law with jurisdiction for the location of the entity's planned location. Civil information centres are operated to provide professional support for the operation of NGOs,

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32 L. Tóth, É. Varga and P. Varga, *A társadalmi vállalkozások helyzete Magyarországon* [The situation of social enterprises in Hungary], NESsT Europe Nonprofit Kft., Veszprém 2011, pp. 19–22, https://tarsadalmivallalkozasoknapja.files.wordpress.com/2011/05/2011-nesst-country-assessment-hungary-hu.pdf.

33 L. Tóth, É. Varga and P. Varga, *A társadalmi vállalkozások helyzete Magyarországon* [The situation of social enterprises in Hungary], NESsT Europe Nonprofit Kft., Veszprém 2011, p. 7, https://tarsadalmivallalkozasoknapja.files.wordpress.com/2011/05/2011-nesst-country-assessment-hungary-hu.pdf.

to strengthen their sustainability and to facilitate the proper use of public finance grants. They also operate the Civil Information Portal, an accessible website for the collection, organisation and publication of public interest information on NGOs, and that can provide information about NGOs on request.

NGOs manage their assets independently to achieve the purpose defined in their deed of incorporation, which may not be primarily for the purpose of carrying out economic/business activities and which may also be a public benefit activity, as described below. An NGO may engage in economic/business activities to ensure the economic conditions for achieving its objective, provided that this does not jeopardise the activities in accordance with its basic objective. An NGO may only borrow money and incur liabilities in a way that does not jeopardise the performance of its basic activities and the maintenance of its operations. The supreme body of the NGO is responsible for keeping the organisation viable and for adopting or initiating the necessary measures in the event of imminent insolvency, taking the interests of creditors into account.

The assets of an NGO may also be augmented by the profits of its economic and business activities. Fundraising activities can also be carried out for NGOs. Fundraising on behalf of or for the benefit of an NGO must not disturb donors or other persons, or violate personal rights and human dignity. NGOs are liable for their debts with their own assets; a founder or member of an NGO will enjoy limited liability.

The public prosecutor's office monitors compliance with the legal requirements for operation of NGOs. Compliance does not cover matters that would otherwise be subject to judicial or administrative proceedings (for example issues regarding tax, accounting, etc.).

2.2. PUBLIC BENEFIT STATUS

2.2.1. Conditions for Public Benefit Status

A complex set of conditions must be met to obtain and keep public benefit status. An organisation (i) carrying out public benefit activities and (ii) registered in Hungary can be a public benefit organisation if (iii) it has adequate resources to meet the common needs of society and individuals, (iv) enjoys sufficient support from society, and (v) is either:

- an NGO (not including a civil society), or
- another organisation for which acquiring public benefit status is permitted by law, or for which law establishes its public benefit status.

Public benefit activities are those that contribute to the satisfying the common needs of society and individuals. Whether such contributions are being made

is assessed according to data on the target group in a public benefit report each public benefit organisation must issue each year. Each year's report is scrutinised to ensure the services of the organisation are accessible to persons other than the members of the organisation, its employees and volunteers.

To be registered as having public benefit status, the deed of incorporation of an organisation must include a series of elements, which serve as restrictions on organisational activities and impose a non-distribution constraint. The deed of incorporation must describe the public benefit activity the organisation carries out, in relation to which public task it carries out the public benefit activity, the legislative provision prescribing this public task, and, if it is a member organisation, that it does not exclude non-members from its public benefit services. It must also state that the organisation only carries out economic/ business activities without jeopardising the performance of public benefit activities or as per the basic objective specified in the deed of incorporation. It must assert that the organisation does not engage in direct political activity, it is independent of political parties and does not provide financial support to them. Finally, it must affirm that the organisation does not distribute the profits achieved in the course of its management, but uses them for its public benefit activities as defined in its deed of incorporation.

An organisation has adequate resources to qualify for public benefit status by meeting any one of several conditions for the previous two closed financial years. It might show adequate resources based on income by showing annual average income of more than HUF 1 million. Alternatively, adequate resources can be demonstrated by posting a positive aggregate profit after tax (profit for the year) for the relevant two years. Finally, adequate resources can be established by staff costs (expenses) – excluding the allowances for senior management – amounting to no more than one-quarter of total costs (expenses).

There are also multiple ways to demonstrate that an organisation has sufficient support from society to be granted public benefit status. Again, each metric is applied based on the previous two closed financial years. As will be explained in more detail below, Hungary offers individual taxpayers the option to dedicate a portion of their personal tax payments to non-profit organisations and churches. If an organisation receives at least 2% of its total income (excluding public funding) from such taxpayer-directed tax revenues, it is deemed to demonstrate sufficient support to qualify for public benefit status. Alternatively, an organisation can also show sufficient public support if its costs and expenses incurred for the public benefit activity amount to half of the total expenses on average over two years, or if it is assisted in its public benefit activities by at least 10 people volunteering in the public interest on a permanent basis (on average over two years).[34]

[34] Act LXXXVIII of 2005 on Voluntary Activities in the Public Interest.

The court will terminate the public benefit status of the organisation and delete the relevant data from the register if it fails to meet these conditions at any time.

2.2.2. Rights and Obligations of Public Benefit Status

Only organisations with public benefit status are entitled to use the designation 'public benefit' and this status carries some substantial benefits. A public service contract may only be concluded between a government/public administration/ budgetary body and an NGO if the NGO has public benefit status. Public benefit organisations, as well as NGOs and those who support both types of organisations, are entitled to tax and duty exemptions or tax and duty relief under special legislation.

Public benefit organisations must also, however, comply with additional governance burdens. The meetings of the supreme body comprising several members as well as of the administrative and representative body are open to the public; this may be restricted in cases provided for by law. If the annual income of a public benefit organisation exceeds HUF 5 million, the establishment of a supervisory body separate from the management body is mandatory, even if such an obligation does not otherwise exist under other legislation. The supervisory body shall establish its own rules of procedure.

Public benefit organisations are further excluded from certain types of activities. They may not issue bills of exchange or other debt securities. They may not take out loans for the development of their economic/business activities to the extent that doing so would jeopardise their public benefit purpose. In addition, to carry out investment activities, a public benefit organisation must draw up an investment policy adopted by the supreme body after obtaining the opinion of the supervisory board, if such a body has been established, and after obtaining the opinion of the supervisory body.

Finally, special disclosure obligations apply to organisations with public benefit status. Together with their financial statements, they must prepare public benefit reports, which must be filed and published in the same way as the financial statements. Anyone may inspect the financial statements and the public benefit report of the public benefit organisation and make a copy at their own expense.

3. FORMS OF ORGANISATION FOR SOCIAL ENTERPRISES

Social enterprises in Hungary utilise four main forms of organisation: foundations (including public benefit asset management foundations), associations, non-profit companies (including mainly limited liability companies), and social

cooperatives (including start social cooperatives). All of these are legal persons. The main characteristics of these legal entities are reviewed below, with a particular focus on how they relate to the social enterprise criteria.

3.1. FOUNDATIONS

A foundation is an autonomous body of assets with separate and distinct property, established for a specific and legally permissible purpose, and with an autonomous manager independent of its founder. A foundation is established by the founder for the continuous pursuit of a permanent objective defined in the foundation's memorandum of association.[35] The purpose of the foundation is defined, and according to judicial practice the activity to be carried out by the foundation must be defined with sufficient precision and in a manner consistent with the purpose of the foundation. During its operation, the foundation may only develop its activities in accordance with the objectives set out in its memorandum of association. It should be stressed that the foundation cannot be established to carry out economic activities, other than economic activities directly related to achieving the foundation's purpose.

The foundation must be endowed with assets at the time of its creation in order to ensure it can operate, and these assets must be sufficient to achieve its objectives. The assets of the foundation may be used to provide a benefit in connection with achieving the foundation's objective to the person designated as a beneficiary by the foundation's memorandum of association. It is also necessary to specify in which cases the foundation's board of trustees is entitled to make payments from the foundation's assets. This should be specified in detail in the memorandum of association, for example scholarships to be awarded by means of a competition, ongoing support for a specific institution, bearing the costs of organising events, etc.

3.2. PUBLIC BENEFIT ASSET MANAGEMENT FOUNDATIONS

Asset management foundations, which can be established for public benefit purposes as well as for private purposes, were introduced into Hungarian law in 2019. A public benefit asset management foundation may not be established for the benefit of the founder, an affiliate, a foundation officer, members of the

[35] For more on foundations in general, see G.B. Szabó, Á. Menyhei and I. Sándor, *Az alapítvány. Történeti, tipológiai, működési, adózási és vagyonkezelési omnibus* [Foundation: a historical, typological, operational, tax and asset management omnibus], HVG-ORAC, Budapest 2021; Z. Csehi, *A magánjogi alapítvány* [Private foundation], Gondolat Kiadó, Budapest 2006.

foundation bodies or their relatives.[36] They are subject to statutory minimum capital of HUF 600 million (about €1.5 million).

The Act on Asset Management Foundations defines in detail what constitutes a public benefit objective.[37] However, to qualify as a public benefit asset management foundation, two further criteria must also be met in addition to the purposes. The beneficiaries of the foundation must be open as to who they are, and the founder must request that the foundation be declared to be of public benefit.[38] The AMF Act enables asset management foundations registered as public interest entities to qualify for public benefit status if they so wish;[39] they only need to apply for it in their registration application, i.e. public benefit asset management foundations do not need to fulfil the requirements detailed in the Civil Act.

3.3. ASSOCIATIONS

An association is established and has a registered membership for the joint, permanent and continuous pursuit of its objectives. Relevant statutes require an association to be established for the members to achieve a common goal, i.e. to bring together the members' shared individual interests and provide a legal framework to realise them. The objective of the association must be a permanent one that the members wish to achieve on a continuous basis.

The most important characteristic of an association is its non-profit character. An association may not be formed primarily for the purpose of pursuing an economic activity, which does not preclude it from pursuing some form of economic activity as a secondary activity in a manner that does not jeopardise its objectives. If the majority of the association's objectives are directed towards economic activities, it is operating unlawfully.

Establishing an association is subject to registration with the court, which is constitutive.[40] To set up an association, the statutes must be adopted by a unanimous declaration of will of at least 10 legal persons or natural persons. The statutes of the association must be drawn up and adopted by these founding members. The statutes of association must contain the name of the association, its purpose, its registered office, its organisational structure and its assets.

The decision-making body of the association is the general assembly or the assembly of delegates, which consists of the association's members.

[36] Sections 3:379(4) and 3:386 of Act V of 2013 on the Civil Code.

[37] Section 6(2) of Act XIII of 2019 on asset management foundations.

[38] Section 4(2) of Act XIII of 2019 on asset management foundations.

[39] Section 4(3) of Act XIII of 2019 on asset management foundations.

[40] The registration of associations is governed by the Act CLXXXI of 2011 on the Court Registration of NGOs and Related Procedural Rules.

An association's executive body is the president or the executive director, and establishing a supervisory body (supervisory board) is mandatory if more than half of the members are not natural persons or if the number of members exceeds 100. In addition to these bodies, it is also possible to establish other officer positions (e.g. secretary, treasurer, etc.) in the statutes. It is important to stress that membership rights in an association are not property rights; they are non-marketable and non-inheritable.

The rules on civil law contracts do not apply to the statutes of the association. The Civil Code contains the private law rules for associations, supplemented by certain provisions of the Civil Act.

3.4. COOPERATIVES

A cooperative aims not only to make a profit but also to take into account the economic, cultural, social and educational needs of its members. In addition, some of a cooperative's income goes into a non-distributable community fund and some is distributed to the members, partly in proportion to their cooperation with the cooperative, and partly according to their contribution to the assets. The cooperative is based on the principle of 'one member – one vote', as opposed to voting rights tied to the level of contribution that usually prevails in the case of companies.

Cooperatives are established with a fixed amount of capital and operate based on the principles of open membership and variable capital. To establish a cooperative, at least seven founding members are required, who subscribe shares in the cooperative and declare the formation of the cooperative.

The highest self-governing body of the cooperative is the general assembly, comprising all the members, or optionally, depending on the provisions of the statutes, the assembly of delegates, which takes decisions on the main, strategic matters of the cooperative. The senior executives of the cooperative are the chairman of the board and the members of the board, or, in the case of a cooperative with fewer than 15 members, the director of operations, who may act as the board.

3.5. SOCIAL COOPERATIVES

The aim of a social cooperative is to create work opportunities for its disadvantaged members and otherwise help improve their social situation.[41] A social cooperative must indicate its main activity in its name, along with the

[41] Articles 14–19 of Act X of 2006 on Cooperatives.

designation 'social cooperative'. A social cooperative may have public benefit status.

One condition for its establishment is that in addition to its natural person members, the social cooperative must be a member of at least one local authority or national minority government, or an association of these with legal personality, or a public benefit organisation performing charitable activities as defined by law. No member of a social cooperative – with the exception of a local authority or a public benefit organisation performing charitable activities – may be a member without being personally involved. Moreover, the number of members who are not natural persons may not exceed 25% of the membership.

The social cooperative membership of an organisation with public benefit status performing charitable activities shall cease if the member ceases to have public benefit status. A social cooperative member that is an organisation with public benefit status performing charitable activities shall immediately inform the executive officer of the social cooperative of the termination of its public benefit status.

The basic feature of the social cooperative is that members contribute directly with their work to its joint production. Work by members is a separate legal relationship not covered by the law governing other employment relationships, in which the compensation for the work performed may be made in kind, in whole or in part, transferring goods jointly produced by the members, in proportion to the work performed by the members.

3.6. START SOCIAL COOPERATIVES

A start social cooperative[42] is a social cooperative whose establishment and operation comply with two additional requirements. First, their establishment and operation must involve a local authority that is a public employer under the legislation on public employment. Second, their founders must include a person who is in a public employment relationship with the local authority or has been in a public employment relationship with the local authority within a year of becoming a member. These entities must also include the designation 'start social cooperative' and an indication of their main activity in their names. The function of these social cooperatives is to continue within their framework the relationship established by the public employer municipality and its public employees on the basis of the public employment legal relationship. The purpose of this is that former public employees can be employed within the framework of the social cooperative representing the next step towards market employment, but with the cooperation of the (former) public employer municipality.

42 Section 21/A–21/B of Act X of 2006 on Cooperatives.

3.7. NON-PROFIT COMPANIES

In principle, the business company can also operate in such a way as to fulfil the function of a social enterprise, but this is rare. It is much more typical that companies with this function are established as non-profit companies.

Companies are enterprises with legal personality established for the purpose of conducting a joint business-like economic activity with the financial contribution of the members, in which the members share in the profits and bear the losses jointly. There are four business entities with legal personality in the Hungarian legal system, namely: general partnerships, limited partnerships, limited liability companies and joint-stock companies.

The non-profit nature of the company must be indicated in the company name before the company type, and the public benefit status may be indicated and the company's activities must be defined in the deed of incorporation. A non-profit company has owners, which is the main point of differentiation from foundations and associations.

3.8. DIVIDENDS

Associations, foundations and non-profit companies cannot make payments to their members (founders) from their profits. It is possible in the case of social cooperatives, but is not done proportionally to members' shares, but rather in accordance with the measure of member contribution.

4. STATE AND PRIVATE CERTIFICATIONS AND METRICS

In Hungary, there is no specific state designation for social enterprises, there are only private initiatives that try to bring them together and link them (see section 1.1). To date, no system of criteria has been established to clearly identify these and give them some kind of branding or designation.[43]

5. SUBSIDIES AND BENEFITS

The following is an overview of the financial provisions in legislation that provide support and benefits to social enterprises. Hungarian legislation applies the categories of NGOs and public benefit organisations when determining the benefits.

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[43] European Commission, *A map of social enterprises and their eco-systems in Europe. Country report: Hungary*, Publications Office of the European Union, Luxembourg 2014, p. 5.

5.1. ACCOUNTING AND REPORTING BY PUBLIC BENEFIT ORGANISATIONS

Public benefit organisations are also required to keep books, open bank accounts, and prepare financial statements (balance sheet and income statement) and a public benefit report. An organisation with public benefit status may only keep double-entry books. The accounting records of NGOs must be kept in such a way that the income, costs, expenses and profit (loss) of its basic objective (public benefit) activity and economic/business activity can be separately identified.[44]

5.2. TAX ADVANTAGES

Non-profit organisations are entitled to a number of statutory tax allowances and duty exemptions.

5.2.1. Corporate Tax

Non-profit organisations are subject to corporate tax, regardless of whether or not they have carried out business activities in the fiscal year in question.[45] However, NGOs and other non-profit organisations do not have to file a corporate tax return – unless they carry out real estate activities – if they have no income from business activities in the fiscal year, or they do not recognise any costs or expenses related to these activities.

Public benefit organisations do not have to pay corporate tax in the fiscal year if the income from their business activities does not exceed 15% of their total income.[46] NGOs that are not classified as public benefit organisations, except for national interest representation organisations, do not have to pay corporate tax if the annual income from their business activities does not exceed HUF 10 million and does not exceed 10% of its total income for the fiscal year.[47] If an organisation that does not have public benefit status exceeds the tax-free threshold for the fiscal year, it will have to pay tax on the entire tax base of the business activity.

5.2.2. Benefits for Corporate Donors

The Corporate Tax Act provides for lower or higher deductions for corporate sponsors of public benefit organisations depending on whether their support

44 Section 19 of Act CLXXV of 2011 on the right of association, the status of non-profit organisations and the operation and support of non-governmental organisations.
45 In accordance with the provisions of Act LXXXI of 1996 on corporate tax and dividend tax.
46 First sentence of Section 9(7) of Act LXXXI of 1996 on corporate tax and dividend tax.
47 Section 9(3)(c) of Act LXXXI of 1996 on corporate tax and dividend tax.

is based on a permanent donation agreement.[48] Any legal person can be a corporate sponsor; no special legal qualification is required. Corporate donors may take donations into account as tax base deductibles up to 20% of the value of the donation made in support of a public benefit activity of a public benefit organisation, and up to 40% in the case of a permanent donation contract. Collectively, however, these deductions are capped at to the total of the corporate taxpayer's pre-tax profit.

Non-profit organisations without public benefit status, including NGOs, may not receive deductible donations for tax purposes and may not issue donation receipts to their donors.

5.2.3. Personal Income Tax Relief

The Personal Income Tax Act does not provide relief from tax liability for employees of public benefit organisations.[49] On the other hand, amounts paid by a public benefit foundation to an individual in accordance with its public benefit purpose are exempt from tax if they are paid for studies, research or study abroad in educational institutions (scholarships), to socially disadvantaged persons on the grounds of social assistance, or to participants in student and recreational sports, up to HUF 500 per occasion.[50] The value of non-monetary benefits given to an individual from a public benefit association or foundation for a public benefit is also exempt from tax, except for fringe benefits. However, cash benefits for any individuals are exempt from tax up to a monthly amount not exceeding 50% of the official minimum wage.

5.2.4. Donation of 1% of Personal Income Tax

An individual taxpayer can direct 1% of the tax paid to 'non-profit beneficiaries' and 1% to a beneficiary chosen from among 'church beneficiaries'.[51]

5.2.5. Value-Added Tax

Non-profit organisations can become subject to VAT,[52] but qualify for exemption when they provide services in their capacity as public service providers. Public services are all activities carried out by public bodies, or under the control and

[48] Section 4(1)(a) of Act LXXXI of 1996 on corporate tax and dividend tax.
[49] Act CXVII of 1995 on personal income tax.
[50] Appendix 1, point 3.1 of Act C of 2000 on accounting.
[51] Act CXXVI of 1996 on the use of a specified amount of personal income tax in accordance with the taxpayer's instruction.
[52] Act CXXVII of 2007 on value-added tax.

regulation of the state, aimed at meeting the needs of the community. Of course, their transactions exempt from VAT under generally applicable law will also avoid VAT.

5.2.6. Duty Exemption

Taxes are distinguished from duties (levies) by the fact that taxpayers do not have the right to ask for compensation in exchange for their payment, while duties are defined as mandatory consideration for some state service. Non-profit organisations benefit from full personal exemption from duties.[53] However, duty exemption is only granted to an organisation if it was not liable to pay corporate income tax – or, in the case of a non-resident organisation, the equivalent of corporate income tax – on its income from business activities in the fiscal year preceding the year in which assets were obtained or, in the case of procedural fees, the fiscal year before the procedure was initiated. If the non-profit organisation is subject to corporate tax, it may still receive relief in relation to the subject of the duty in certain cases.

In addition to the above, non-profit organisations are not subject to the obligation to pay vocational training contributions, and in some cases are exempt from customs duties.

6. PRIVATE CAPITAL

Hungarian social enterprises finance their activities from the following sources: (i) fees for services or sales of products; (ii) investors' capital (equity); (iii) loans; (iv) grants; (v) private donations; (vi) microfinance; or (vii) other. Sales and/or fees (38%) and grant finance (36%) are the most important sources of capital.[54]

Hungarian legislation does not contain specific provisions for investments in social enterprises and for social enterprises that may be listed on a stock exchange in the future. There are currently no social enterprises in Hungary whose shares are traded on the stock exchange.

Social enterprises are mainly supported through various public programmes and by local authorities. In addition, they have access to a range of EU funding. Assistance through the Structural Funds usually takes the form of co-financing. Of course, private-sector investment and support is also constantly on the increase. The community bank MagNet Bank, which considers itself an 'ethical

53 Article 5 of Act XCIII of 1990 on duties.

54 N. Etchart, A. Horváth, A. Rosandić and A. Spitálszky, 'The State of Social Entrepreneurship in Hungary. SEFORÏS Country Report', NeSsT, 2014, p. 13, https://www.researchgate.net/publication/332802667_Social_enterprises_and_their_ecosystems_in_Europe_Updated_country_report_Hungary.

bank', has launched an initiative to provide social enterprises and non-profit organisations with more favourable conditions for their social responsibility.

To date there is only one financial support institution operating in Hungary, the local office of the US social enterprise support organisation NESsT, which entered the country in 2001 (it is also active in some other Central and Eastern European countries and in Latin America). NESsT may be considered a venture philanthropy fund in some respects, although it is not operated as a fund. It provides both capacity-building services and investment for social enterprises, channelling, apart from loans, guarantees and capital investment, a considerable amount of non-refundable grants.[55]

7. CONCLUDING REMARKS

The phenomenon of social enterprises is known in Hungary, although legislation uses this terminology only in exceptional cases. The legal framework of associations, foundations, cooperatives, social cooperatives and non-profit companies primarily provides the background for their operation. In addition, they must comply with the special provisions applicable to non-governmental organisations, and in particular with the rules applicable to non-profit-making organisations, in order to be able to benefit from certain financial benefits.

In the last two decades, social enterprises have gained an increasingly significant role in the Hungarian civil sphere and in the economy. We are constantly seeing more and more initiatives that are also playing an innovative role, which is particularly to be welcomed.

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[55] European Commission, *A map of social enterprises and their eco-systems in Europe. Country report: Hungary*, Publications Office of the European Union, Luxembourg 2014, pp. 5–6.

SOCIAL ENTERPRISES IN IRELAND

Oonagh B. Breen, Paula Dolan and Deiric O'Broin

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1. WHAT IS A SOCIAL ENTERPRISE?

1.1. DEFINITION

Prior to July 2019, there was no single agreed definition of social enterprise in Ireland. The 'National Social Enterprise Policy for Ireland 2019–2022' (the National Policy), developed by the Department of Rural and Community Development and published in July 2019, provides, for the first time, an official definition for social enterprise in Ireland.

The definition in the policy is:

> A Social Enterprise is an enterprise whose objective is to achieve a social, societal or environmental impact, rather than maximising profit for its owners or shareholders.
>
> It pursues its objectives by trading on an ongoing basis through the provision of goods and/or services, and by reinvesting surpluses into achieving social objectives.
>
> It is governed in a fully accountable and transparent manner and is independent of the public sector. If dissolved, it should transfer its assets to another organisation with a similar mission.[1]

The use of the phrase 'rather than maximising profit', although qualified by the addition of 'for its owners or shareholders', arguably suggests that maximising profit should not be an objective. A clearer statement on the benefit of profit generation with limitations on distribution may be more in keeping with the principles of social enterprise.

The reference to 'by reinvesting surpluses into achieving social objectives' is definitive. It appears to leave no scope for rewarding shareholders or investors. Flexibility on this aspect could widen the net of social enterprise, broaden access to funding and benefit greater numbers.

The definition recommends that if a social enterprise is dissolved, 'it should transfer its assets to another organisation with a similar mission.' The ostensibly optional nature of this aspect of the definition, conveyed by the use of the word 'should' rather than 'must' or 'shall', may not sit well with all in the sector.

The Irish definition of social enterprise is broadly consistent with the European Union (EU) definition[2] which is:

- The organisation must engage in economic activity;
- It must pursue an explicit and primary social aim that benefits society;

[1] Department of Rural and Community Development, 'National Social Enterprise Policy for Ireland 2019–2022', https://assets.gov.ie/19332/2fae274a44904593abba864427718a46.pdf.

[2] European Parliament, 'European Parliament resolution of 5 July 2018 with recommendations to the Commission on a Statute for social and solidarity-based enterprises', 2016/2237(INL), https://www.europarl.europa.eu/doceo/document/TA-8-2018-0317_EN.html.

- It must have limits on distribution of profits or assets to prioritise the social aim;
- It must be independent from the State or other for-profit organisations; and
- It must have inclusive governance i.e. characterised by participatory and/or democratic decision-making processes.[3]

It is noteworthy that the Irish definition does not specifically include participatory or democratic governance, although it is often considered to be an integral part of social enterprise.[4]

Other long-standing actors in the Irish social economy,[5] which border and at times may overlap with the social enterprise space, include credit unions, cooperatives and charities. Unlike social enterprises, however, these entities enjoy dedicated legal frameworks and policies in Ireland.

1.2. AREAS OF OPERATION

Social enterprises in Ireland operate in a broad range of sectors. Sectors with significant social enterprise activity include: childcare; elderly care; health care; mental health supports; housing; sport; youth supports; employment; food; culture; and environmental initiatives.[6]

A recent survey of Irish social enterprises undertaken by researchers at Dublin City University, funded by the European Programme for Employment and Social Innovation,[7] found that most social enterprises fell into the following categories of operation: community; sport; social inclusion and local development (over 40%); health, including disability, mental health and age-related health (over 20%); employment; environment; education and training; food; housing; and social enterprise support. Many social enterprises operate in more than one category.[8]

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[3] ESELA, 'Social Enterprise in Europe – Developing Legal Systems which Support Social Enterprise Growth', https://www.icnl.org/wp-content/uploads/legal_mapping_publication_051015_web.pdf.

[4] C. Borzaga, S. Poledrini and G. Galera, 'Social Enterprise in Italy: Typology, Diffusion and Characteristics', Euricse Working Papers No. 96|17, 2017, https://www.euricse.eu/wp-content/uploads/2017/11/WP-96_17-ICSEM.pdf.

[5] The Irish social economy is made up of several different organisation types, all of whom have a social purpose. It includes, inter alia, social enterprise, credit unions, cooperatives, foundations, associations and charities.

[6] M. O'Shaughnessy, *Social enterprises and their ecosystems in Europe. Updated country report: Ireland*, European Commission, Publications Office of the European Union, Luxembourg 2020, https://europa.eu/!Qq64ny.

[7] EaSI-funded project 'Financing Social Enterprise in Ireland models of Impact Investing and Readiness', report due 2023.

[8] T. Lawlor and G. Doyle, 'Research on Legal Form for Social Enterprise', commissioned by the Department of Rural and Community Development and Rethink Ireland, https://rethinkireland.ie/wp-content/uploads/2021/12/Research-on-Legal-Form-for-Social-Enterprises.pdf.

Work integration social enterprises (WISE), which aim to provide employment for those marginalised from the workforce, for example those with disabilities or with a criminal record, play an important role in addressing unemployment in Ireland.[9]

1.3. UNIQUE CHARACTERISTICS

The National Policy identifies a variety of different forms of social enterprise operating in Ireland, including: WISE, which assist marginalised groups gain employment; enterprise development social enterprises, which offer business supports to other social enterprises; deficient demand social enterprises, which provide goods and services within a community where demand is insufficient to attract commercial operators; environmental social enterprises, addressing environmental issues; social enterprises contracted with the public sector; and some cooperatives.[10]

Broadly, a social enterprise business model has two key elements: (i) addressing societal needs; and (ii) an economic model directing profit to that need. Data on the actual number of social enterprises in Ireland is poor and unreliable.[11] Some attempts have been made to estimate the number. However, the estimates vary significantly. The absence of a formal definition of social enterprise prior to 2019 contributed to this. In addition, there has been a tendency historically to conflate the charity sector and the social enterprise sector. This issue is further explored in the discussion which follows on organisation forms.

A 2013 report[12] estimated the number of social enterprises in Ireland to be 1,420, employing over 25,000 people, with a total income of around €1.4 billion. However, the report acknowledged that many of these organisations had little or no income from trading. This is incompatible with the definition of social enterprise in the National Policy.

The Department of Rural and Community Development recently called for tenders[13] to undertake a mapping study of the social enterprise sector. The

[9] M. O'Shaughnessy, *Social enterprises and their ecosystems in Europe. Updated country report: Ireland*, European Commission, Publications Office of the European Union, Luxembourg 2020, https://europa.eu/!Qq64ny.

[10] Department of Rural and Community Development, 'National Social Enterprise Policy for Ireland 2019–2022', https://assets.gov.ie/19332/2fae274a44904593abba864427718a46.pdf.

[11] C. Borzaga, G. Galera, B. Franchini, S. Chiomento, R. Nogales and C. Carini, *Social enterprises and their ecosystems in Europe. Comparative synthesis report*, European Commission, Publications Office of the European Union, Luxembourg 2020, https://europa.eu/!Qq64ny.

[12] Forfás, 'Social Enterprise in Ireland – Sectoral Opportunities and Policy Issues', www.tcd.ie/business/assets/pdf/centre-social-engagement/23072013-Social_Enterprise_in_Ireland-Sectoral_Opportunities_and_Policy_Issues-Publication.pdf.

[13] Tender refers to a method of procurement.

project involved the design and implementation of a baseline data collection exercise regarding the sector. In March 2022, the project was awarded to Amárach Research, in partnership with Social Enterprise Republic of Ireland (SERI) and the Irish Local Development Network. This research has recently been published, revealing that there are 4,335 social enterprises operating in communities across Ireland.[14]

1.4. PROMINENT SOCIAL ENTERPRISES

The social economy in Ireland is not new. Industrial and provident societies, associations, cooperatives, credit unions, foundations and charitable organisations have long existed. Cooperatives and credit unions have played undeniably important roles in Irish socio-economics for decades.[15] In Ireland, cooperatives have operated largely in the agricultural sector and in financial services, for example Raiffeisen banks[16] and credit unions.

Ireland's first cooperatives were established in County Cork and the first cooperative creamery was opened in County Limerick in 1889. The first cooperative agricultural credit society, based on the Raiffeisen system, was set up in County Cork in 1894. From the establishment of the first cooperative creamery in 1889, the movement peaked at over 1,000 cooperative societies and 150,000 members by 1920.[17] The cooperative movement in Ireland retains its strongly agricultural orientation and the largest cooperative, Dairygold, has its roots in dairy cooperatives established in 1908 and 1919. Its turnover in 2020 was €1.016 billion.[18]

The Irish League of Credit Unions represents 226 credit unions and has €18 billion in assets.[19] The Credit Union Development Association represents 50 credit unions with assets of €7 billion.[20]

There have been no significant social enterprise controversies in recent years. However, there were a number of financial scandals, primarily relating to remuneration packages, in registered charities that traded and provided

[14] Amárach Research, SERI and ILDN, 'Social Enterprises in Ireland: A Baseline Data Collection Exercise Report, commissioned by the Department of Rural and Community Development', May 2023, https://www.socialenterprise.ie/_files/ugd/d0fc11_2da8f1b579bd4866baf45581e2c65e30.pdf.

[15] www.creditunion.ie/about-credit-unions/history-of-credit-unions/ and http://icos.ie/about/history/.

[16] C.L. Colvin and E. McLaughlin, 'Raiffeisenism abroad: why did German cooperative banking fail in Ireland but prosper in the Netherlands?' (2014) 67(2) *Economic History Review* 492.

[17] P. Doyle, *Civilising rural Ireland – The co-operative movement, development and the nation-state, 1889–1939*, Manchester University Press, Manchester 2019.

[18] www.dairygold.ie/wp-content/uploads/2021/04/Dairygold-Annual-Report-2020-WEB.pdf.

[19] www.creditunion.ie.

[20] www.cuda.ie.

services as social enterprises. These organisations are subject to regulation by the Charities Regulatory Authority.[21]

1.5. SOURCES OF FINANCE

Both corporate and cooperative forms of social enterprise potentially have access to the same sources of funding: investment from members or shareholders, grants, donations and loans.

A recent survey of Irish social enterprise indicates that grant aid and government funding are important sources of funding for the majority of social enterprises when establishing. Personal funding also represents a significant source of finance, while very few social enterprises rely on debt finance at the start-up stage.[22]

The research indicated that as social enterprises become established, traded income becomes the most significant source of finance. However, the majority of social enterprises continue to be reliant on government and other grant funding. A culture of grant dependency is seen as an impediment to the growth of demand for alternative sources of funding.[23] Only 23% of social enterprises surveyed indicated that they had relied on debt finance to fund day-to-day activities, while 30% had used debt finance to expand their social enterprise. Traditional banks and social finance providers were the most commonly used sources of debt finance, with very few social enterprises borrowing from credit unions. Most of this debt finance was secured by personal guarantees.

Over half of the social enterprises surveyed indicated that they envisaged borrowing in the future, with the majority indicating that social finance providers would be their preferred source of this finance.

In addition to traditional banks and credit unions, there are currently a small number of dedicated social finance providers in the Irish market, including Community Finance Ireland and Clann Credo. The Social Finance Foundation, a not-for-profit, limited company with no share capital, using a 12-year, €72 million loan at a low rate of interest provided by the Irish banking industry, works as a wholesale supplier of funding to these social finance providers.[24]

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21 www.irishtimes.com/news/social-affairs/decision-taken-to-shut-down-scandal-hit-charity-console-1.2713791, www.independent.ie/irish-news/crc-scandal-kiely-wont-give-back-the-charity-cash-29929583.html, and www.independent.ie/irish-news/rehab-used-charity-cash-to-pay-for-their-staff-cars-29945871.html.

22 EaSI-funded project 'Financing Social Enterprise in Ireland models of Impact Investing and Readiness', report due 2023.

23 M. O'Shaughnessy, *Social enterprises and their ecosystems in Europe. Updated country report: Ireland*, European Commission, Publications Office of the European Union, Luxembourg 2020, https://europa.eu/!Qq64ny.

24 S. O'Leary and A. Brennan, 'Ireland's Social Finance Landscape' (2017) 6(1) *ACRN Oxford Journal of Finance and Risk Perspectives* 90.

Although very few social enterprises had relied on more nascent sources of finance, such as crowdfunding, the vast majority indicated that with the appropriate support, they would be willing to consider using such sources of funding. There was less enthusiasm for the future use of private equity funding, primarily owing to concerns relating to governance and profit distribution. However, half of those surveyed indicated that they would be willing to consider such funding. At this time, no social enterprise in Ireland is publicly held.

In terms of grant aid and non-repayable finance, key players in the Irish social enterprise sector include: Pobal, Rethink Ireland, Enterprise Ireland, the Local Enterprise Offices of city and county councils, Social Entrepreneurs Ireland, Philanthropy Ireland, the Arthur Guinness Fund, and The Ireland Funds. Recently the Department of Rural and Community Development, in partnership with Community Foundation Ireland, announced the launch of a new hybrid social finance product incorporating a loan, a non-repayable loan, business supports and capacity-building support.[25] Community Foundation Ireland also announced a collaborative initiative with the Irish League of Credit Unions to help enhance lending to local community organisations.[26]

2. SOCIAL ENTERPRISE LEGAL FORMS

While the definition provided in the National Policy delineates the concept of social enterprise for policy purposes, it is not a legally enforceable definition and does not correspond to any particular legal form. Instead, social enterprises in Ireland have a range of options to choose from when establishing. A social enterprise can choose from a number of different legal structures available under the Companies Act 2014 (the 2014 Act), including non-profit and for-profit options. Alternatively it can choose to incorporate as a cooperative under the Industrial and Provident Societies Acts, 1893–2021,[27] or it can choose to remain unincorporated. A social enterprise's legal form can impact matters such as registration and reporting requirements, taxation, access to finance, access to grant aid, governance, liability and directors' remuneration.[28]

[25] https://rethinkireland.ie/current_fund/hybrid-social-finance-loan-2023-2024/.

[26] https://www.independent.ie/business/irish/credit-unions-team-up-with-social-enterprise-funder-to-provide-loans-to-charities-and-sports-groups/a1310498438.html.

[27] In November 2022, the Minister for Enterprise, Trade and Employment introduced the General Scheme for the Cooperatives Societies Bill 2022, https://enterprise.gov.ie/en/legislation/legislation-files/general-scheme-for-the-co-operative-societies-bill-2022.pdf. When enacted, this proposed legislation will repeal the Industrial and Provident Societies Acts. Existing societies will be facilitated either to wind up (Head 256) or to convert either to companies (Head 258) or to cooperative societies (Head 257) under the new Act.

[28] A. Triponel and N. Agapitova, 'Legal Framework for Social Enterprise – Lessons from a Comparative Study of Italy, Malaysia, South Korea United Kingdom and United States',

2.1. SOCIAL ENTERPRISE COMPANY FORMS

In Ireland, the 2014 Act consolidated all company legislation dating back to 1963. It introduced reforms and provides for several company types.[29] A social enterprise can choose any of these forms in the same way as a for-profit organisation. Some of these forms are a better fit for social enterprises than others, but none is specifically designed to cater for the sector.

The Corporate Enforcement Authority (CEA)[30] enforces compliance with company law for all companies governed by the 2014 Act. The Companies Registration Office (CRO)[31] is responsible for the incorporation of companies, the registration of business names and enforcement relating to company filing requirements. Both the CEA and the CRO operate under the Department of Enterprise, Trade and Employment.

Setting up a company is relatively straightforward and can be done online. The CRO website sets out the necessary requirements and fees and provides links to sample company constitutions set out in the legislation. Online filing is now mandatory for new company incorporations.[32]

2.1.1. Company Limited by Guarantee

The company limited by guarantee (CLG) is by far the most popular type of organisation form used by social enterprises in Ireland. Recent surveys estimate that between 68%[33] and 72%[34] of social enterprises incorporate in this way. The surveys additionally found that over 60% of social enterprises have charitable status. It should be noted that while the CLG is a legal form of organisation governed by the 2014 Act, charitable status is not a legal form of organisation. It is a status governed by law, namely the Charities Act 2009. The basic characteristics of CLGs and of the other corporate forms used by Irish social enterprises are discussed briefly below. Readers are referred to specialised works for a more detailed consideration of these forms.[35]

World Bank Group, 2016, http://docments.worldbank.org/crated/en/290291492573779508/pdf/114405-18-4-2017-15-11-50-DesignLegalFrameworksforSEsApr.pdf.

29 https://dbei.gov.ie/en/What-We-Do/Company-Corporate-Law/Companies-Act-2014/.

30 https://cea.gov.ie/en-ie/.

31 www.cro.ie/en-ie/.

32 www.cro.ie/Registration/Company/Required-Steps.

33 EaSI-funded project 'Financing Social Enterprise in Ireland models of Impact Investing and Readiness', report due 2023.

34 T. Lawlor and G. Doyle, 'Research on Legal Form for Social Enterprise', commissioned by the Department of Rural and Community Development and Rethink Ireland, https://rethinkireland.ie/wp-content/uploads/2021/12/Research-on-Legal-Form-for-Social-Enterprises.pdf.

35 T.B. Courtney et al., *The Law of Companies*, Bloomsbury, Dublin 2016.

The CLG structure provides the benefits of separate legal personality and of limiting liability of members. A CLG can enter into contracts in its own right, including contracts to reward members based on the CLG's performance,[36] although CLGs with charitable status are prohibited from the latter type of action. Liability of members only arises on winding up. Liability is limited to the amount undertaken to be contributed to the assets of the company, frequently a nominal amount, for example €1.

CLGs do not have share capital. Members are not shareholders. A CLG can accept loans and donations from members and non-members. The constitution of a CLG frequently prohibits the distribution of profits to members, but this is not mandated by the 2014 Act.[37] The constitution of a CLG is made up of a memorandum of association and articles of association.

Unless the CLG's constitution provides otherwise, directors' remuneration, if there is any, is determined by the members. Members control a CLG; they can amend the constitution and remove directors. Directors can be remunerated employees of CLGs. However, restrictions apply to the payment of directors in CLGs with charitable status. In practice, many CLG directors act on a voluntary basis. A CLG must prepare and file annual accounts with the CRO, as required by the 2014 Act.

A CLG may be formed for any legal purpose. A CLG's constitution must contain an objects clause. The objects clause of a CLG's constitution, which is set out in the memorandum of association, will outline its permitted activities. Acts which are ultra vires the CLG will not be void. Directors are responsible for ensuring that a CLG acts within its objects.

As mentioned above, most social enterprises in Ireland incorporate as a CLG and also register for charitable status. In order to acquire charitable status, a CLG or any other organisation legal form must register with the Charities Regulatory Authority (CRA).

The CRA, established by the Charities Act 2009, regulates charitable organisations in Ireland.[38] The Act requires a charity to have a charitable purpose that is for the public benefit, for example the prevention or relief of poverty or economic hardship, the advancement of education, the advancement of religion, or any other purpose that is of benefit to the community. The charitable purpose must benefit the public.[39] Public benefit is defined in the 2009 Act.[40] A purpose that is of 'benefit to the community' includes, inter alia, promotion of health and

[36] 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file.

[37] T.B. Courtney et al., *The Law of Companies*, Bloomsbury, Dublin 2016, 32.038.

[38] For a more detailed consideration of charity law see O. Breen and P. Smith, *Law of Charities in Ireland*, Bloomsbury, Dublin 2019.

[39] Charities Act 2009, s. 2.

[40] Charities Act 2009, s. 3(2)–(7).

the arts, or protection of the environment and animals.[41] The charitable purpose must be stated in the objects clause in the company's constitution.

All charities must provide an annual report to the CRA. Corporate charities must also fulfil their reporting obligations under the 2014 Act.[42] Of the 11,426 charities registered in Ireland in 2020, 4,760 were incorporated as companies.[43] A 2020 survey of social enterprises identified the principal reasons for seeking charitable status as: to access grant aid and social finance; to protect their reputation; to build trust among stakeholders; and to benefit from charitable tax exemption.

To be granted charitable tax status by the Revenue Commissioners, certain requirements must be met. The charitable purpose must be set out in the company's objects. Income and property must be applied only to the company's purpose and cannot be distributed to members. Directors cannot be remunerated. There are also restrictions on trading, which must be directly associated with the primary purpose of the charity.[44] If wound up, the assets must be transferred to another entity with similar objects. CRA consent is required to amend the memorandum of association.[45]

Charitable status can address some of the shortcomings for social enterprises of legal forms available under the 2014 Act, for example asset lock and prohibition on payment of directors and on disbursement of any profit. However, the inability to recoup VAT can be a disadvantage if the entity has significant trading. It also has significant cost implications for capital projects. To ameliorate the hardship of this, the Revenue Commissioners introduced a Charities VAT Compensation Scheme in 2018.[46] It is available to refund charities on certain eligible VAT payments. Only one claim can be made per annum. The fund is capped annually at €5 million.[47]

Charitable status can be required to access certain sources of funding but can ultimately prove an impediment to growth based on trade and investment. Charitable status also prevents the remuneration of directors. This means that the founders of a social enterprise with charitable status cannot be board members if they are remunerated employees of the social enterprise. This has the potential to result in the founders of a social enterprise losing control of the organisation.[48]

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41 Charities Act 2009, s. 3(11).

42 J.C. O'Connor and H. McGrath, 'Charitable Organisations in Ireland: overview' (2020), https://uk.practicallaw.thomsonreuters.com/8-632-9148?transitionType=Default&contextData=(sc.Default)&firstPage=true.

43 www.charitiesregulator.ie/media/2211/final_charities-regulator-annual-report-2020.pdf.

44 O. Breen and P. Smith, *Law of Charities in Ireland*, Bloomsbury, Dublin 2019.

45 T.B. Courtney et al., *The Law of Companies*, Bloomsbury, Dublin 2016, 32.003.

46 www.revenue.ie/en/companies-and-charities/charities-and-sports-bodies/vat-compensation-scheme/vat-compensation-scheme-for-charities/index.aspx.

47 O. Breen and P. Smith, *Law of Charities in Ireland*, Bloomsbury, Dublin 2019, pp. 154–62.

48 P. Dolan, 'Is a New Legal Form Required for Social Enterprise in Ireland?', LLM dissertation, Dublin City University, 2020.

An example of a large Irish social enterprise incorporated as a CLG with charitable status is Sensational Kids CLG.[49] It promotes the health and welfare of children with special needs by providing clinical assessments, occupational therapy, sensory integration therapy, speech and language therapy, and psychological services. It operates four centres across Ireland. In fulfilling its core mission, Sensational Kids adopts a social enterprise business model through which it aims not to be dependent on grant income or donations to continue its operations. Its trading income (comprising clinical, retail and training income) currently accounts for an impressive 71% of total income. This funding model – where grants/donations are a welcome bonus rather than core to survival – gives the organisation more flexibility in how it delivers its services and allows it to plan and grow sustainably.

2.1.2. Private Company Limited by Shares

The 2014 Act created a new private company limited by shares (LTD).[50] 89% of companies registered in Ireland are LTDs, of which most are for-profit entities.

Regarding social enterprises, the most significant feature of an LTD is that it cannot have an objects clause in its constitution. Consequently, directors cannot act ultra vires the company. This may make this type of incorporation unattractive to many social enterprises, which desire to constrain the entity within a chosen social mission, but it is used by some. There is no legal impediment to using an LTD to operate a social enterprise.

LTDs have separate legal personality and full unlimited contractual capacity.[51] If a director has an interest in a contract entered into by the LTD, it must be declared to the board.[52] An LTD has limited liability; on winding up, the liability of shareholders is limited to the amount, if any, unpaid on the shares taken by them in the LTD.[53]

Companies limited by shares must have share capital; this allows for the raising of equity finance. This is the shareholders' interest in the company,[54] for which they will generally expect a return in the form of dividends.[55] The shareholders control the company and can pass resolutions and change the

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49 www.sensationalkids.ie.

50 https://dbei.gov.ie/en/What-We-Do/Company-Corporate-Law/Companies-Act-2014/.

51 T.B. Courtney et al., *The Law of Companies*, Bloomsbury, Dublin 2016, 1.138.

52 Companies Act 2014, s. 231.

53 T.B. Courtney et al., *The Law of Companies*, Bloomsbury, Dublin 2016, 1.138.

54 T.B. Courtney et al., *The Law of Companies*, Bloomsbury, Dublin 2016, 3.026.

55 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file.

company's constitution. They can also remove directors. The ownership structure of an LTD may not suit a community organisation.[56]

An LTD can issue different classes of shares. For example, it could issue shares with no dividend entitlement.[57] Asset locks and limits on profit distribution can be incorporated into the company's constitution. Using these and other legal mechanisms, it is possible to create an LTD which has the characteristics frequently expected in a social enterprise.

While an LTD can be perceived as incompatible with social enterprise, some social enterprises choose to incorporate in this way. This can facilitate access to certain business supports, for example Enterprise Ireland business and financial support, although being an LTD can present challenges for accessing grant aid. However, it can be an advantageous model for raising private investment and debt finance. Jobs for Family Carers LTD is a recently established social enterprise which has used the LTD legal form to incorporate. Its purpose is to provide employment opportunities for individuals who cannot engage with the mainstream employment market due to their commitments as carers.[58]

2.1.3. Designated Activity Company

The 2014 Act introduced a new private limited company, a designated activity company (DAC). A DAC can be limited by shares (corresponding to a private company limited by shares under previous legislation).[59] Alternatively, a DAC may be limited by guarantee with share capital. The constitution of a DAC is made up of a memorandum of association and articles of association.

As at the end of 2019, there were 5,069 DACs limited by shares. There were only 95 DACs limited by guarantee with share capital.[60]

Like a CLG, the constitution of a DAC has two parts: a memorandum and articles of association. A key feature of a DAC is that it has an objects clause in its memorandum of association outlining the activity to which the company designates itself. The objects clause can be amended by special resolution.

Control of the DAC resides with the shareholders or members. A DAC's articles of association can include provisions which limit dividends and/or provide for asset lock. A DAC can raise capital by issuing shares to members. Members can make loans and donations to the company. Employees of a DAC

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[56] Irish Social Enterprise Network, 'Social Enterprise Toolkit', 2017.

[57] 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file.

[58] https://jobsforfamilycarers.ie.

[59] https://dbei.gov.ie/en/Publications/Publication-files/Quick-guide-to-the-New-Company-Types-.pdf.

[60] Companies Registration Office Report, 2018, www.cro.ie/Publications/Publications/Corporate.

can be shareholders and directors and can be remunerated accordingly. Non-executive directors may also be remunerated but have no automatic entitlement.

Section 971 of the 2014 Act, unusually given the requirement for share capital, envisages that, subject to certain requirements, a DAC may operate as a 'not-for-profit' or charity. In the same manner as described above, a DAC must register with the Charities Regulator to be granted charitable status. It must apply to the Revenue Commissioners for charitable tax exemption status. Historically, the Revenue Commissioners have been reluctant to grant this status to companies with share capital.[61] A DAC can operate as a not-for-profit but choose not to register as a charity.

The existence of an objects clause in a DAC is well suited to a social enterprise. As with an LTD, concerns relating to directors and dividends can be addressed in the DAC's constitution and shareholder agreements. For example, Athchursail, which is incorporated as a DAC, serves the waste management needs of the three Aran Islands (which have Special Areas of Conservation status under the EU Natural Habitats Directive) and has transformed its recycling infrastructure.

2.1.4. Unlimited Company

Like a limited company, an unlimited company (UC) has a separate legal personality to its members. It can contract and own property. However, a UC's members are, in insolvency, liable for the debts of the company on an unlimited basis. For this reason, UCs are not generally used for trading companies. They account for little more than 2% of registered companies in Ireland.

In addition to the potential liability of members, rules on distribution and the filing of financial statements are likely to make UCs unattractive propositions to social enterprise.

2.1.5. Group Structures

It is possible for a social enterprise to be made up of more than one company type – for example, a parent company and subsidiaries. A parent for-profit company may be incorporated as an LTD and own a subsidiary organisation in the CLG form. Similarly, a not-for-profit organisation could set up a subsidiary to conduct trading activities.[62] The use of group structures is not common

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[61] T.B. Courtney et al., *The Law of Companies*, Bloomsbury, Dublin 2016, 30.099.

[62] 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file. See also O. Breen and P. Smith, *Law of Charities in Ireland*, Bloomsbury, Dublin 2019, pp. 415–40.

among Irish social enterprises. Recent research found only 20% of Irish social enterprises were part of a group of organisations. This research also found that there was a lack of awareness among social enterprises regarding the potential benefits of the use of such structures.[63]

An example of a large Irish non-profit social enterprise incorporated using a group structure is Grow it Yourself (GIY). It helps people grow food and learn about food sustainability. GIY is a social enterprise consisting of two companies: GIY Ireland CLG and GIY Ireland Activities Ltd. Initially established as a CLG, the business later established an LTD trading subsidiary in order to access additional sources of finance and to scale.[64]

2.1.6. *Directors' Duties*

In Ireland, directors of incorporated companies owe a fiduciary duty to the company. A key aspect of this fiduciary duty is that directors must act for a proper purpose without self-interest.[65]

In Ireland, section 227 of the 2014 Act provides that a director's duty is to the company. The Act (ss. 224 and 228) also specifically provides that directors must have regard to the interests of employees in general, as well as the interests of its members.

The Act further provides that directors must 'act in accordance with the company's constitution'. A company's constitution can be altered by its members to include any lawful requirement. Members can use the company constitution to impose contractual duties on directors.[66]

An issue of concern for social enterprise which is common to all organisation types under the 2014 Act is the absence of asset lock. However, it is possible to incorporate an asset lock obligation into a company's constitution. However, it should be borne in mind that such an addition, like any addition to a constitution, can be undone.

Another addition to a company's constitution which might be attractive to a social enterprise would be an obligation on directors to take various matters into consideration in decision-making, for example the company's stated objects, employees, suppliers, the community and the environment.

The CEA is responsible for enforcement where directors fail in their fiduciary duty.

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[63] EaSI-funded project 'Financing Social Enterprise in Ireland models of Impact Investing and Readiness', report due 2023.

[64] https://giy.ie.

[65] A. Keay and L. Kosmin, *Directors' Duties*, Jordan, Bristol 2009, 2.36–2.38.

[66] T.B. Courtney et al., *The Law of Companies*, Bloomsbury, Dublin 2016, 16.030.

2.2. COOPERATIVES

The cooperative model has been used as a vehicle for social enterprise by several EU Member States.[67] Many EU countries legally recognise social enterprise in the cooperative form.[68] The cooperative model is arguably closer to the philosophy of social enterprise than a company form.[69]

In Ireland, friendly societies and industrial and provident societies developed as part of the mutual self-help movement of the 19th century. This included cooperatives, building societies, savings banks, credit unions and trade unions.

The CRO[70] maintains the Register of Friendly Societies. The entities that make up the register are governed by three key pieces of legislation: the Industrial and Provident Societies Acts, 1893–2021; the Friendly Societies Acts, 1896–2021; and the Trade Union Acts, 1871–1990. Cooperatives are governed by the Industrial and Provident Societies Acts, 1893–2021. The cooperative model of organisation under these frameworks has a number of features which make it compatible with social enterprise. These include: democratic structure and governance; activities limited to the stated objects; and the possibility of incorporating an asset lock. In addition, members have the benefit of limited liability.

Not all cooperatives are social enterprises. Some operate for the benefit of their members only. These are known as mutuals. Others operate for the benefit of the wider community and some of these may consider themselves social enterprises.[71]

In 2020, there were 960 industrial and provident societies on the register. This number has remained fairly static over the past decade.[72]

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67 A. Fici, 'A European Statute for Social and Solidarity Based Enterprise', Policy Department for Citizens Rights and Constitutional Affairs, 2017, www.europarl.europa.eu/supporting-analyses.

68 A. Fici, 'European Social Enterprise Law After the "Social Business Initiative" Communication of 2011: A Comparative Analysis from the Perspective of Worker and Social Cooperatives', CECOP, Brussels 2020, https://cecop.coop/uploads/file/bzuQI79nF5yrrwoDvUNUg47Ro7iaHA6wAxsvK9yo.pdf.

69 A. Fici, 'Recognition and Legal Forms of Social Enterprise in Europe: A Critical Analysis from a Comparative Law Perspective' (2016) 27(5) *European Business Law Review* 639.

70 www.cro.ie/en-ie/.

71 A. Fici, 'European Social Enterprise Law After the "Social Business Initiative" Communication of 2011: A Comparative Analysis from the Perspective of Worker and Social Cooperatives', CECOP, Brussels 2020, https://cecop.coop/uploads/file/bzuQI79nF5yrrwoDvUNUg47Ro7iaHA6wAxsvK9yo.pdf.

72 Registrar of Friendly Societies Annual Report 2020, http://www.cro.ie/Portals/0/Forms/RFS%20Annual%20Report%202021%20Final%20PDF%20Revised.pdf?ver=f7UkFB0NDd2NLcFOY4XwVA%3d%3d. It should be noted in this regard that it is no longer possible to register a new Friendly Society. The change was introduced following the application of s. 5 of the Friendly Societies and Industrial and Provident Societies (Miscellaneous Provisions) Act 2014.

Rules governing the society's operation must include the matters required by the Industrial and Provident Societies Act 1893, including the object of the cooperative or the purpose for which it will function. Activities of the organisation are limited to the objects. The rules can also include an asset lock.[73] Registration support and model rules exist for new cooperatives.[74]

Once registered, a cooperative has legal personality separate from its members. It can enter into contracts and has limited liability. Member liability is limited to the shares they hold in the cooperative.

Each cooperative is governed by its committee of management. A significant distinguishing feature of cooperatives, compared to companies, is that there can only be one class of share. Each member is limited to one vote. All members contribute and control equally. The default position under current legislation limits a member's interest to not greater than €150,000 or 1% of capital, whichever is greater. The rules of the cooperative, however, can provide otherwise. This feature of democratic governance makes a cooperative form of organisation a good fit with social enterprise.[75]

A cooperative can change its name, amalgamate with another cooperative or convert into a company form. A company can also convert into a cooperative.[76]

Industrial and provident societies operate across a wide range of industries. There are many large and well-known cooperatives in the agri/food sector.[77] The Dublin Food Cooperative Society Limited[78] is a significant Irish social enterprise that is incorporated in this way. It was established in 1983 and incorporated in 1991. The cooperative operates for the benefit of its 2,000 members and the wider community. Although the recipient of grant aid in the past, the cooperative's main funding is now from traded income.

An alternative to establishing a cooperative under the Industrial and Provident Societies Acts, 1893–2021 is to utilise the Companies Act 2014 to establish a cooperative-type organisation. The Great Care Coop, Ireland's first carer-run and owned cooperative,[79] is a CLG incorporated with a cooperative-style governance structure.

The Department of Enterprise Trade and Employment is currently undertaking a long-awaited extensive overhaul of the legislation governing

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73 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file.

74 http://icos.ie/starting-a-co-op/registering-a-co-op/.

75 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file.

76 www.cro.ie/Society-Union/RFS-Industrial-and-Provident-Societies.

77 www.cro.ie/Society-Union/RFS-Industrial-and-Provident-Societies.

78 https://dublinfood.coop/co-op/story/.

79 www.thegreatcarecoop.ie/ourstory.

cooperatives in Ireland. The Industrial and Provident Societies Act 1893 is widely regarded as being significantly outdated, with many of its provisions predating the establishment of the state.[80]

In 2022, the Department of Enterprise, Trade and Employment launched a public consultation on the reform and modernisation of this legislation. The aim of the Cooperatives Societies Bill is to provide a modern and effective legislative framework suitable for the diverse range of organisations using the cooperative model in Ireland.[81] Preparation of the revised legislation is at an advanced stage.

If an Irish social enterprise intends to operate across the EU, it may be worth considering incorporating as a European Cooperative Society (Societas Cooperativa Europaea, SCE). The SCE is a pan-European legal form of cooperative. It was introduced by the EU in 2006 to facilitate the cross-border activities of cooperatives. Five members, who must be from more than one Member State, are required to establish an SCE.[82]

SCEs were established by Council Regulation (EC) No. 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE). The Regulation was given full effect in Irish Law by SI No. 433/2009 – the European Communities (European Cooperative Society) Regulations 2009.[83] Employee involvement is governed by SI No. 259/2007 – the European Communities (European Cooperative Society) (Employee Involvement) Regulations 2007.[84] The CRO is also responsible for the registration of European Cooperative Societies.[85]

While the cooperative form of organisation plays a significant role in the economies of several EU Member States, to date there has been limited interest in incorporating as an SCE in Ireland.[86]

2.3. UNINCORPORATED ORGANISATIONS

In Ireland, a social enterprise is not obliged to legally incorporate. Unincorporated organisations require limited formalities to establish and have less onerous reporting requirements than incorporated entities. The cost of set-up is minimal. However, an unincorporated entity does not have a separate legal personality

80 www.independent.ie/business/farming/agri-business/root-and-branch-overhaul-of-laws-governing-co-operatives-on-the-way-37900571.html.
81 https://enterprise.gov.ie/en/News-And-Events/Department-News/2022/January/28012022.html.
82 https://ec.europa.eu/growth/sectors/proximity-and-social-economy/social-economy-eu/cooperatives/european-cooperative-society-sce_en.
83 https://www.irishstatutebook.ie/eli/2009/si/433/made/en/print.
84 https://www.irishstatutebook.ie/eli/2007/si/259/made/en/print.
85 https://www.cro.ie/en-ie/Society-Union/RFS-Fees/RFS-Fees-SCE.
86 www.eurofound.europa.eu/observatories/eurwork/industrial-relations-dictionary/european-cooperative-society.

to its members/owner. It cannot contract or own property in its own right. Personal liability of members is unlimited both during the lifetime of the entity and on winding up.[87] Attracting finance[88] and high-calibre employees[89] can be difficult for these organisations. The lack of public governing documents is inconsistent with transparency. For these reasons, this may not be an attractive option for social enterprises. In Ireland more than half of organisations with charitable status are unincorporated.[90] Examples of unincorporated entities are sole traders, unincorporated associations and partnerships.

Members or owners of these unincorporated entities are liable for income tax, universal social charge and pay-related social insurance, and capital gains tax if it arises.

These entities cannot raise equity finance. Many use personal funds to establish. They may also be able to raise loan finance but collateral or personal guarantees are often required. Being unincorporated can present difficulties in attracting grant or donation finance.[91]

A social entrepreneur may choose this form of organisation initially and then later incorporate in one of the manners outlined above. It may also be a suitable form for a short-term social project.

3. SOCIAL ENTERPRISE LIFECYCLE

3.1. FORMATION

In Ireland currently, establishing a social enterprise is no different from establishing any commercial organisation. A social enterprise can operate as an unincorporated entity, or it can choose to incorporate in any of the legal forms provided for in the 2014 Act or as an industrial and provident society. The CRO is responsible for the registration of all bodies corporate. Registration can be done online.

Since social enterprise is not a term with legal meaning in Ireland, no pre-approval or specific criteria are required to establish a social enterprise. There is no regulation of social enterprises in Ireland and there is no register of these organisations. Social enterprises which incorporate have the same obligations as

87 O. Breen and P. Smith, *Law of Charities in Ireland*, Bloomsbury, Dublin 2019, Ch. 7.
88 Irish Social Enterprise Network, 'Social Enterprise Toolkit', 2017, Ch. 4.
89 Irish Social Enterprise Network, 'Social Enterprise Toolkit', 2017, Ch. 4.
90 www.charitiesregulator.ie/media/2211/final_charities-regulator-annual-report-2020.pdf.
91 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file.

other incorporated organisations to prepare and file annual accounts with the CRO, as is required by the 2014 Act. Filings in the CRO are publicly available.

If a social enterprise is registered as a charity it will also be obliged to meet the reporting requirements of the Charities Regulator under the 2009 Act.

All company forms are required to register for corporation tax, which at the time of writing is 12.5% on traded income. In line with recent OECD agreement, this is set to increase to 15% in 2023 for very large corporations by applying a qualified domestic top-up tax to companies with turnover greater than €750 million.[92] Corporation tax on non-traded income is 25%. If a company has employees, it must register for the associated payroll taxes. When turnover reaches levels set out by the Revenue Commissioners, companies must also register for VAT. Companies can choose to register for VAT immediately on incorporation.[93] A cooperative's tax obligations are the same as a company governed by the 2014 Act.[94]

If an organisation has been granted charitable status by the CRA, it can apply to the Revenue Commissioners for charitable tax exemption status. This means the organisation may be exempt from paying income tax, corporation tax, capital gains tax, deposit interest retention tax, capital acquisitions tax, dividend withholding tax, professional services withholding tax, and stamp duty. If the charity has employees, income tax under the pay-as-you-earn (PAYE) system will arise.[95]

3.2. MAINTENANCE

All companies governed by the 2014 Act have legal registration and filing obligations with the CRO. There is no regulator for social enterprise in Ireland. All company forms are required to adhere to annual and ongoing compliance obligations. This includes maintenance of registers, the holding of meetings and the recording of minutes, and the preparation and filing of annual accounts.[96]

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92 https://www.irishtimes.com/business/economy/2023/03/28/ireland-set-to-avoid-implementing-15-headline-corporate-tax-rate/.

93 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file.

94 http://icos.ie/wp-content/uploads/2012/02/Co-operative-Development-Starting-a-co-op.pdf.

95 https://www.revenue.ie/en/companies-and-charities/charities-and-sports-bodies/charitable-tax-exemption/index.aspx. See also O. Breen and P. Smith, *Law of Charities in Ireland*, Bloomsbury, Dublin 2019, Ch. 10.

96 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file.

The contents of these returns and audit requirements are prescribed by the 2014 Act and will depend on matters such as turnover, value of assets and number of employees.[97] Ongoing filing obligations also apply to cooperatives, but unlike smaller companies, smaller cooperatives are currently not exempt from audit requirements.[98] Filings with the CRO are publicly available.

The measurement of social impact is not widespread among social enterprises in Ireland. In a recent survey, only 27% of respondents indicated that they did formally measure their social impact.[99] This is not very surprising given there is no legal recognition of social enterprise in Ireland and, therefore, there is no formal requirement for social enterprises to demonstrate their impact. The limited uptake of social enterprise certifications (discussed below) also explains the limited engagement with impact measurement. However, in the same survey, when asked if they would be prepared to consider agreeing to certain performance or impact targets related to their social enterprise purpose in order to access finance, 90% of respondents indicated that they would. This indicates a huge willingness to engage with impact measurement if rewards and benefits follow.

3.3. EXIT

The liability of shareholders or members on winding up will depend on the legal form adopted.

For a CLG, which is the most common form of incorporation used by Irish social enterprise, liability is limited to the amount undertaken to be contributed to the assets of the company,[100] usually a nominal amount, for example €1.[101]

DACs, being a form of company with an objects clause, may also be attractive to a social enterprise as a legal form. If a DAC is limited by shares, shareholder liability on winding up is limited to the amount already invested and any amount unpaid on shares registered in the name of the member. In DACs limited by guarantee, liability includes the amount undertaken on foot of the guarantee.[102]

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97 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file.

98 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file.

99 EaSI-funded project 'Financing Social Enterprise in Ireland models of Impact Investing and Readiness', report due 2023.

100 T.B. Courtney et al., *The Law of Companies*, Bloomsbury, Dublin 2016, 32.001–32.002.

101 T.B. Courtney et al., *The Law of Companies*, Bloomsbury, Dublin 2016, 32.011.

102 T.B. Courtney et al., *The Law of Companies*, Bloomsbury, Dublin 2016, 30.022.

In an unincorporated social enterprise or a social enterprise incorporated as an unlimited company, liability of shareholders or members on winding up is unlimited.

On winding up, the liability of the members in a cooperative is limited to the shares they hold in the cooperative.

Regardless of legal form, if shareholders or members have provided personal guarantees for the debts of the social enterprise, this will not be protected by limited liability where it exists.

A social enterprise can choose to incorporate in any legal form and can also change from one form of incorporation to another.[103] If an organisation with charitable status wishes to change its form of incorporation, it will be necessary to reapply to the CRA for charitable status and the Revenue Commissioners for charitable tax exemption. The same applies to an unincorporated entity that wishes to incorporate. It should be noted that while it is legally permissible for a DAC to be a charity, the Revenue Commissioners are reluctant to grant charitable tax-exempt status to companies with a share capital.[104] Subject to complying with certain requirements, two organisations with charitable status can merge and retain their charitable status and tax exemption.[105]

There is no legal form under the 2014 Act that mandates the transfer of assets on winding up. However, if a social enterprise, whether it takes a corporate form or other form, has charitable status, it must transfer its assets on winding up to another organisation that has a similar purpose. This is known as the doctrine of cy-près. Both the CRA and the Revenue Commissioners require a clause to that effect in the constitution of the organisation being granted charitable status and charitable tax exemption status.

It is possible to voluntarily incorporate clauses in a company's constitution that stipulate what must be done with assets on winding up. It is common for the constitution of a CLG to stipulate that in a solvent winding up its assets will be transferred to an organisation with a similar objects clause.[106] Other mandatory actions on winding up can also be included in the company constitution. This is a decision for the shareholders or members.

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103 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file.

104 T.B. Courtney et al., *The Law of Companies*, Bloomsbury, Dublin 2016, 32.099.

105 https://www.revenue.ie/en/companies-and-charities/charities-and-sports-bodies/charitable-tax-exemption/charities-that-are-changing-legal-structure.aspx.

106 'Social Enterprise in Ireland, Legal Structures Guide 2020', Thomson Reuters Foundation, Mason Hayes and Curran Solicitors, www.trust.org/contentAsset/raw-data/803a5a3e-2cac-478a-bc4f-5dcac13b3f10/file.

4. CERTIFICATION

There is no government-controlled or supported certification for social enterprises in Ireland. B Corp is a private certification regime for for-profit social enterprises. It is run by a non-profit organisation named B Lab, founded in 2006 in Pennsylvania.[107] B Corps are certified by B Lab to meet standards of social and environmental performance, accountability and transparency.[108] At the time of writing, there are nine B Corps certified in Ireland.[109] Prominent B Corps in Ireland include Danone Dairy Ireland, Cully & Sully and Urbanvolt. There are over 130 certified B Corps operating in Ireland, many of these being certified in the UK.[110]

In November 2020, Social Impact Ireland announced it had partnered with Social Enterprise Mark CIC (an organisation which accredits social enterprises in the UK). The mark is an independent, externally assessed guarantee that a business is operating as a social enterprise. The mark launched with five social enterprises undertaking the awards process.[111]

While these organisations achieving B Corp status have commitments to social and or environmental aims woven into their company constitutions, the certification does not include elements aligned with the organisational objective, reinvestment and asset-locking components of social enterprise as articulated in Ireland's National Policy definition.

The criteria for accreditation for the SE Mark more closely align with the Irish definition of social enterprise. For example, there are requirements in relation to asset lock and profit distribution, as well as a rigorous assessment process of their legal structure and governance, trading model, business strategy and impact. Both certifications, however, are entirely private and neither triggers tax or other governmental benefits or advantages for certified entities.

5. PREFERENTIAL TREATMENT

5.1. SUBSIDIES GRANTS AND TAXATION

There are currently no government subsidies specifically targeted for social enterprises, but a number of government agencies do provide grants to social enterprises. Nationally, the Department of Rural and Community Development

107 https://bcorporation.net/about-b-lab.
108 https://bcorporation.net/about-b-lab.
109 Data provided by B Lab Global Support Team.
110 https://www.bcorporation.net/en-us/find-a-b-corp?query=Ireland.
111 https://socialimpactireland.ie/social-enterprise-mark-comes-to-ireland/.

delivers the Community Services Programme via Pobal.[112] The programme allocated grants of €43,054,761 in 2019.[113] In addition, a number of city and county councils provide limited grant support. For example, Dublin City Council established the Social Enterprise Grant Award Scheme in 2015. It provides €60,000 per annum to social enterprises in the Dublin City Council area.[114]

The government also co-funds several grant schemes with philanthropic organisations, including Rethink Ireland.[115] There are also a small number of initiatives funded by corporate and individual donations, including Social Entrepreneurs Ireland.[116]

In Ireland, there are no tax exemptions or preferential tax treatments for social enterprises. The Revenue Commissioners treat social enterprises exactly like for-profit corporations and they are subject the same tax obligations. The only exception to this is where a social enterprise has charitable status and has been granted a charitable tax exemption by the Revenue Commissioners.

There is currently no preferential tax treatment for investors who invest in social enterprises.

5.2. PUBLIC PROCUREMENT

Organisations that operate as social enterprises may by virtue of EU legislation be eligible for differential treatment in public procurement. For the most part, public procurement rules and policies are based on the principles of transparency, non-discrimination, proportionality and equal treatment. The rules aim to level the playing field for all businesses operating within the EU, preventing the direct award of contracts to preferred bidders.

However, there is a provision in the EU rules (Regulations 20 and 77 of European Union (Award of Public Authority Contracts) Regulations 2016, SI No. 284/2016 in Ireland) which allows for the reservation of contracts for social enterprises.

The term social enterprise is not used. Instead, the rules refer to the outdated 'sheltered workshop' terminology. The 'reservation' provision allows for contracting authorities to reserve certain public contracts for certain sheltered workshops and economic operators. However, the provision has strict boundaries – a contract can only be reserved for social enterprises whose primary operating purpose is the integration of people with disabilities or disadvantaged persons.

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112 www.gov.ie/en/policy-information/487d0f-the-community-services-programme/.

113 www.gov.ie/en/collection/8da77-community-services-programme-annual-reports/.

114 https://www.localenterprise.ie/DublinCity/Enterprise-Development/Awards/Dublin-City-Social-Enterprise-Awards/.

115 https://rethinkireland.ie/current_fund/social-enterprise-development-fund-2022-2023/.

116 https://socialentrepreneurs.ie/about/#how_we_are_funded.

If a social enterprise has a non-reserved purpose but can demonstrate that at least 30% of the employees are people with disabilities or disadvantaged persons, it can apply for the reserved contracts.

Additionally, the social enterprise will be required to demonstrate that:

- its objective is the pursuit of a public service mission linked to the delivery of the services;
- its profits are reinvested to achieve the organisation's objectives;
- the ownership or management structure is based on employee ownership or participatory principles or requires the active participation of employees or stakeholders; and
- the organisation has not been awarded a services contract by the contracting authority pursuant to the Regulations within the last three years.

Social enterprises can also demonstrate their value to the public sector by meeting socially focused award criteria. Contracting authorities can award contracts on the basis of cost, a lifecycle costing or a best price–quality ratio.[117] The best price–quality ratio may include qualitative, environmental or social aspects, once the criteria are linked to the subject matter of the contract (Regulations 67 and 70). Such criteria may include social, environmental and innovative operational characteristics. Weightings must be assigned to each criterion and should be transparently set out in the procurement documents.[118] Qualitative criteria must not restrict competition or confer an unrestricted freedom of choice onto the contracting authority.[119]

Procurers tend to find it easier to include social clauses or targeted recruitment and training requirements as 'contract performance clauses'. Social enterprises are a perfect fit for contracts which include employment-related clauses. These tend to require contractors to ensure that a certain percent of all new entrant employees fall within certain categories (i.e. persons with disabilities, people who are at risk of unemployment, early school leavers, or people who are long-term unemployed).[120]

[117] S. Arrowsmith, *The law of public and utilities procurement*, 3rd ed., Sweet & Maxwell, London 2012, p. 631.

[118] S. Arrowsmith and PF. Kunzlik, *Social and environmental policies in EC procurement law: new directives and new directions*, Cambridge University Press, Cambridge/New York 2009.

[119] A. Sánchez-Graells, *Public procurement and the EU competition rules*, 2nd ed., Bloomsbury, London 2015, p. 9.

[120] E. Van den Abeele, 'Integrating Social and Environmental Dimensions in Public Procurement: One Small Step for the Internal Market, One Giant Leap for the EU?', ETUI Working Paper 2014.08, 2014, https://www.etui.org/sites/default/files/14%20WP%202014%2008%20Integrating%20social%20and%20environmenrtal%20EN%20Web%20version.pdf.

6. PRIVATE CAPITAL

The use of private capital in Irish social enterprise to date has been limited. The manner in which most Irish social enterprises incorporate, i.e. as a CLG, prohibits the raising of equity finance. Despite this impediment, recent research has indicated that 50% of social enterprises would consider equity finance even where it may involve the distribution of profits.[121]

Private capital does contribute to funding social enterprises in the form of philanthropic donations. In addition, many social entrepreneurs rely on their own financial resources, particularly when establishing. There is also a strong appetite among Irish social enterprises to explore more innovative forms of funding, such as crowdfunding.[122] The impact of the European Crowdfunding Service Providers Regulation (EU) 2020/1503 on the prevalence of this sort of financing in the Irish social enterprise sector remains to be seen.[123]

7. OTHER CONSTITUENCIES

With the exception of cooperatives and credit unions, there is no statutory framework to facilitate employees or customers playing a role in preserving the balance between profit and social mission. However, a social enterprise can voluntarily decide to include commitments in this regard in its constitution.

A number of social enterprises, primarily those providing local economic and social development services,[124] provide for the election of individuals from the communities they operate in to serve as directors on the board.[125]

Where a social enterprise is found to have failed to adhere to its objects clause and directors have failed in their fiduciary duty, the CEA has enforcement powers. In the same way as a for-profit organisation, social enterprises can also resort to the civil courts to adjudicate legal disputes.

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121 EaSI-funded project 'Financing Social Enterprise in Ireland models of Impact Investing and Readiness', report due 2023.

122 T. Lawlor and G. Doyle, 'Research on Legal Form for Social Enterprise', commissioned by the Department of Rural and Community Development and Rethink Ireland, https://rethinkireland.ie/wp-content/uploads/2021/12/Research-on-Legal-Form-for-Social-Enterprises.pdf.

123 www.irishtimes.com/business/financial-services/crowdfunding-faces-regulation-to-protect-investors-1.4775615.

124 https://ildn.ie/about/local-development-companies/.

125 http://dublinnorthwest.ie/about/company-information/company-structure/.

8. PROSPECTIVE CHANGES IN THE LAW

There are no current plans to introduce new legislation to govern social enterprises in the corporate form. An overhaul of the legislation governing cooperatives is at an advanced stage, as described above. There is no official timeline available for the introduction of this legislation. However, it is expected that it will be in the near future.

Irish research conducted in 2018 indicated that 51% of social enterprises believe a new legal form for social enterprise is required.[126] In support of commitments made in the National Policy, further research was recently undertaken to examine the issues encountered by social enterprise in Ireland in relation to legal form.[127] This research included a survey in which 59% of respondents said their current legal form met their needs. Additionally, only 23.5% of respondents disagreed or strongly disagreed that current legal forms can be used to accommodate governance and ownership needs of social enterprise. However, in the same survey, 67% of respondents said they believed there was a need for a new legal form of organisation for social enterprise. Only 10% disagreed, with the remainder being unsure.

The same survey found that where social enterprises did have issues with their legal form, these issues were largely in the following areas: payment of directors; access to funding (charitable status being required for some funding but precluding others); lack of formal recognition (absent charitable status); reporting requirements, particularly if reporting was required to the CRO and the Charities Regulator; and the prohibition on profit distribution. All of these issues are connected to charitable status. Although not a legal form, it has significant legal and practical implications.

The survey found that the issues social enterprise wished to see addressed by a dedicated legal form were: recognition; clarity on definition; regulation; director's remuneration; access to funding; investors/shareholders; distribution of profits; asset lock; fiscal benefits; compliance and reporting; and the need for an alternative to registering for charitable status.

Asked what features a dedicated form of social enterprise should include, respondents cited: a requirement to report social impact; a requirement to lock assets within the enterprise; and the ability to remunerate directors. While

126 'Social Enterprise in Ireland: Research Report to support the development of a National Social Enterprise Policy', Research Report commissioned by Social Finance Foundation and Department of Rural and Community Development, 2018, https://www.gov.ie/pdf/?file=https://assets.gov.ie/40297/74afae66c14d4d738e1a76b77d7a61c9.pdf#page=1.

127 T. Lawlor and G. Doyle, 'Research on Legal Form for Social Enterprise', commissioned by the Department of Rural and Community Development and Rethink Ireland, https://rethinkireland.ie/wp-content/uploads/2021/12/Research-on-Legal-Form-for-Social-Enterprises.pdf.

some cited that private shareholding should be permissible, others called for restrictions on the distribution of profits.

9. CONCLUSION

The Irish social economy has a long and vibrant history on the ground. Industrial and provident societies, associations, cooperatives, credit unions, foundations and charitable organisations operate across a broad range of sectors and have made significant contributions to the sector for many decades. Although there is no national register, at the time of writing the Department of Rural and Community Development has just published the results of a national census of social enterprise.[128]

Legal engagement with social enterprise is at an even more embryonic phase. Ireland's first national policy on social enterprise was published only in July 2019. It contains a definition of Irish social enterprise broadly in line with the EU definition, but this definition is not legally enforceable and does not delineate a dedicated legal form of organisation for social enterprise. This leaves organisations free to choose from any of the forms available in the Companies Act 2014, or to establish as a cooperative, or as an unincorporated entity. The vast majority choose the CLG legal form. Unless they have charitable status, there is no requirement for Irish social enterprises taking any of these forms to have an asset lock built into their company constitution or rules. However, there is nothing to prevent a non-charitable social enterprise from including an asset lock in its constitution.

Access to finance is a common driver behind the choice of legal form for Irish social enterprise and many choose to register for charitable status as it gives improved access to various grant aids and philanthropic donations. Irish charities, including those that are social enterprises, are regulated by the Charities Regulator under the Charities Act 2009. Inadequate access to finance is a significant issue for Irish social enterprise. Although there are a small number of dedicated social finance providers in the Irish market, there is limited reliance on debt finance among Irish social enterprises. Social entrepreneurs frequently use personal finances as a source of funding when establishing, and novel financing mechanisms such as crowdfunding and quasi-equity have to date played a very limited role.

Although there are some grant aids and business supports available to social enterprise specifically, unless registered as a charity, a social enterprise will not

[128] Amárach Research, SERI and ILDN, 'Social Enterprises in Ireland: A Baseline Data Collection Exercise Report, commissioned by the Department of Rural and Community Development', May 2023, https://www.socialenterprise.ie/_files/ugd/d0fc11_2da8f1b579bd4866baf45581e2c65e30.pdf.

be eligible for tax advantages. Nor are there fiscal incentives available for social enterprise investors.

Ireland also does not have a national social enterprise recognition status or mark. Although B Lab's B Corp certification is available and the UK SE Mark is currently being piloted in Ireland, the numbers of participants in both private certification schemes is extremely small.

Looking to the horizon, there are no plans underway to introduce a specific legal form or national legal mark or status for Irish social enterprise. The proposed new cooperative legislation is forthcoming, however, and is likely to have appeal within the sector. The extent to which Irish social enterprise will adopt this legal form, and its impact, remains to be seen.

SOCIAL ENTERPRISES IN ITALY

Andrea Fusaro

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1. THE CONCEPT OF A SOCIAL ENTERPRISE AND THE INDUSTRIES IN WHICH THEY OPERATE

Italy enacted a law on social enterprises in 2005,[1] and then again in 2017.[2] According to the latter, all private entities, including those constituted in the form of companies, may acquire the status of social enterprise, if, in accordance with the provisions of that legislative decree, they operate on a permanent basis and principally as an undertaking of general interest, engaging in non-profit-making and civic, solidarity and social utility activities, adopting responsible and transparent management arrangements, and promoting the wider involvement of employees, users and other stakeholders interested in their activities (Article 1 Legislative Decree of 3 July 2017, no. 112). These organisations provide social and social health services to citizens, but they also operate in the areas of training and employment, culture, sport, the environment and research, and are constantly expanding into other areas of general interest.

The identity, roles and resilience of social enterprises in Italy are described in the recent Iris Report on Social Enterprise,[3] which is divided into two sections: the first section addresses how social enterprise has developed so far, and the second explores the impact of the COVID-19 pandemic on social enterprise and how it has reacted – as far as we can know – to this unprecedented situation. In this report we will go into more detail on some of the elements present in the first of these two sections with an effort towards understanding how many social enterprises there are in Italy, what they do, how many people they employ, and the main economic data that characterises them.[4]

1.1. SOCIAL ENTERPRISES IN LAW

Only some entities engaged in social enterprise are recognised as social enterprises under Italian law.[5] About 30% of these enterprises have been formed in the last five years, although the data indicates a tendency of those entities with more history to show greater entrepreneurial solidity. A group of enterprises

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1 Legislative Decree 24 March 2006, no. 155, Regulation of social enterprises, pursuant to Law 13 June 2005, no. 118.

2 Legislative Decree 3 July 2017, no. 112, Revision of the rules on social enterprises, pursuant to Article 2, paragraph 2, letter c) Law 6 June 2016, no. 106.

3 C. Borzaga and M. Musella (eds), *L'Impresa Sociale in Italia: Identità, ruoli e resilienza. IV Rapporto Iris Network*, 2021, https://irisnetwork.it/2021/04/impresa-sociale-quarto-rapporto-download/.

4 G. Marocchi, *I numeri dell'impresa sociale in Italia*, welforum.it/i-, 26 April 2021.

5 The most recent figure, reported in 2018, speaks of 16,557 companies, with 458,222 employees; in this subset social cooperatives have an almost exclusive role, with 15,751 units with almost 452,000 employees.

comprising a little more than one-third of the total have over 15 years employed almost three-quarters of the total number of employees in the field, while those established in the last five years employ just 8%.[6]

1.2. SOCIAL ENTERPRISES IN FACT

It is possible to describe all Italian social enterprises by aggregating social enterprises in law that have at least one employee on the payroll, other third-sector entities (e.g. associations or foundations) that predominantly carry out business activities, and non-profit enterprises that have never applied for recognition as social enterprises, in all cases always having at least one worker on the payroll. A large proportion of entities with the characteristics of a social enterprise do not need to be legally recognised as such due to the persistent absence of implementing rules that would provide incentives for social enterprises not to set up as cooperatives. Perhaps cultural factors also lead some members of the associative world not to want to take on this status. Having said this, in the economic analysis there is no reason not to include these units in a census of all the de facto social enterprises. This set provides a more complex picture of social enterprises than would be perceived by considering only those that have obtained that legal status.[7]

The Iris Report also proposes an interesting comparison between the dimensional indicators that characterise social enterprises and the economic system of Italy. Social enterprises, in fact, are not characterised by being smaller than other types of enterprises: the number of enterprises of insignificant size is lower amongst social enterprises than amongst for-profit enterprises. Further,

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6 Social assistance, the typical sector of type A social cooperatives, includes only 56% of employees, which reaches 98.5% if the sector of 'economic and social development' is added, in which type B social cooperatives are grouped. A significant part consists of companies of negligible size: 53.9% do not reach €200,000 in turnover and 27.5% stop at less than €49,000; 19.2% have no employees on the payroll. In addition to the variable already highlighted in the year of establishment and therefore the situation of start-ups that characterises almost a third of the companies considered, sectoral differences strongly emerge: on average, sports and cultural enterprises have six employees, compared to 60 in the health care sector (where 22.6% of enterprises have a turnover of more than €2 million) or 34.5 in the social care sector. Also significant is the territorial variable, if we consider for example that 47% of northern companies have at least 10 workers against a share of less than 30% in southern island Italy.

7 From which have been subtracted the units without employees (social cooperatives fall from 15,751 to 12,956, while the number of workers obviously remains unchanged), but where there are 9,560 entities in a form other than the social cooperative in which a total of just under 200,000 people work. The exclusion of uninvolved entities obviously leads to an average increase in size indicators, as well as to a sectoral rebalancing, since the typical sectors of social cooperation are flanked by others – culture, sport and recreation, and education and research – which are more frequent in social enterprises with other legal forms.

the number of enterprises with a turnover of more than €500,000 and €2 million is higher in social enterprises (de facto, but also, to a lesser extent, legal) than in other enterprises.

Five years after the reform of the third sector, the social enterprises qualifying for legal status and de facto social enterprises operating in Italy constitute two quite different constellations.[8] The reform of 2016/2017 had intended to intervene in some aspects that, in the common opinion of scholars and professionals, limited the attractiveness of the status of social enterprise. In particular, concerns were raised that the status was unattractive, given its many constraints and no rewards beyond some limitations on governance requirements. To this end, the reform envisaged, in addition to the solution implemented of rigidities on governance, essentially two well-tested measures. The first required the non-imposition of profits from indivisible reserves – those which form the intergenerational capital that has proved so valuable in the development of social cooperation – which was taken from the cooperative model. The second provided tax deductibility for capital investments, which was borrowed from the scheme of innovative start-ups. This approach represents an appreciable form of standardisation: it enhances and combines institutions that are already well established and repurposes them for the purpose of major institutional innovation.

Unfortunately, this potential progress has been lost in the implementation phase. Decrees have not been adopted to regulate the system of controls for non-cooperative social enterprises, nor has the European Union been notified prior to the introduction of the above-mentioned measures in the Italian tax system which, in the current regulatory scenario, would in fact become fully effective no earlier than 2024, even if the above-mentioned blocks were to be removed now. In fact, none of the benefits provided for social enterprises by the reform are currently operational.

1.3. THE DISTINCTIVE QUALITIES OF SOCIAL ENTERPRISE BUSINESS MODELS AS COMPARED TO TRADITIONAL VENTURES

The Iris Report[9] also examines the size and characteristics of the sector, the contribution to economic and employment growth, the welfare of the

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[8] Even with the prudential definition appropriately adopted in this edition of the Iris Report – in previous editions the Report had always tried to also imagine the impact of the possible inclusion, in the category of social enterprises, of for-profit enterprises operating in general interest sectors – there is a significant 40% of de facto social enterprises that have not chosen to qualify as such.

[9] C. Borzaga and M. Musella (eds), *L'Impresa Sociale in Italia: Identità, ruoli e resilienza. IV Rapporto Iris Network*, 2021, https://irisnetwork.it/2021/04/impresa-sociale-quarto-rapporto-download/.

recipients of services and social policies, and the response to the COVID-19 pandemic.[10]

In Italy, the appearance of social enterprises coincided with the closure of large public or semi-public residential structures. The term 'social enterprise' was used for the first time in Italy at the end of the 1980s to indicate various novel private initiatives, often set up and managed by volunteers, which operated not as traditional non-profit organisations, but directly provided social services and productive activities to encourage integration of disadvantaged people into employment. At that time, the Italian legal system lacked a legal form consistent with the objectives and ownership structure of these new entrepreneurial initiatives. Therefore, promoters utilised the cooperative form, to which both the Italian Constitution and tradition attribute an explicit social function. Various types of 'social' cooperatives were thus created until they were recognised and regulated as 'social cooperatives'.[11] In Italy, the social enterprise has thus assumed predominantly, if not exclusively, the cooperative form.[12]

2. SOCIAL ENTERPRISE LEGAL CATEGORIES

Proper legal recognition, as well as the related supervision of such entities, was first established by the delegated law of 13 June 2005, no. 118, the provisions of which were implemented by Legislative Decree of 24 March 2006, no. 155 ('Discipline of social enterprise, pursuant to law no. 118 of 13 June 2005') and now reformed by Legislative Decree 112/2017.[13] With the introduction of the legal status of the social enterprise, the concept of entrepreneurship was definitively distinguished from that of a profit-making purpose: that is, the existence of enterprises with purposes other than profit was recognised. The added value compared to a traditional enterprise lies in the attempt to produce services with a high relational content, in seeking to 'network' with experiences

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10 Over 22,000 social enterprises that employ almost 650,000 employees. 57.5% are social cooperatives and associations come next (15.4%). Compared to the 2011 Census, there is an increase of 10.2% in companies and 19% in employees. Over 40% of social enterprises employ more than 10 employees. 46.3% have a turnover of less than €200,000, although 10.8% exceed €2 million. Almost half of the companies operate in the north (47.6%), where 37.2% of companies have a turnover exceeding €500,000, while in the south 55.2% have a turnover not exceeding €200,000. 31% of social enterprises work in social services, 19% in employment integration, in education and research (18.3%), culture and sport (18.2%) and health (8%).

11 Law no. 381 of 1991.

12 C. Borzaga and A. Ianes (eds), *Economia della solidarietà. Storia e prospettive della cooperazione sociale*, Donzelli, Rome 2006.

13 Revision of the discipline on social enterprise, pursuant to Article 2, paragraph 2, letter c) of Law no. 106 of 6 June 2016 (OJ no. 167 of 19 July 2017).

in the third sector, in producing positive externalities for the community. Fundamental to this are the promotion of local development, the adoption of values such as social justice, the guarantee of democratic organisation and the direct involvement of workers in management, equal opportunities, and the reduction of inequalities.

2.1. THE REFORM OF 2017

The reform adopted in 2017 consists of the two Legislative Decrees dedicated respectively to the revision of the pre-existing social enterprise supervision (no. 112/2017) and a new Third Sector Code (no. 117/2017). Legislative Decree 117/2017 (Third Sector Code) regulates third-sector entities (*enti del terzo settore*, ETS), where various types of entities covered by this special legislation have been brought together. Under the post-2017 regime, an entity meeting the requirements to qualify as a social enterprise will also qualify as an ETS, but the latter is a broader category encompassing a range of entity types.

2.2. ETS REQUIREMENTS

To qualify as an ETS requires both objectives and actual activities meeting statutory requirements. The required purposes are identified as 'non-profit pursuit of civic, solidarity and socially useful purposes' (Art. 5). The actual activities consist of the exercise – by subjects other than social enterprises (including social cooperatives) – 'exclusively or principally' of 'one or more activities of general interest for the non-profit pursuit of civic, solidarity and socially useful purposes'. Commercial initiatives by ETSs are easily accommodated within the definition of 'activities of general interest'. Article 5, which expressly indicates the types of permissible activities,[14] includes a few that are purely disbursing, but others are presented as economic, and sometimes expressly qualified as 'commercial'. In addition, it is envisaged that these activities may be carried out exclusively or mainly in the form of a commercial enterprise, which is followed by the obligation to register with the Companies' Register,[15] to keep

[14] Pursuant to Article 5, activities are considered to be of general interest if they have some objects in the area of social interventions, health interventions and services, education, preservation and improvement of the conditions of the environment, protection and enhancement of cultural heritage and landscape, scientific research, or cultural, artistic or recreational activities of social interest.

[15] Article 11, 2nd paragraph, Legislative Decree 117/2017.

accounting records,[16] and to file financial statements drawn up in compliance with Articles 2434 et seq. of the Italian Civil Code.[17]

Critically, an ETS may also not have profit as its ultimate or main purpose. The assets of this type of enterprise are subject to a non-transferability constraint. It is never possible, not even in the event of dissolution, to distribute funds or reserves to the benefit of those who are part of it, but the entire assets must be donated to other non-profit associations indicated in the statute. The absence of a profit motive and the disinvestment of assets is also maintained in the case of division, merger or transformation of the social enterprise.

2.3. SOCIAL ENTERPRISE REQUIREMENTS

Social enterprises are one type of qualifying ETS. According to Article 1 Legislative Decree 112/2017, a social enterprise is any entity, including companies, that carries out on a stable and principal basis a non-profit general interest business activity and pursues civic, solidary and socially useful purposes, adopting criteria in accordance with the indications provided. These include 'responsible and transparent management methods' favouring 'the widest involvement of workers, users and other stakeholders' and not limiting 'the provision of goods and services to members or associates only' (Art. 1, paragraph 1, letter c)). Volunteers cannot be more than 50% of workers, and single-member companies, public administrations and entities which limit, even indirectly, the supply of goods and services to members or associates only are also excluded from social enterprise status. A specific list indicates the activities that the law considers to be in the general interest. In addition, those entities in which very disadvantaged workers, disadvantaged or disabled persons, and persons benefiting from international protection are employed, regardless of their object, are considered social enterprises. Qualifying social enterprises also have reporting obligations, namely filing the company's balance sheet and financial status with the companies' register, and completing and filing a mission report. Social cooperatives qualify as social enterprises per se, and Law 381/1991 applies to them, with precedence over Legislative Decree 112/2017; they must also maintain registration in the Register of Cooperatives.

The regulations for social enterprises also make an important exception to the ETS non-distribution constraint. Although ETSs are generally prohibited from subjective profit-making, those ETSs qualifying as social enterprises are allowed to distribute up to 50% of annual profits and operating surpluses. If

[16] Article 2214 of the Italian Civil Code.

[17] Article 13, 3rd–4th paragraphs, Legislative Decree 117/2017.

a social enterprise is established using a corporate form of organisation, it is permitted a free share capital increase. If it uses a non-corporate form, a social enterprise may freely make disbursements in favour of third-sector entities other than social enterprises, which are not founders, associates, partners of the social enterprise or companies controlled by it, aimed at promoting specific social utility projects.[18] With this exception, the prohibition of subjective profit is safeguarded by effecting indirect distribution, such that even transactions on favourable terms may constitute a distribution of profits.[19] This provision was particularly aimed at making obtaining social enterprise status and investment in such entities more attractive. Additional detail is provided in the following subsections.

2.3.1. Permissible Objects of Entities Adopting Social Enterprise Status

The activities of general interest that characterise social enterprise are narrower than those for ETSs, and exclude: charitable activities; promotion of the culture of legality, peace among peoples, non-violence and unarmed defence; the promotion and protection of human, civil, social and political rights; mutual aid initiatives, including time banks and solidarity purchasing groups; international adoptions; and civil protection, which is only carried out by third-sector entities if they are different from social enterprises. For completeness, it should be noted that instead microcredit is provided for social enterprises and not for non-business forms of the third sector.[20]

[18] Article 3, paragraph 3, letter c) Legislative Decree 112/2017.
[19] Article 3 Legislative Decree 112/2017.
[20] The sectors of activity in which social enterprises can operate are described in Article 2 Legislative Decree 112/2017: '(a) social interventions and services …; b) health interventions and services; c) social-health services …; d) education, education and vocational training …, as well as cultural activities of social interest with an educational purpose; e) interventions and services aimed at safeguarding and improving the conditions of the environment and the prudent and rational use of natural resources, with the exclusion of the activity, habitually carried out, of collection and recycling of urban, special and dangerous waste; f) interventions for the protection and enhancement of the cultural heritage and landscape …; g) university and post-graduate training; h) scientific research of particular social interest; i) organisation and management of cultural, artistic or recreational activities of social interest, including activities, including publishing, promotion and dissemination of the culture and practice of voluntary work, and of the activities of general interest referred to in this article; (j) community radio broadcasting …; (k) organisation and management of tourist activities of social, cultural or religious interest; l) out-of-school training, aimed at the prevention of school drop-out and school and training success, the prevention of bullying and the fight against educational poverty; m) instrumental services to social enterprises or other Third Sector entities provided by entities made up of no less than 70 per cent social enterprises or other Third Sector entities; n) development cooperation …; o) commercial, production, education and information, promotion, representation, licensing of certification marks, carried out within or in favour of fair trade supply chains, to be understood as a commercial relationship with a producer operating in a disadvantaged economic area located, as a rule, in a developing country, on the basis of a long-term agreement aimed at promoting

2.3.2. Rights to Participation

Adequate forms of involvement of workers, users and other stakeholders in the activities shall be provided for in the business regulations or in the bylaws of social enterprises. Involvement shall be intended as a mechanism of consultation or participation whereby workers, users and other persons directly affected by the activities are able to exercise influence on the decisions of the social enterprise, with particular reference to issues directly affecting working conditions and the quality of goods or services. The memorandum of association or the articles of association may reserve to persons external to the social enterprise the appointment of members of the social bodies. In any case, the appointment of the majority of the members of the administrative body shall be reserved to the assembly of the members or partners of the social enterprise.[21]

2.3.3. Continuity of Existence

The transformation, merger and division of a social enterprise shall be carried out in such a way as to preserve its non-profit nature, its assets and its pursuit of the activities and purposes. The transfer of a company or of a branch of a company related to the conduct of a general interest business must be carried out subject to a sworn report by an expert appointed by the court in whose district the social enterprise has its headquarters or is located, certifying the real value of the assets of the enterprise in such a way as to preserve its pursuit of its activities and aims.[22] In the event of the voluntary dissolution of the entity or the voluntary loss of the status of social enterprise, the residual assets – after deducting, in the case of social enterprises established using a corporate form, the capital actually paid up by the shareholders, the capital actually paid in by the shareholders, revalued or increased as the case may be, and the dividends resolved and not distributed within the limits set forth – are donated, except for the specific provisions in the case of cooperative companies, to other third-sector entities, according to the provisions of the articles of association.[23]

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the producer's access to the market, and which provides for the payment of a fair price, development measures in favour of the producer and the obligation of the producer to ensure safe working conditions, in compliance with national and international law, so as to enable workers to lead a free and dignified existence, and to respect trade union rights, as well as to commit to combating child labour; p) services aimed at the insertion or reintegration into the labour market of workers and persons …; q) social housing …, as well as any other activity of a temporary residential nature aimed at meeting social, health, cultural, training or work needs; r) humanitarian reception and social integration of migrants; s) microcredit …; t) social agriculture; u) organisation and management of amateur sport activities; v) redevelopment of unused public assets or assets confiscated from organised crime.'

[21] Article 7 Legislative Decree 112/2017.

[22] Article 12 Legislative Decree 112/2017.

[23] Article 12 Legislative Decree 112/2017.

2.3.4. Disclosure/Reporting

Special criteria must be met when drafting a social enterprise's mission report.[24] In particular, there are:

- obligations of transparency and information, including towards third parties, through forms of publicity of the financial statements of the entity, as well as through publication on its institutional website;
- obligations of internal control, reporting, transparency and provision of information towards members, workers and third parties, depending on the economic dimension of the activity carried out;
- the requirement to provide information additional to that which is merely economic and financial; and
- the possibility given to interested parties, through the social balance sheet, to know the value generated by the organisation and to make comparisons over time of the results achieved.

In addition:

- only information relevant to the understanding of the organisation's performance and situation, even prospective, must be reported;
- the logical procedure followed to classify the information must be clear;
- the reports must relate to the year of reference;
- the publication must make possible both temporal and, if possible, spatial comparisons (presence of other average organisations in the sector, etc.);
- information must be presented in a clear and comprehensible manner accessible to all;
- data reported must refer to the information sources used;
- if third parties are in charge of treatments or specific aspects, they must have complete autonomy;
- only information relevant to understanding the performance of the institution and the situation, including prospective ones, must be reported;
- the main stakeholders who influence and are influenced must be identified and all useful information must be included to enable them to evaluate the overall results;
- the logical procedure followed to classify information must be clear;
- information must be presented impartially, independent of partisan interests, by reviewing positive and negative aspects of management without favouring any category;

[24] Article 9 Legislative Decree 112/2017.

- the logical procedure followed to classify information must be clear;
- positive data reported must be objective and not overstated;
- similarly, negative data must not be understated; and
- uncertain effects should not be documented as certain.

2.3.5. Limitations on Profit Distributions to Owners (Non-Distribution Constraint)

A social enterprise must allocate profits and surpluses to carry out its statutory activity or to increase its assets. The law prohibits, in Article 3 of Legislative Decree 112/2017, the indirect distribution of profits and also stipulates what indirect profit distributions consist of by providing a list. However, the law also stipulates that, exceptionally, social enterprises incorporated as companies may allocate less than 50% of their annual profits and surpluses, less any losses accrued in previous years, to free increases in share capital subscribed and paid up by members or to free distributions to third-sector entities other than social enterprises, which are not founders or associates. As noted earlier, this provision was particularly aimed at making obtaining social enterprise status and investment in such entities more attractive.

2.3.6. Employee Hiring Requirements

As mentioned above, an enterprise activity in which, in pursuit of civic, solidarity and socially useful purposes, specific types of workers (in particular, disadvantaged or disabled workers) are employed should always be considered of general interest, regardless of the object of the activity.[25]

Workers in the social enterprise are entitled to economic and normative treatment not less than that provided for by the collective agreements. In any case, the difference in pay between employees of the social enterprise may not exceed a ratio of 1:8, to be calculated on the basis of gross annual remuneration, except for proven needs relating to expenses incurred to acquire specific skills for the purposes of carrying out activities of general interest. Social enterprises shall report on compliance with this parameter, and explain the reasons for any derogation, in their mission reports. In social enterprises it is permissible to carry out volunteer activities, but the number of volunteers employed in the business activity cannot exceed the number of workers. As the social enterprise is characterised by its entrepreneurial nature, consequently there must be a greater presence of paid workers. In addition, their activities can be used to an extent that is complementary to and not a substitute for the parameters of employing paid workers provided for in current regulations. The social enterprise must then

[25] Article 2 Legislative Decree 112/2017.

insure the volunteers against accidents and illnesses related to the performance of the activity itself, as well as for third-party liability.[26]

2.3.7. *Legal Forms of Organisation Typically Adopted by Social Enterprises*

In Italy, no specialised legal form of organisation designed for social enterprises has been created.

> [A]ll private entities, including [entities with a corporate form], which, in accordance with the provisions of this decree, carry out on a stable and principal basis a business activity of general interest, non-profit and for civic, solidarity and social benefit purposes, adopting responsible and transparent management methods and favouring the widest involvement of workers, users and other stakeholders in their activities [can qualify for the status as a social enterprise].[27]

These entities include recognised and non-recognised associations, foundations, committees, companies (of persons and capital but not those formed by a single natural person), cooperatives and consortia. Social cooperatives are qualified as social enterprises by law, which in turn qualifies them as ETSs. As mentioned above, cooperative social enterprises are the most widespread type of social enterprise and public administrations, single-member companies or those that provide services and goods only for the benefit of their members cannot be considered social enterprises.

Governance rules are lacking in Legislative Decree 112/2017, so they are drawn from the legal form adopted by each ETS. The requirements of honourableness and professionalism are prescribed for the owners,[28] meaning that the articles of association must contain specific indications, and balance independence with stakeholder involvement. A supervisory body is required regardless of the type adopted.[29] An ETS's statutes must provide for involvement of workers, users and other stakeholders, i.e. 'consultation or participation mechanisms through which workers, users and other stakeholders directly affected by the activities are put in a position to influence the decisions of the social enterprise, with particular reference to issues directly affecting working conditions and the quality of goods or services', taking into account collective agreements, the nature of the activity carried out, the categories of stakeholders to be involved and the size of the enterprise, in accordance with guidelines adopted by decree of the Minister of

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26 Article 13 Legislative Decree 112/2017.

27 Article 1 Legislative Decree 112/2017.

28 For the requirements of honourableness and professionalism to be met, the person must have the necessary knowledge, skills and experience, must not have a criminal record or have committed administrative or fiscal irregularities, and must be able to make decisions without external influence.

29 Article 10 Legislative Decree 112/2017.

Labour and Social Policies, after consulting the National Council of the Third Sector.[30]

Depending on the different type of body which acquires the status of social enterprise, the supervision to which they are subject can differ to some extent. Regarding civilly recognised religious bodies, the supervision is limited to the exercise of general interest activities. Moreover, mutual aid societies which receive an annual payment of membership contributions not exceeding €50,000 and which do not manage supplementary funds are not subject to the obligation to register in the social enterprises section of the business register.

3. BENEFITS

ETS status, which is automatically conferred by qualification as a social enterprise, is accompanied by tax advantages. In addition, the Third Sector Code guarantees a privileged relationship with reference to relations with public entities.[31] The Single National Registry of the Third Sector (RUNTS), an easily searchable computerised registry introduced in the 2017 reforms, also ensures the full transparency of ETSs through the publicity of the information that is entered into it. The high degree of transparency fostered by this system enhances the attractiveness of ETSs to donors.

With respect to taxation advantages, Legislative Decree 117/2017 distinguishes between commercial and non-commercial ETSs. It is necessary to consider every activity carried out by the entity to determine if it is commercial or non-commercial. Activities of general interests which are carried out free of charge, or upon payment that does not exceed the actual costs, or with earnings that do not exceed 5% of the related costs, are considered non-commercial. In addition, an entity will be considered commercial if its earnings arising from commercial activities are more than those arising from non-commercial activity, and vice versa (Art. 79 Third Sector Code). If the ETS is commercial, all income, even non-commercial income, will be taxed at ordinary rates. If the ETS is non-commercial, only its income arising from commercial activities of general interest and from other activities (neither commercial nor non-commercial) will be taxed. The Code provides a subsidised flat rate system. Moreover, in Article 83, the Third Sector Code has introduced special tax deductions and credits for those who donate to ETSs.

On the other hand, as regards the ordinary corporate taxation system, once the taxable income to be subjected to taxation has been determined, it is taxed as follows: for sole proprietorships, according to the progressive rates, or according

[30] Article 11 Legislative Decree 112/2017.
[31] Article 55.

to the rules established for the preferential tax regime used; for partnerships, income is charged to each partner, regardless of actual receipt, in proportion to the share in profits; and for corporations, according to the proportionally set rate, which is currently 24% in most cases.

With respect to the relationship between ETSs and public administration, public bodies are charged with ensuring active engagement with third-sector entities, through forms of co-programming, co-planning and accreditation. This has contributed decisively to a turning point in the relations between public bodies and the third sector, which is no longer seen as being in opposition to public administration, but as an ally in identifying ways to protect rights and respond to citizens' needs.

Entities with social enterprise status enjoy further special benefits. Article 18, paragraphs 1 and 2 of Legislative Decree 112/2017 guarantee a substantial detaxation of the profits and the management surplus, which will not represent taxable income if they are, for example, allocated to a dedicated unavailable reserve under Article 15 of Legislative Decree 112/2017. Article 18, paragraphs 3 and 4 recognise a special deducibility regime regarding investments for social enterprises to encourage capital investments by providing incentives for investors. These benefits apply even though companies which obtain this status can, in compliance with certain conditions, share their profits with shareholders.

4. PRIVATE INVESTMENTS

Paragraphs 3 and 4 of Article 18 of Legislative Decree 112/2017 provide incentives for those individuals or legal entities who invest in the share capital of one or more corporations or cooperatives (including social cooperatives) that have been qualified as social enterprises for no more than five years.

Individuals who invest in the share capital of these firms may deduct 30% of the amount so invested from their gross personal income. The annual investment may not exceed €1 million and must be maintained for at least five years, under penalty of full repayment of the tax incentives enjoyed, plus legal interest, even if the transfer of the investment is only partial. If the annual gross tax payable by a lender is less than the deduction due, the remainder of the deduction can be used in subsequent tax years, but not beyond the third. Only individual taxpayers qualify for the personal income deduction. Corporations are eligible for an analogous deduction (up to €1.8 million), but under the corporate income tax. Investors in the capital of these companies obtain governance rights as shareholders or members, according to the type of company in which they have invested.

The procedures for implementing the tax breaks described in the preceding paragraph are determined by a decree of the Minister of Labour in consultation with the Minister of Economy and the Minister of Economic Development.

5. PRIVATE CERTIFICATIONS

The B Corp certification is also available in Italy. This certification is issued by B Lab, a US-based non-profit organisation, based on an analysis of the environmental and social performance of the entity seeking certification. This particular certification, however, will not be compatible with social enterprise status, due to its consideration that certified entities will pursue subjective profit-making purposes, while also taking general interests into consideration. In contrast, B Corp certification will be compatible with the status of benefit corporation, introduced in Italy as of 2016, which is available to entities that, in addition to pursuing a lucrative purpose with selfish aims, also choose to take care of general interests and by reason of this enjoy special benefits granted by law. The Italian benefit corporation is a status available both to existing companies and to new companies; it is not a new entity form. Moreover, this status of benefit corporation, in turn, will not be considered compatible with that of a social enterprise, for the same reasons.

6. SOCIAL ENTERPRISE LIFECYCLE

To qualify as a social enterprise, an entity must first be established by public deed. This is followed by registration in the special section of the business register by a notary public.[32] For social enterprises, this registration fulfils the requirement of registration in the RUNTS,[33] but social enterprises must still provide for the incorporation in RUNTS of additional information not required for registration in the business register and its forms, but which is required for registration in RUNTS.[34]

6.1. MAINTENANCE

The social enterprise shall keep a ledger and an inventory book in accordance with the applicable provisions of the Civil Code and shall draw up and file with the registrar of companies its prepared financial statements. The social enterprise must also file with the register of companies and publish on its website the mission report drawn up in accordance with the guidelines adopted by decree of the Minister of Labour and Social Policies and taking into account,

32 Article 5 Legislative Decree 112/2017.
33 Article 11, paragraph 3, Legislative Decree 117/2017; Article 29 Ministerial Decree of 15 September 2020.
34 Article 7. 2 of Annex A to the Ministerial Decree of 15 September 2020.

among other elements, the nature of the activity carried out and the size of the social enterprise, including for the purpose of assessing the social impact of the activities carried out.[35]

The articles of incorporation of the social enterprise must provide for the appointment of one or more auditors, who have a supervisory role in ensuring compliance with the law, the articles of incorporation, and the purposes. They shall certify that the social budget has been prepared in accordance with the guidelines. The auditors may perform acts of inspection and review at any time. They may ask the directors for information on management performance or specific corporate matters. In some cases, the statutory audit shall be carried out by a statutory auditor or auditing firm registered in the appropriate register, or by auditors registered in the appropriate register of statutory auditors.[36]

6.2. MISSION REPORTS

Social enterprises are subject to filing/reporting or audit requirements. To track their activities and impact they use metrics developed by the Ministry of Labour and Social Policies. Third-sector organisations are now obliged to draw up and submit a mission report to the members' meeting (together with the financial statements). The mission report is the document that describes not only the economic aspects, but also the management choices made with respect to the activities engaged in to pursue the social purpose. It must contain quantitative data – not exclusively monetary – reporting the results of the activity carried out. This document tells the story of the organisation in its entirety, since it goes into detail and makes stakeholders aware of the objectives achieved, the economic results and the social results that are not recorded in the financial statements alone.[37] ETSs with a budget of more than €200,000 must draw up a mission report and, in addition to communicating the activity previously carried out and the aims to be pursued, must also detail and list all other budget documents (if any), such as the notes to the accounts or the report of the board of auditors.

The Ministry of Labour and Social Policies promotes liaison activities with other government departments, the National Council of the Third Sector and social partners, in order to develop systemic actions and carry out monitoring and research activities. In doing so, it may delegate inspection functions to the National Labour Inspectorate in order to verify compliance with the law by social enterprises. In addition, in the exercise of these inspection activities the Ministry may make use of recognised association bodies.[38] Social enterprises

35 Article 9 Legislative Decree 112/2017.
36 Article 10 Legislative Decree 112/2017.
37 Article 13 Legislative Decree 112/2017.
38 Article 15 Legislative Decree 112/2017.

may allocate a share of no more than 3% of their annual net profits to funds established by those associations, specifically and exclusively intended for the promotion and development of social enterprise through actions and initiatives of various kinds, such as financing studies and research projects on the topic of social enterprise or training activities for social enterprise operators, promoting the establishment of social enterprises or their associative bodies.[39]

6.3. EXIT

The transfer of a business or a branch of a business related to the performance of a general interest activity, merger, demerger or other devolution of assets must be carried out subject to a sworn report by a court-appointed expert, attesting to the real value of the social enterprise's assets in such a way as to preserve the social enterprise's exercise of its activities and purposes.[40] In addition, the administrative body of the social enterprise shall notify, in writing, the Ministry of Labour and Social Policies of its intention to carry out any of these acts,[41] and the relevant government agency must approve such changes. Any denial by the Ministry can be appealed before the administrative court.[42]

Shareholders, employees or other constituencies must approve any such changes only if bylaws require their involvement. It is not otherwise required by law that such approval take place, but involvement of such constituencies is encouraged. Involvement means a mechanism of consultation or participation by which workers, users and other persons directly concerned by the enterprise's activities are enabled to exercise an influence on the decisions of the social enterprise, with particular reference to issues directly affecting working conditions and the quality of goods or services. The forms and modalities of involvement, which must be indicated in the social budget, must be identified by the social enterprise, taking into account collective agreements, the nature of the activity carried out, the categories of subjects to be involved and the size of the social enterprise, according to guidelines adopted by decree of the Minister of Labour and Social Policies, after consultation with the National Council of the Third Sector. In addition, the statutes of social enterprises must establish the cases and modalities of worker and user participation and, in social enterprises that exceed certain size limits, provide for the designation by workers, and possibly users, of at least one member of both the administrative and supervisory bodies.[43]

[39] Article 16 Legislative Decree 112/2017.
[40] Article 12 Legislative Decree 112/2017.
[41] Article 12 Legislative Decree 112/2017.
[42] Article 12 Legislative Decree 112/2017.
[43] Article 11 Legislative Decree 112/2017.

Assets of a social enterprise cannot be converted to for-profit use. In the event of voluntary dissolution of the entity or voluntary loss of the status of social enterprise, the residual assets, after deducting, in the case of social enterprises established in the forms of companies, the capital actually paid in by the members, possibly revalued or increased, the dividends resolved and not distributed shall be devolved to other bodies of the third sector.[44]

7. PERSPECTIVE ON CHANGES AND CONCLUSIONS

Looking ahead, a key step in the completion of the 2017 reforms concerns the notification to the EU of tax rules subject to EU authorisation. Delay in obtaining authorisation could jeopardise the full operation of these reforms and also create a regulatory coordination flaw. Excessively lengthening the transitional period, in particular the time to obtain EU vetting, will delay the entry into force of its social enterprise-related facilitation provisions. Although the social enterprise was regulated for the first time in 2005 and further regulated in 2016, not many entities applied for and assumed such status due to the absence of tax incentives, the presence of supervisory mechanisms and the strict preclusion of profit distribution. The Third Sector reforms in 2017 endeavoured to make social enterprise status more attractive by establishing benefits (tax privileges, donation incentives, etc.) that come with social enterprise status. The legislature has shown a particular preference for entities with a corporate structure, which more than others are in line with the exercise of a business activity, by adopting for them a special exemption relating to the non-distribution constraint.

[44] Article 12 Legislative Decree 112/2017.

SOCIAL ENTERPRISES IN JAPAN

Nobuko Matsumoto*

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1. WHAT IS SOCIAL ENTERPRISE?

1.1. ABSENCE OF SPECIFIC RULES OR REGULATIONS ON SOCIAL ENTERPRISES IN JAPAN

What is social enterprise? Looking at examples of mechanisms called social enterprise overseas, the following four types of mechanisms may be included therein. The first example is a benefit corporation in some states of the US, which is a specialised for-profit legal form, is allowed to distribute its profit to investors, and is simultaneously required to pursue social purposes. The second example is a community interest company (CIC), available in the UK, which is a specialised for-profit legal form that can only distribute a limited ratio of profit. The third example is work integration social enterprises (WISE), which are required to hire vulnerable people. The fourth example is a firm certified under a system that allows firms pursuing social missions to identify themselves: an example of this is B Corp certification provided by B Lab.[1]

In Japan, there are no mechanisms that correspond to these four types. There are no special legal forms or certification systems for so-called social enterprises. Moreover, the concept of social enterprise itself is not widely known in Japan.

1.2. JAPANESE CORPORATE CULTURE FINDS SIGNIFICANCE IN CONTRIBUTING TO SOCIETY

The fact that there is no special legal infrastructure for social enterprises does not imply that Japanese society does not accept the idea of businesses with

[1] https://www.bcorporation.net/en-us/certification/.

social aims. On the contrary, Japanese for-profit corporations have found great significance in tackling social problems. According to the Cabinet Office's 2015 research that surveyed small-to-medium for-profit business corporations in the service industry (real estate, restaurants, hotels, medical service, welfare service, education, etc.), 62.5% companies answered either 'very well applicable' (17.6%) or 'applicable' (44.9%) to the question whether their main business purpose was to solve social issues rather than pursuing profits.[2] One of the reasons why the idea of social enterprises does not attract much focus in Japan might be because it is natural for Japanese business corporations to involve themselves with social issues; accordingly, people do not recognise the necessity to prepare special legal infrastructure for social enterprise.[3]

In Japan, businesses with a social mission use for-profit corporate or non-profit corporate forms. As these traditional legal forms are not specifically designed for social enterprises, there is a certain inconvenience in using them for this purpose, as described below.[4] As Japan has no fixed definition of social enterprise,[5] this report will use the term to refer to companies whose main purpose is to solve social problems through engagement in business activities.

2. LEGAL FORMS AND LIFECYCLE OF SOCIAL ENTERPRISES

2.1. WHAT LEGAL FORMS OF ORGANISATION ARE TYPICALLY ADOPTED BY SOCIAL ENTERPRISES?

As mentioned above, in Japan, there is no specialised legal form designed for social enterprises. One can engage in business for social purposes using both

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2 'Wagakuni-ni-okeru-syakaiteki-kigyou-no-katsudoukibo-ni-kansuru-chousa-houkokusyo' [Report on Scale of Social Enterprises in Japan], March 2015, hereinafter 'Cabinet Office's 2015 research', https://www.npo-homepage.go.jp/uploads/kigyou-chousa-houkoku.pdf.

3 See N. Matsumoto, 'Corporations with Social Aims in the Japanese Legal System' in H. Peter, C. Vasserot and J. Silva (eds), *The International Handbook of Social Enterprise Law*, Springer 2023, pp. 676–80.

4 See also N. Matsumoto, 'Recent Changes in Laws Regarding Nonprofit Corporations and Charitable Trusts in Japan' (2018) 45 *Zeitschrift fur Japanisches Recht* 129, and N. Matsumoto, 'Corporations with Social Aims in the Japanese Legal System' in H. Peter, C. Vasserot and J. Silva (eds), *The International Handbook of Social Enterprise Law*, Springer 2023, especially pp. 681–90.

5 The Cabinet Office's 2015 research determines whether a company is a social enterprise based on seven requirements: (i) it works to solve social issues through business; (ii) the main purpose of its business is not to pursue profit but to solve social issues; (iii) its profit is used mainly in the reinvestment to the business, not in new investment or distribution to shareholders; (iv) the ratio of profit distributed to shareholders is 50% or less; (v) a revenue of 50% or more is earned through business; (vi) the ratio of revenue earned through public insurance is 50% or less; and (vii) among the revenue excluding subsidies, membership fees and contributions, the ratio of revenue of businesses entrusted by the government is 50% or less.

for-profit corporations and non-profit corporations, although the fit is imperfect. When one engages in business for social purposes using a for-profit corporation, there are insufficient mechanisms to compel the firm to pursue and preserve its social mission. The question further remains whether for-profit corporate directors are allowed to prioritise social objectives over making a profit (see section 2.2 below). Alternatively, when one uses a non-profit corporate form, a social enterprise cannot raise money through investment, making it difficult to expand the size of the businesses.

The appendix at the end of this report shows some characteristics of each legal form. In Japan, the most popular traditional forms for for-profit business are: (i) share corporations (*kabushiki-gaisya*); and (ii) one-person-managed unincorporated businesses (*kojin-jigyou*), which are an option for sole proprietors.[6] In general, these forms seem suitable for social enterprises considering that Japanese for-profit businesses have a culture of pursuing social interests (see section 1.2 above). There are, however, some challenges, as described more fully in section 2.2 below.

Social enterprises can take the form of non-profit corporations in Japan as well. Non-profit corporations are generally understood to be prohibited or restricted from distributing profit to their members. While they can earn profit, they cannot distribute it to members. Non-profit corporation forms include: (iii) general incorporated associations (*ippan-syadan-houjin*); (iv) public interest incorporated associations (*koueki-syadan-houjin*); (v) NPO (an abbreviation of non-profit organisations) corporations (*tokutei-hieiri-katsudou-houjin*); and

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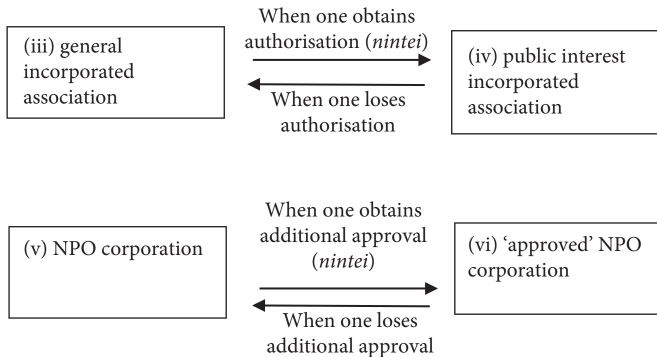
There seems to be some problems in this definition. As mentioned in the text, in Japanese culture, corporations are expected not only to pursue profit but also to solve social issues. Therefore, it seems that many corporations tend to answer 'yes' to the second question. Moreover, it is said that Japanese small or medium-sized family corporations tend not to make distributions to shareholders. That is to say, family members who are shareholders and directors of the corporation tend to be paid not in the form of distributions but in the form of remuneration as a director. As a result, many family corporations tend to answer 'yes' to the third and fourth questions. Therefore, using these seven requirements, it is probable that more corporations are determined as social enterprises than there really are.

6 Other than share corporations and one-person-managed unincorporated business, there is a form of unincorporated association (*kumiai*), based on the Civil Code (minpou, Act No. 89/1896). However, one tends to not choose a form of an unincorporated association, because the form is not very popular, it does not provide limited liability, and the incorporation of share corporations is quite easy.
Moreover, there exists a legal form of a consumer cooperative (*syouhi-seikatsu-kyoudou-kumiai*), based on the Consumer Cooperatives Act (syouhi-seikatsu-kyoudou-kumiai-hou, Act No. 200/1948). Consumer cooperatives are often used in the area of retail sales and they have the nature of mutual benefit corporations (for 'mutual benefit corporations', see D.P. Lee, 'The Business Judgment Rule: Should It Protect Nonprofit Directors?' (2003) 103 *Columbia Law Review* 925, 931, and G.A. Mann, 'Agency Costs and the Oversight of Charitable Organizations' (1999) *Wisconsin Law Review* 227, 242). The Consumer Cooperatives Act provides that a consumer cooperative's purpose should be to promote its members' cultural and economic life (section 2.1(2)) and to serve its members through its business (section 9).

(vi) 'approved' (*nintei*) NPO corporations (*nintei-tokutei-hieiri-katsudou-houjin*). Among them, the general incorporated association and NPO corporation are most suitable for social enterprises, although some of their characteristics may be incompatible for certain social enterprises, especially those seeking equity investment. Figure 1 shows the relationship between these forms with respect to public authorisations or approvals (*nintei*).[7]

Figure 1. Relationships between each type of non-profit corporation



Source: Produced by the rapporteur.

2.2. SHARE CORPORATIONS

Share corporations (*kabushiki-gaisya*), as per the Companies Act,[8] are the most popular legal form for business enterprises in Japan. Japanese culture focuses on the interests of employees and other stakeholders, which makes it easier to run a social enterprise using the structure of a share corporation. However, two issues arise when a social enterprise organises itself as a share corporation. First, whether directors of a share corporation are allowed to prioritise social objectives over profit-making is unclear. Second, it is not guaranteed that a share corporation will pursue and preserve its social objectives.

Certainly, in Japan, directors of a share corporation are understood to have wide discretion when considering stakeholder interests or making donations.[9]

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7 Although the unofficial English translation of the Act on public interest incorporated associations uses the term 'authorization' and that on NPO corporations uses the term 'approval', the original Japanese term is *nintei* for both.

8 Kaisya-hou, Act No. 86/2005. An unofficial English translation is available at https://www.japaneselawtranslation.go.jp/ja/laws/view/4135 and https://www.japaneselawtranslation.go.jp/ja/laws/view/4136 (Japanese Law Translation Database System (Ministry of Justice).

9 See the Yahata-Seitetsu case (1970), in which a large steel company made a political donation to the Liberal Democratic Party and its shareholder brought a derivative suit to pursue directors' liability. The Japanese Supreme Court stated: 'If they donate an amount that unreasonably exceeds the appropriate scale, they breach their duty of loyalty as directors'

Moreover, the Japanese version of the business judgment rule – which provides that 'unless the process or content of the decision-making is extremely unreasonable, a director who does this [makes the decision in question] does not breach his duty of care as a prudent manager'[10] reduces the likelihood that directors will be held liable for breach of fiduciary duty. It remains questionable, however, whether it constitutes a breach of fiduciary duty when directors clearly state that they prioritise pursuing social objectives over profit-making.

Regarding the second issue, there are insufficient mechanisms to compel share corporations to pursue their social objectives (see also section 6 below). A social enterprise structured as a share corporation is subject only to rules for a regular share corporation, and no rule requires a share corporation to pursue a social objective. One might stipulate in the articles of incorporation that a firm prioritises social objectives over shareholders' profit by using most of its profit to address social issues. In cases where every shareholder agrees with the specific provision and the shares are transferred only to persons who agree with the provision, there would be no need to void the provision. The provision, however, may be deleted or amended in the future if the shareholders change their minds.[11]

2.3. GENERAL INCORPORATED ASSOCIATIONS

2.3.1. Characteristics

A general incorporated association (*ippan-syadan-houjin*), incorporated as per the Act on General Incorporated Associations and General Incorporated Foundations (General Corporation Act),[12] is a non-profit corporation and an association-type corporation in the sense that it has members. A general incorporated association is a good option for a business with social purposes because it can pursue any objective and requirements for its incorporation and management are easy to meet. Some of the characteristics, however, might be problematic for some aspects of social enterprises.

(Judgment of the Supreme Court of Japan, 24 June 1970, *Minshu* 24(6) 625; the English translation is from J.M. Ramseyer and M. Iwakura, *Casebook Mergers & Acquisitions*, Shoji-Homu 2015, p. 140).

10 Judgment of the Supreme Court of Japan, 15 July 2010, *Hanrei-Jihou* (2091) 90. The English translation is from J.M. Ramseyer in J.M. Ramseyer et al., *An American Perspective on Japanese Law*, Yuhikaku 2019, p. 235. The addition in brackets is inserted by the rapporteur.

11 See N. Matsumoto, 'Corporations with Social Aims in the Japanese Legal System' in H. Peter, C. Vasserot and J. Silva (eds), *The International Handbook of Social Enterprise Law*, Springer 2023, pp. 684–85, note 29 and its text.

12 Ippan-syadan-houjin-oyobi-ippan-zaidan-houjin-ni-kansuru-houritsu, Act No. 48/2006. An unofficial English translation is available at https://www.japaneselawtranslation.go.jp/ja/laws/view/4354 (Japanese Law Translation Database System (Ministry of Justice)).

Most critical concerns are regarding its peculiar rules on limitations on distributions. General incorporated associations cannot make distributions to members while they continue to exist. In addition, they cannot provide in their articles of incorporation that they will distribute their residual assets on dissolution to members. In other words, they cannot promise, in advance, to distribute their residual assets to members.[13] These entities, however, are not fully subject to non-distribution constraints. In the event that its articles of incorporation do not have any provision regarding to whom its residual assets shall be distributed, a general incorporated association can distribute its residual assets to members in accordance with the resolutions of its member meetings on its dissolution.[14] This nature may make general incorporated associations less suitable as a format for social enterprise in two ways. First, they cannot get funding through investment. Second, potential consumers and contributors to the corporation who prefer to deal with corporations that surely pursue social objectives might feel anxious that the money they pay or give will not be used to tackle social problems but will be distributed to members of the company in the end.[15]

A second possible concern is whether a general incorporated association would permanently pursue its social objectives. The objective of each general incorporated association is provided in the articles of incorporation and directors must pursue that objective. However, members can freely change the objectives with resolutions of member meetings. Therefore, a general incorporated association with the purpose of promoting public interest might change its objectives and begin working as an organisation promoting only the mutual benefit of its members.

2.3.2. Formation

One can easily incorporate a general incorporated association by entering it at a registry. No authentication, authorisation or approval is needed. There is no special requirement concerning the independence of directors.

2.3.3. Conversion

Share corporations cannot convert into general incorporated associations or vice versa. As mentioned in section 2.4 below, once general incorporated associations are authorised in accordance with the Act on Authorisation of Public Interest

[13] General Corporation Act, section 11.2.
[14] General Corporation Act, section 239.1.
[15] Regarding the role of non-distribution constraint, see H.B. Hansmann, 'The Role of Nonprofit Enterprise' (1980) 89 *Yale Law Journal* 835, 844.

Incorporated Associations and Public Interest Incorporated Foundations (Act on Authorisation),[16] they become public interest incorporated associations; when they lose the authorisation, they again become general incorporated associations.

2.3.4. Maintenance

Basic financial statements must be publicly disclosed and full financial statements must be disclosed to members and creditors,[17] though they need not include disclosure or self-assessment regarding social activities or social impact. General incorporated associations are not subject to any governmental supervision.

2.3.5. Exit

A general incorporated association can be dissolved by resolution of its member meeting.[18] Approval from governmental agencies is not necessary. If its articles of incorporation do not provide for the ownership of remaining assets, member meetings can decide to whom the remaining assets should be given.[19] As explained in section 2.1.3 above, at the point of dissolution, member meetings can decide to distribute remaining assets to members.

2.4. PUBLIC INTEREST INCORPORATED ASSOCIATIONS

2.4.1. Characteristics

When a general incorporated association applies for the status of a public interest incorporated association under the Act on Authorisation and obtains authorisation, it becomes a public interest incorporated association (*koueki-syadan-houjin*). As public interest incorporated associations are fully subject to the non-distribution constraint, they cannot raise funds through investment. To be authorised, a general incorporated association must meet strict criteria, some of which may be inconvenient for social enterprises. First, its principal objective must be to operate the 'business for public interest purposes', which must fall into any of the 22 categories of businesses listed in the Act.[20] If the

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16 Koueki-syadan-houjin-oyobi-koueki-zaidan-houjin-no-nintei-ni-kansuru-houritsu, Act No. 49/2006. An unofficial English translation is available at https://www.japaneselawtranslation.go.jp/ja/laws/view/145 (Japanese Law Translation Database System (Ministry of Justice)).

17 General Corporation Act, sections 128–29.

18 General Corporation Act, section 148(3).

19 General Corporation Act, section 239.2.

20 Act on Authorisation, sections 5(1), 2(4), and its appendix. The 22 categories include businesses: (i) to promote academic and scientific technology; (ii) to promote culture and

business of a social enterprise does not fall into one of these categories, a public interest incorporated association cannot be used. Second, with respect to the 'business for public interest purposes', the revenue is expected to not exceed the amount compensating the reasonable cost of its operation.[21] This requirement may make it difficult for a public interest incorporated association to run a social enterprise, as it limits its profit-making, and thus may make its survival difficult.

Other requirements include the following. If it operates any business other than one for public interest purposes ('profit-making business'), the operation of the profit-making business should not hamper the operation of the business for public interest purposes, and the ratio of expenditures for the business for public interest purposes should exceed 50% of all money spent.[22] Family members cannot exceed one third of the directors.[23] Public interest incorporated associations must provide in their articles of incorporation that in case of liquidation, they shall cause the remaining assets to be attributed to certain parties, such as public interest corporations and national or local governments.[24] This requirement means that a public interest incorporated association is completely prohibited from distributing its assets to its members.

2.4.2. Formation

For the formation of public interest incorporated associations, see section 2.4.1 above.

art; (iii) to support persons with disability or needy persons or victims of accident, disaster or crime; (iv) to promote the welfare of senior citizens; (v) to support persons having the will to work and seeking the opportunity of employment; (vi) to enhance public health; (vii) to seek the sound nurturing of children and youths; (viii) to enhance the welfare of workers; (ix) to contribute to the sound development of mind and body of citizens or to cultivate abundant human nature through education and sports, etc.; (x) to prevent crimes or to maintain security; (xi) to prevent accident or disaster; (xii) to prevent and eliminate unreasonable discrimination and prejudice by reason of race, gender or others; (xiii) to respect and protect the freedom of ideology and conscience, the freedom of religion or of expression; (xiv) to promote the creation of a gender-equal society or other better society; (xv) to promote international mutual understanding and for economic cooperation to overseas developing regions; (xvi) to preserve the global environment or protect and maintain the natural environment; (xvii) to utilise, maintain or preserve the national land; (xviii) to contribute to the sound operation of national politics; (xix) to develop a sound local community; (xx) to secure and promote fair and free opportunities for economic activity and to stabilise and enhance the lives of the citizenry by way of activating the economy; (xxi) to secure a stable supply of goods and energy indispensable for the lives of the citizenry; and (xxii) to protect and promote the interests of general consumers (the English translation is from https://www.japaneselawtranslation.go.jp/ja/laws/view/145, with minor edits by the rapporteur).

21 Act on Authorisation, section 5(6).

22 Act on Authorisation, section 5(8).

23 Act on Authorisation, section 5(10).

24 Act on Authorisation, section 5(18).

2.4.3. *Maintenance*

In addition to the mandatory disclosure required of general incorporated associations, as to public interest incorporated associations, detailed financial statements and other documents must be reported to a governmental agency (the prime minister or the prefectural governor) and publicly disclosed.[25] This requirement may be burdensome for small organisations. These documents must include explanation of its social activities and its ratio of expenditures for the 'business for public interest purposes'. There is no third-party standard for an assessment of whether a corporation has achieved its social goals.

Governmental agencies (the prime minister or the prefectural governor) supervise public interest incorporated associations,[26] and when they fail to meet the requirements, they may lose the authorisation and become general incorporated associations.[27]

2.4.4. *Exit*

A public interest incorporated association can be dissolved by resolution of its member meeting. No approval from any governmental agencies is necessary. On dissolution, the remaining assets must be distributed to certain parties, such as other public interest corporations and national or local governments.[28]

When a public interest incorporated association loses its authorisation, it becomes again a general incorporated association, but part of its assets, calculated based on the amount of property which is obtained by excluding the property that is consumed for the purpose of operating the business for public interest purposes from the property and subsidy donated or given to the public interest incorporated association, must be distributed to certain parties, such as public interest corporations and national or local governments.[29]

2.5. NPO CORPORATIONS

2.5.1. *Characteristics*

Another category of Japanese non-profit corporations is the NPO corporation (*tokutei-hieiri-katsudou-houjin*) under the Act on Promotion of Specified

25 Act on Authorisation, sections 21–22.
26 Act on Authorisation, sections 27–28.
27 Act on Authorisation, section 29.
28 Act on Authorisation, section 5(18).
29 Act on Authorisation, sections 5(17), 30(2).

Non-profit Activities (NPO Act).[30] The 'authentication' required to establish an NPO corporation is not difficult to obtain.[31]

NPO corporations appear suitable as formats for social enterprises for the following reasons. First, the system of NPO corporations is well known, as compared to general incorporated associations or public interest incorporated associations, and has been widely used. This is because the NPO Act was enacted in 1998, while the General Corporation Act and the Act on Authorisation were enacted in 2006.

As to distributions, NPO corporations are fully subject to the non-distribution constraint, unlike in general incorporated associations (see section 2.3.1 above). When an NPO corporation is liquidated, the remaining assets may only be distributed to certain parties, such as public interest corporations and national or local governments.[32] The full non-distribution constraint makes it impossible for NPO corporations to raise funds through investment. At the same time, however, consumers and contributors to the corporation do not have to feel anxious that the money they pay or give will be distributed to members of the company. This nature might make NPO corporations suitable formats for social enterprise. Furthermore, disclosure requirements are not burdensome compared with those for public interest incorporated associations.[33]

It should be noted, however, that other challenges remain for using NPO corporations as social enterprises. First, the primary purpose of NPO corporations must be to engage in 'specified non-profit activities', which must fall into any of 19 categories of activities listed in the NPO Act.[34] If the business engaged by a social enterprise does not fall into these categories, an NPO corporation cannot be used. Second, the NPO Act allows NPO corporations

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[30] Tokutei-hieiri-katsudou-sokushin-hou, Act No. 7/1998. An unofficial English translation is available at https://www.japaneselawtranslation.go.jp/ja/laws/view/3028 (Japanese Law Translation Database System (Ministry of Justice)).

[31] NPO Act, section 10. See T. Ohta, *Hieiri-houjin-setsuritsu-unei-gaidobukku* [Guidebook for organising and running non-profit corporations], Koueki-houjin-kyoukai 2012, p. 64.

[32] NPO Act, sections 11.3, 32.

[33] It should be noted that the NPO Act imposes some restrictions on family members becoming directors and auditors (section 21).

[34] NPO Act, sections 2.2, 2.1 and its appendix. The 19 categories are activities for: (i) enhancing health care, medical care and welfare; (ii) promoting social education; (iii) promoting development of communities; (iv) promoting tourism; (v) revitalising rural areas or hilly and mountainous areas; (vi) promoting science, culture, arts or sports; (vii) preserving the environment; (viii) disaster relief; (ix) regional security; (x) protecting human rights or promoting peace; (xi) international cooperation; (xii) promoting the formation of a gender-equal society; (xiii) assisting sound development of children; (xiv) developing an information-oriented society; (xv) promoting science and technology; (xvi) vitalising the economy; (xvii) supporting the development of vocational skills or the expansion of employment opportunities; (xviii) protecting consumers; and (xix) doing liaison work or providing advice or assistance for the operations or activities of organisations engaging in any of the activities set forth in the preceding items (the English translation is from https://www.japaneselawtranslation.go.jp/ja/laws/view/3028, with minor edits by the rapporteur).

to pay remuneration only to a third of directors and auditors.[35] This restriction may be cumbersome and inconvenient to some social enterprises.

2.5.2. Formation

For the formation of NPO corporations, see section 2.5.1 above.

2.5.3. Maintenance

Disclosure and reporting to the governmental agencies (the prefectural governor or the head of the designated city) should be made.[36] These documents must include an explanation regarding its social activities. There is no third-party standard for an assessment of whether a corporation has achieved its social goals.

Governmental agencies supervise NPO corporations,[37] and when they fail to meet the requirements, they may lose their authentication[38] and be forced to dissolve.[39] Failure to file a report (usually for three years or more) is a common reason for revocation of authentication.

2.5.4. Exit

NPO corporations are primarily dissolved in one of two ways. First, they can be dissolved by resolution of the member meeting.[40] Approval by a governmental agency is not necessary. Second, an NPO corporation is dissolved when an NPO corporation loses its authentication.[41] When NPO corporations are dissolved, the remaining assets must be distributed to certain parties, such as public interest corporations and national or local governments.[42]

2.6. APPROVED NPO CORPORATIONS

2.6.1. Characteristics

When an NPO corporation applies for and obtains additional 'approval' (*nintei*) under the NPO Act,[43] it is called an 'approved NPO corporation'

35 NPO Act, section 2.2(1)b.
36 NPO Act, sections 28–30.
37 NPO Act, sections 41–42.
38 NPO Act, section 43.
39 NPO Act, section 31.1(7).
40 NPO Act, section 31.1(1).
41 NPO Act, section 31.1(7).
42 NPO Act, section 11.3.
43 NPO Act, section 44.

(*nintei-tokutei-hieiri-katsudou-houjin*) and obtains more favourable tax treatment, which includes tax preferences for contributors to the NPO corporation (see section 4.1 below). The additional approval is effective for five years, at which time the approved NPO corporation must reapply. When an approved NPO corporation loses its additional approval, it becomes a (standard) NPO corporation.

This form, however, is unsuitable as a format for social enterprises. To obtain additional approval, an NPO corporation must meet the 'public support test', which requires that the NPO corporation receives at least one-fifth of its revenue from donations or that the NPO corporation receives donations of at least JPY 3,000 from at least, on average per year, 100 people.[44] For social enterprises that generate revenue from trading rather than donations, this requirement may be cumbersome and difficult to meet.

2.6.2. Formation

For the formation of approved NPO corporations, see section 2.6.1 above.

2.6.3. Maintenance

Approved NPO corporations must engage in disclosure and reporting to governmental agencies.[45] These documents must include an explanation of its 'specified non-profit activities' and ratio of expenditures for the activities. There is no third-party standard for an assessment of whether the corporation has achieved its social goals.

Governmental agencies (the prefectural governor or the head of the designated city) supervise approved NPO corporations.[46] When they fail to meet the requirements for approval, for example the 'public support test' explained above, they may be stripped of it and become (standard) NPO corporations.[47]

2.6.4. Exit

The procedure for liquidation of an approved NPO corporation is the same as that of an (standard) NPO corporation (see section 2.5.4 above). No additional process is required.

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44 NPO Act, section 45.1(1).
45 NPO Act, sections 28, 29, 30, 52–56.
46 NPO Act, sections 64–66.
47 NPO Act, section 67.

3. STATE/PRIVATE CERTIFICATIONS

In Japan, there are no government designations or certifications available for social enterprises.

B Lab itself or its B Corp certification are hardly known in Japan. According to B Lab's website, only 30 Japanese companies are B Corps.[48] Those companies are small to medium-sized companies and there is not an example of a listed company certified as a B Corp in Japan. One example of a B Corp is Eco Ring Co., Ltd., which engages in reuse and recycling through purchasing and reselling of brand-name products and was certified in June 2021.[49]

4. SUBSIDIES AND BENEFITS

4.1. TAX PREFERENCES

Certain corporate forms enable the corporations that adopt them, in some cases along with their contributors, to attain tax preferences. As to the corporation tax imposed on the entity, general incorporated associations,[50] public incorporated associations, NPO corporations and approved NPO corporations enjoy the tax preference that only revenues generated from 'profit-making businesses'[51] under the Corporate Tax Act are taxable. In addition, for public interest incorporated associations, revenues generated from the 'businesses for public interest purposes' are not taxable, even if they are generated from 'profit-making businesses' under the Corporate Tax Act. Contributors to public interest incorporated associations and approved NPO corporations also enjoy tax preferences. Individual contributors can acquire reductions for taxable income and corporation contributors can include certain amounts in deductible expenses.

4.2. OTHER BENEFITS

In Japan, there are no procurement preferences designed for social enterprises. However, there are some procurement preferences managed by national and

48 https://www.bcorporation.net/en-us/find-a-b-corp. Searched on 10 August 2023 by using 'Japan' as location and checking the box 'Headquarters Only'.

49 https://www.bcorporation.net/en-us/find-a-b-corp/company/eco-ring.

50 But only if the articles of incorporation provide that residual assets will be given to certain parties, such as certain public interest corporations and national or local government.

51 Houjin-zei-hou-sekourei (Order for the Enforcement of the Corporation Tax Act), section 5.

local governments, which can be utilised by corporations with social missions. For example, the Act on promotion of governmental procurement of goods from facilities where persons with disabilities work[52] offers procurement preferences to facilities that hire certain number of persons with disabilities. In addition, the Act on promotion of governmental procurement of eco-friendly goods[53] requires national government to formulate a policy for procurement. The policy settled based on this Act provides detailed criteria, including, for example, that restaurants which will be operated in the governmental offices shall use tableware that can be used repeatedly.

5. PRIVATE CAPITAL

As with other countries, so-called 'ESG (environmental, social and governance) investment' is attracting attention in Japan. However, 'impact investment', which focuses not only on sustainability but also on the extent to which the business makes some positive impact on the environment or society, still remains uncommon and limited in Japan. Nevertheless, some players have started engaging in impact investment. For example, the Japan Venture Philanthropy Fund,[54] established in 2013 and jointly operated by Nippon Foundation[55] and Social Investment Partners,[56] is sourced by contributions and provides investments or loans to social businesses.

As there are no specific legal systems for social enterprises, securities regulations and securities exchanges do not treat share corporations differently depending on whether they are social enterprises.

6. ROLES PLAYED BY PARTIES AND ENFORCEMENT MECHANISMS

To compel social enterprises to pursue their social missions, what role can constituencies play? What mechanisms can they use?

[52] Kuni-tou-ni-yoru-syougaisya-syuurou-shisetsu-tou-karano-buppin-tou-no-cyoutatsu-no-suishin-tou-ni-kansuru-houritsu, Act No. 50/2012.

[53] Kuni-tou-ni-yoru-kankyou-buppin-tou-no-cyoutatsu-no-suishin-tou-ni-kansuru-houritsu, Act No. 100/2000.

[54] http://www.jvpf.jp/en/about/.

[55] https://www.nippon-foundation.or.jp/en.

[56] http://sipartners.org/english/.

When social enterprises are organised using the form of share corporations (see section 2.2 above), only shareholders have voting rights and can play roles in corporate governance. The mechanisms that shareholders can use to compel directors to pursue their social missions are insufficient. If directors are not sufficiently pursuing their social missions, nearly the only way shareholders can influence the situation is by dismissing those directors.[57] It is true that directors who breach their fiduciary duties are subject to liability for damages to the company,[58] and shareholders can pursue such liability through derivative suits.[59] However, in the event that the directors focus on making a profit, failing to pursue social missions and the corporation has experienced no financially evaluable damages, that mechanism will not work, because shareholders can only pursue financially evaluable damages. Employees, customers and other stakeholders have no mechanism to compel the corporation pursue its mission.

When social enterprises are organised using general incorporated associations or public interest incorporated associations (see sections 2.3 and 2.4 above), directors are elected by the resolution of the member meeting, and the member meeting can also dismiss directors without cause.[60] In the case of NPO corporations and approved NPO corporations (see sections 2.5 and 2.6 above), the process of member election is provided in the articles of incorporation, and members have rights to dismiss directors only if dismissal rights are provided in the articles of incorporation.[61] Similar to the case of share corporations, without financially evaluable damages to the corporation, mechanisms to pursue liability for damages will be a poor fit. Employees or customers have no mechanisms to use.

Public interest incorporated associations (see section 2.4 above), NPO corporations (see section 2.5 above) and 'approved' NPO corporations (see section 2.6 above), however, are supervised by a governmental agency. In extreme cases, if a social enterprise adopting one of these forms is ignoring its social mission, it would lose its authorisation or authentication. As mentioned in section 2.5.3 above, however, failure to file a report (usually for three years or more) is the most common reason for revocation of authentication for NPO corporations. There are few cases[62] where authorisation of a public interest

57 Companies Act, section 239.
58 Companies Act, section 423.
59 Companies Act, section 847.
60 General Corporation Act, sections 63, 70.
61 NPO Act, section 11.1(6).
62 There were 12 cases in the 2019 fiscal year, and 15 in the 2020 fiscal year (Cabinet Office, 'Reiwa-3-nen-koueki-houjin-no-gaikyou-oyobi-koueki-nintei-tou-iinkai-no-katsudou-

incorporated association has been revoked, but most of these revocations were made based on an application for revocation made by the corporation itself.

7. PROSPECTIVE CHANGES

In June 2022, the Japanese cabinet approved the 'Grand Design and Action Plan for a New Form of Capitalism'.[63] It includes a section titled 'Consider reforms of new and existing corporate forms that play public roles in the private sector', which refers to benefit corporations in US. It says '[t]he [Japanese] government will consider the need for a new legal system as a new form of public private partnership. A forum will be established to study this concept as part of the Council of New Form of Capitalism Realization.'[64]

8. IS A SPECIFIC LEGAL FORM OR CERTIFICATION SYSTEM NECESSARY?

Is a specific legal form or a certification system necessary for the growth of social enterprises in Japan?

As explained so far, one can engage in businesses with social aims by using an existing legal form. When one uses non-profit legal forms, general incorporated associations or NPO corporations can be good options. However, as non-profit corporations cannot raise money through investment, it may be difficult for them to enlarge the size of their businesses. In that case, the option to run social enterprises using the mechanism of for-profit corporations seems to be necessary. But share corporations too are not perfect as formats for social enterprises. What kind of new legal infrastructure, if any, is needed?

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houkoku' [Overview of Public Interest Corporations and Activity Report of Public Interest Corporation Commission 2021], December 2022, https://www.koeki-info.go.jp/outline/pdf/2021_01_houkoku.pdf).

63 Atarashii-shihonshugi-no-gurando-dezain-oyobi-jikkou-keikaku. A provisional English translation is available at https://www.cas.go.jp/jp/seisaku/atarashii_sihonsyugi/pdf/ap2022en.pdf.

64 The English translation is from https://www.cas.go.jp/jp/seisaku/atarashii_sihonsyugi/pdf/ap2022en.pdf.

Introducing a new certification system may be easier than introducing a new legal form of organisation. Considering that it is not guaranteed that a share corporation will preserve and pursue its social objectives (see section 2.2 above), it would be beneficial to introduce a certification system to identify corporations that are truly pursuing social objectives and make those corporations attract ethical consumers and investors engaging in impact investment. The certification should be given by the government or by a private organisation accredited by the government, in order to unify the requirements and criteria which are necessary to get the certification. To obtain certification, corporations should be required to engage in activities or investment to solve social issues, and disclose the details of these activities along with the approximate amount consumed for that purpose annually.

Whether or not a new specific legal form of organisation is necessary, in addition to a certification system, is a more complicated issue. As described in section 2.2 above, when a social enterprise organises itself as a share corporation, the issue of whether directors are allowed to prioritise social objectives over profit-making arises. Certainly, directors of share corporations are given wide discretion, and the Japanese version of the business judgment rule reduces the likelihood that directors will be held liable for breach of fiduciary duty. Therefore, as long as directors explain that 'we balance social contribution and profit-making', the risk that directors will breach their fiduciary duties does not seem high. It remains questionable, however, whether it constitutes a breach of fiduciary duty when directors clearly state that 'we prioritise pursuing social objectives over making a profit' or 'we reduce dividends to shareholders and use that amount to solve social issues'. In the latter case, it may infringe on the interests of shareholders who do not want corporations to sacrifice profit. If there are a large number of corporations that wish to operate in this latter fashion, introduction of a new specific legal form may be required. It should also be noted that if a new legal form for social enterprises is introduced and conversion from ordinary share corporations to this new legal form is allowed, the right to exit should be provided to protect existing shareholders.

APPENDIX

Table 1. Characteristics of each legal form

	(i) Share corporations (*kabushiki-gaisya*)	(ii) One-person-managed unincorporated business (*kojin-jigyou*)	(iii) General incorporated associations (*ippan-syadan-houjin*)	(iv) Public interest incorporated associations (*koueki-syadan-houjin*)	(v) NPO corporations (*tokutei-hieiri-katsudou-houjin*)	(vi) 'Approved' NPO corporations (*nintei-tokutei-hieiri-katsudou-houjin*)
Suitability and inconvenience as legal forms for social enterprises (rapporteur's personal view)	– Apparently suitable – Insufficient mechanisms compelling corporations to pursue social missions (see 2.2) – Question remains whether directors are allowed to prioritise social objectives over profit-making (see 2.2 and 6)	– Apparently suitable – No legal personality – No mechanisms to compel the person to pursue social missions	– Apparently suitable – Cannot get funding through investment – Assets are not completely locked Residual assets can be distributed to members (see 2.3) – Not guaranteed that a general incorporated association will permanently pursue its social objectives (see 2.3)	– Not necessarily suitable – Cannot get funding through investment – Primary purpose must be to operate the 'business for public interest purposes', which must fall into any of the 22 categories of businesses listed in the Act (see 2.4) – Regarding 'business for public interest purposes', the revenue must not exceed the amount compensating the reasonable cost for its operation (see 2.4)	– Apparently suitable – Cannot get funding through investment – Primary purpose must be engaging in 'specified non-profit activities', which must fall into any of the 19 categories of activities listed in the Act (see 2.5) – It can pay remuneration only to one-third or less of directors and auditors (see 2.5.1)	– Not necessarily suitable – Cannot get funding through investment – Primary purpose must be engaging in 'specified non-profit activities', which must fall into any of the 19 categories of activities listed in the Act (see 2.5) – The 'public support test', which requires a certain amount or number of donations, is cumbersome for corporations that produce revenue by trading (see 2.6)

(continued)

Table 1 *continued*

	(i) Share corporations (*kabushiki-gaisya*)	(ii) One-person-managed unincorporated business (*kojin-jigyou*)	(iii) General incorporated associations (*ippan-syadan-houjin*)	(iv) Public interest incorporated associations (*koueki-syadan-houjin*)	(v) NPO corporations (*tokutei-hieiri-katsudou-houjin*)	(vi) 'Approved' NPO corporations (*nintei-tokutei-hieiri-katsudou-houjin*)
Act (shown by abbreviation)	Companies Act	N/A	General Corporation Act	General Corporation Act Act on Authorisation	NPO Act	NPO Act (section 44 et seq.)
Legal personality	Yes	No	Yes	Yes	Yes	Yes
For-profit corporation or non-profit corporation	For-profit	N/A	Non-profit	Non-profit	Non-profit	Non-profit
Can it get funding through investment?	Yes	N/A	No	No	No	No
Formation	It can be easily incorporated by entering it at a registry	N/A	It can be easily incorporated by entering it at a registry	When a general incorporated association obtains 'authorisation', it becomes a public interest incorporated association	'Authentication' is required to establish an NPO corporation	When an NPO corporation applies for and obtains additional 'approval', it is referred to as an 'approved' NPO corporation

Limitations and prohibition on profit distributions to owners or members (non-distribution constraint)	No	N/A	Basically, distribution is prohibited But residual assets can be distributed to members (see 2.3)	Distribution is completely prohibited	Distribution is completely prohibited	Distribution is completely prohibited
Permissible objects	Basically, pursuit of profit But directors have wide discretion	Any object	Any object	The primary purpose must be to operate the 'business for public interest purposes', which must fall into any of the 22 categories of businesses listed in the Act (see 2.4)	The primary purpose must be engaging in 'specified non-profit activities', which must fall into any of the 19 categories of activities listed in the Act (see 2.5)	The primary purpose must be engaging in 'specified non-profit activities', which must fall into any of the 19 categories of activities listed in the Act (see 2.5)
Purpose/mission requirement	No	No	No	Yes	Yes	Yes
Limited liability	Yes	N/A	N/A	N/A	N/A	N/A
Rights to participation in management (incl. voting rights and other governance rights) of owners and other stakeholders (e.g. employees)	Shareholders: Yes Other stakeholders: No	N/A	Members (not owners) have voting rights Other stakeholders: No	Members (not owners) have voting rights Other stakeholders: No	Members (not owners) have voting rights Other stakeholders: No	Members (not owners) have voting rights Other stakeholders: No

(continued)

Table 1 ***continued***

	(i) Share corporations (*kabushiki-gaisya*)	**(ii) One-person-managed unincorporated business (*kojin-jigyou*)**	**(iii) General incorporated associations (*ippan-syadan-houjin*)**	**(iv) Public interest incorporated associations (*koueki-syadan-houjin*)**	**(v) NPO corporations (*tokutei-hieiri-katsudou-houjin*)**	**(vi) 'Approved' NPO corporations (*nintei-tokutei-hieiri-katsudou-houjin*)**
Continuity of existence	Yes	Until the person dies	Yes	Yes	Yes	Yes But obtaining 'approval' is required every five years
Transferability of ownership	Yes	N/A	N/A	N/A	N/A	N/A
Fiduciary duty or other conceptions of obligations for leaders	Yes Directors owe fiduciary duty	N/A	Yes Directors owe fiduciary duty	Yes Directors owe fiduciary duty	Although there is no explicit provision, it can be understood that directors owe fiduciary duty	Although there is no explicit provision, it can be understood that directors owe fiduciary duty
Discretion/ limitations on serving stakeholders beyond investors	Question remains whether directors are allowed to prioritise social objectives over profit-making (see 2.2)	N/A	N/A	N/A	N/A	N/A

Limitations on trading	No	No	No	Trading itself is not limited. However, regarding the 'business for public interest purposes', it is required that the revenue is expected to not exceed the amount compensating the reasonable cost for its operation (see 2.4)	No	No
Disclosure/ reporting requirement	Financial statements must be disclosed in accordance with the Company Act and, if it is listed, the Financial Instrument Exchange Act	No	Financial statements must be disclosed (see 3.3.4)	Detailed financial statements and other documents must be reported (to the governmental agency) and disclosed (see 4.3.4)	Disclosure and reporting (to the governmental agency) (see 5.3.4)	Disclosure and reporting (to the governmental agency) (see 6.3.4)
Disclosure/ reporting requirement as to social activities or social impact	No	No	No	It must include an explanation of its social activities and the ratio of expenditures for the 'business for public interest purposes'	It must include an explanation of its 'specified non-profit activities'	It must include an explanation of its 'specified non-profit activities' and the ratio of expenditures for the activities

(continued)

Table 1 *continued*

	(i) Share corporations (*kabushiki-gaisya*)	(ii) One-person-managed unincorporated business (*kojin-jigyou*)	(iii) General incorporated associations (*ippan-syadan-houjin*)	(iv) Public interest incorporated associations (*koueki-syadan-houjin*)	(v) NPO corporations (*tokutei-hieiri-katsudou-houjin*)	(vi) 'Approved' NPO corporations (*nintei-tokutei-hieiri-katsudou-houjin*)
Supervision by governmental agencies or regulator	No	N/A	No	Yes (see 4.3.4)	Yes (see 5.3.4)	Yes (see 6.3.4)
Procedure of dissolution	Resolution of shareholder meeting	N/A	Resolution of member meeting	Resolution of member meeting	Resolution of member meeting It is also dissolved when it loses its authentication	Resolution of member meeting It is also dissolved when it loses its authentification
Entity and owner taxation (national tax)	Share corporations are subject to corporation tax Shareholders are subject to income tax for dividends received and gain on sale	The person is subject to income tax	General incorporated associations are subject to corporation tax	Public interest incorporated associations are subject to corporation tax	NPO corporations are subject to corporation tax	Approved NPO corporations are subject to corporation tax

Tax preferences for the corporations	N/A	N/A	– If the articles of incorporation provide that residual assets will be given to certain parties, such as certain public interest corporations and national or local government, only revenues generated from 'profit-making businesses' under the Corporate Tax Act are taxable	– Only revenues generated from 'profit-making businesses' under the Corporate Tax Act are taxable – Revenues generated from the 'businesses for public interest purposes' are not taxable	– Only revenues generated from 'profit-making businesses' under the Corporate Tax Act are taxable	– Only revenues generated from 'profit-making businesses' under the Corporate Tax Act are taxable
Tax preferences for investors/ contributors	N/A	N/A	N/A	– Individual contributors can acquire reductions for taxable income – Corporation contributors can include certain amounts in deductible expenses	N/A	– Individual contributors can acquire reductions for taxable income – Corporation contributors can include certain amounts in deductible expenses

Source: Compiled by the rapporteur.

SOCIAL ENTERPRISES IN KAZAKHSTAN

Farkhad Karagussov

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The notion of a 'social enterprise' has not been developed in the legal theory of the Republic of Kazakhstan (RK) and only recently was a legal regime for a 'social entrepreneurship' (*social'noe predprinimatel'stvo*) introduced into Kazakhstan's legislation.

The practice of social entrepreneurship has been emerging in Kazakhstan since the early 2010s, but any qualifications of a business as a social enterprise

have until recently been based only on common understandings and social consensus. Consequently, no official data about the number of social enterprises or their types of activity, geographical presence, business models, organisational forms and other important information existed until 2022. Various unofficial estimations yielded quite disparate results, for instance that from 152 to about 500 social enterprises operated in 2019.[1]

In 2021 Kazakhstan introduced a legal framework for social entrepreneurship,[2] and the official Register of Subjects of Social Entrepreneurship (the Register) was formed soon thereafter in early 2022.[3] In 2023 the competence to regulate certain aspects of social entrepreneurship was transferred from the RK Government to the designated Ministry.[4]

1. WHAT IS A SOCIAL ENTERPRISE?

The concept of 'social entrepreneurship' is defined in the law as follows:

> social entrepreneurship is the entrepreneurial activity of subjects of social entrepreneurship contributing to solution of social problems of citizens and society carried out in accordance with the conditions provided for in Article 79-3 of this [i.e. the Entrepreneurial] Code.[5]

The following three main tasks of social entrepreneurship are indicated in Article 79-2 of the Entrepreneurial Code: (i) ensuring participation of entrepreneurs in solving social problems by way of, among others, introduction of social innovations and assistance in provision of social services; (ii) assistance

1 K. Bapiev, 'Kak v Kazahstane razvivaetsya social'noe predprinima-tel'stvo: Oficial'noj statistiki po etomu vidu biznesa v respublike poka net' [How social entrepreneurship is developing in Kazakhstan: There are no official statistics on this type of business in the republic yet], 14 February 2020, https://kursiv.kz/news/biznes/2020-02/kak-v-kazakhstane-razvivaetsya-socialnoe-predprinimatelstvo; Press release of the National Chamber of Entrepreneurs of the RK (Atameken), 'Voprosy social'nogo predprinimatel'stva obsudili v "Atamekene"' [Social entrepreneurship was discussed in 'Atameken'], 26 September 2019, https://atameken.kz/ru/news/33065-voprosy-social-nogo-predprinimatel-stva-obsudili-v-atamekene.

2 Law of the RK dated 24 June 2021, No. 52-VII, 'On Amendments to Certain Legislative Acts of the Republic of Kazakhstan on Matters of Entrepreneurship, Social Entrepreneurship and Mandatory Social Medical Insurance', https://adilet.zan.kz/rus/docs/Z2100000052.

3 Order of the Minister of the National Economy of the RK dated 29 January 2022, No. 34, 'About Approval of the Register of Subjects of Social Entrepreneurship as of 31 December 2021', as amended, https://www.gov.kz/memleket/entities/economy/documents/details/299951?directionId=203&lang=ru.

4 Law of the RK dated 19 April 2023, No. 223-VII, 'On Amendments to Certain Legislative Acts of the Republic of Kazakhstan on Matters of the Administrative Reform', https://adilet.zan.kz/rus/docs/Z2300000223.

5 Entrepreneurial Code of the RK dated 29 October 2015, No. 375-V, as amended, Art. 79-1, https://adilet.zan.kz/rus/docs/K1500000375.

in employment of those who officially belong to socially vulnerable categories of population ('vulnerable people') and creating opportunities for their labour and social integration; and (iii) promotion of goods manufactured, work performed or services rendered by social entrepreneurship entities by way of, among others, involving personal efforts of vulnerable people.

Although clarification of the law on this point would be welcome, it appears that all those three tasks need not be undertaken by a single entity or person for it to be recognised as a subject of social entrepreneurship (SSE). Rather, when any of those three tasks finds a solution in the activity of a person (whether an individual entrepreneur or a legal entity), that person can be acknowledged as an SSE. Notably, in order to be qualified as an SSE it is not sufficient to declare fidelity to a social mission. Indeed, such a declaration is not required.

1.1. REQUIREMENTS FOR QUALIFICATION AS AN SSE

The following four key features of social entrepreneurship, as it is understood by the RK legislator, can be distinguished: (i) it is an entrepreneurial activity and, therefore, according to the Civil Code it is 'directed at generating net profit';[6] (ii) the business should contribute to solution of social problems of individual citizens, groups of citizens, a community or the entire society through its (or in result of its) regular business activity; and (iii) it can be conducted by individual entrepreneurs or by legal entities provided that (iv) such individual entrepreneurs and legal entities are recognised as SSEs by an entry in the Register.

It is the sole discretion of a person or entity to apply to become an SSE. But applicants are included in the Register if they meet conditions set out in the Entrepreneurial Code.

The following types of activities can be qualified as social entrepreneurship under the Entrepreneurial Code: (i) production of goods, implementation of works or provision of services by efforts of vulnerable people employed by an SSE; (ii) promotion of sale of goods (works and services) produced by vulnerable people; (iii) production of goods as well as offering works and services designated to vulnerable people in order to assist their integration into various social and economic activities equally with other citizens; and (iv) conduct of other types of activities specifically listed in the Code. The Entrepreneurial Code also sets out a list of those groups of population who are recognised as vulnerable people for the purpose of recognition of social entrepreneurship.[7]

Depending on the type of activity they conduct, SSEs are divided into four categories. SSEs of the first category focus on the work integration of vulnerable

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6 Civil Code of the RK (General Part) dated 27 December 1994, No. 268-XII, as amended, Art. 10(1), https://adilet.zan.kz/rus/docs/K940001000_.

7 Entrepreneurial Code, Art. 79-3.

people by way of their employment. SSEs of the second category are those who help to sell the results of the economic activity of vulnerable people, i.e. their goods, works or services. SSEs of the third and fourth categories engage in activities improving the living conditions for vulnerable people by selling goods designated for vulnerable people or assisting their work and social integration through those types of business provided for in the Entrepreneurial Code.[8]

In order to be included in the Register, some measurable criteria and/or quantitative indicators must be met. Rather than imposing general requirements, different statutorily established quantitative indicators apply depending on specific types of activities of an SSE. For example, specific provisions concerning employment of vulnerable people for first-category SSEs require vulnerable people to constitute at least 50% of the total number of employees of the respective SSE and at least 25% of the SSE's total labour costs to be used to pay salaries to them. For the other three categories of SSEs, a minimal share of the total income of a business must be derived from their respective qualified activities (i.e. as social entrepreneurship), and a set amount of their income must be reinvested into their qualified social entrepreneurship activities.[9]

1.2. RECOGNISED SOCIAL ENTERPRISES

The Register, initially approved as of 31 December 2021 and amended in April 2022, includes 25 SSEs operating in nine regions (eight oblasts and the capital) of Kazakhstan.[10] Most of them are present in Kostanay oblast (five) and in Astana city (four).

The SSEs are active in different industries and areas of social life. Some of them engage in preschool education, tailoring and production of uniforms, services for disabled people and senior citizens (e.g. transportation of passengers), special medical services, correction, rehabilitation and elderly care. Other SSEs engage in the production of beverages or waste treatment and qualify as SSEs because they employ vulnerable people. Only a few entities among those recorded in the Register were known as social enterprises years before the adoption of the Law in 2021. For example, Wonderland operated a preschool organisation for children with autism, Ray of Hope ran a centre for social adaptation offering residential care for elderly and disabled people, and Kunde restaurants and food delivery service employed young people with autism.[11]

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8 Ibid.

9 Ibid.

10 Oblasts are the main administrative territorial units of the RK.

11 International Information Agency (KazInform): 'Kazakhstancy vybrali luchshikh socialnykh predprinimatelej strany' [Kazakhstanis have chosen the best social entrepreneurs of the country], 5 May 2021, https://www.inform.kz/ru/kazahstancy-vybrali-luchshih-social-nyh-predprinimateley-strany_a3784650.

Enterprises included in the Register take either for-profit or non-profit forms. These forms, which will be discussed in more detail below, include: individual entrepreneurs (seven), companies with limited liability (13) and public associations (five). All five of the public associations included in the Register are non-profit organisations (NPOs) of disabled persons; they own production units where their members work.[12] When entities are interested in tax benefits and various external support for their production rather than in extracting net profit, the non-profit legal form is particularly appealing for missions aligned with the declared purpose of such organisations (i.e. social and work integration of their members), allowing them to enjoy tax advantages available for NPOs.

The Register shows significantly lower numbers of SSEs than had been expected given understandings of social entrepreneurship in Kazakhstan before the new legal framework was introduced. This mismatch may be attributed to the pre-legislative absence of clarity around the appropriate criteria for social entrepreneurship, as well as conflation of the concepts of 'social entrepreneurship' and 'socially responsible business'.[13] Under the Entrepreneurial Code, social entrepreneurship does not include activities like improvement of local areas and urban environment, construction of children's playgrounds or sports grounds for everyone, other undertakings for the development of social and cultural infrastructure, charity or other similar activities in creation of more favourable living conditions, unless they are specifically ensuring labour or social integration of vulnerable people. Such socially oriented activity of any conventional business now falls within a business's social responsibility, which is a separate legal concept from the notion of social entrepreneurship also provided for in the Entrepreneurial Code.[14]

2. FORMS OF ORGANISATION FOR SSEs

Kazakhstan's law classifies legal entities into commercial and non-profit organisations, with specific legal forms of organisation available to entities in each group. Commercial organisations may perform any kind of activities, pursue generating profit as their main goal, and distribute their profit to their members as dividends. In contrast, NPOs should have a specific social or public interest goal(s) declared and pursued, while any trading activity is prohibited if

[12] Such organisations (albeit repeatedly reorganised to comply with changing law and market conditions) have acted since about 1960s to protect interests of their members and promote their employment and work integration, although concepts of private ownership, entrepreneurship and social enterprises were not recognised during the Soviet era.

[13] Both of these, though separate notions, have been recognised in the Entrepreneurial Code (Art. 20).

[14] Entrepreneurial Code, Arts 75–79.

it does not serve to achieve such goal(s). NPOs may not have profit generation as their main goal, and no matter how profitable their activity is, no profit can be distributed among an NPO's members in any way or any form. Moreover, no mixed types of legal entities are allowed; an entity should be either a commercial organisation or an NPO. Tax treatment of commercial and non-profit organisations is likewise dichotomous. As discussed in greater detail below, for example, any grants received by NPOs are excluded from their taxable income, while grants received by commercial entities are recognised as taxable income of the firm.

Restrictions on NPOs engaging in the sale of goods and services and the more burdensome taxation regime for business entities when receiving grants has complicated development of social entrepreneurship in Kazakhstan. Restrictions on NPO trading will impede their ability to engage primarily in entrepreneurial activity. Social entrepreneurs may even feel compelled to set up costly and opaque structures for their business. For example, according to information available in the media, a complicated structure whereby an NPO is set up to receive grants and a commercial entity or sole proprietorship is registered for trading activity has been widely used to attempt to reduce tax challenges. This complex structure has allowed social entrepreneurs to reduce the likelihood of problems with taxation of their activities.[15]

The expected business activities of social entrepreneurship are more compatible with the operation of Kazakhstani commercial organisations. However, the legal requirement in the Civil Code that commercial organisations pursue extraction of net income as the main goal of their activity and shareholders' rights to claim dividend distribution may cause conflicts between shareholders' interests and the SSE's social goals.[16]

The newly introduced legal framework for social entrepreneurship has not solved this problem, and a call for legal clarity in terms of legal forms for SSEs remains urgent.

2.1. LEGAL FORMS AVAILABLE FOR SSEs PERMIT OR REQUIRE THE PURSUIT OF A SOCIAL MISSION

According to the Civil Code, the universal character of legal capacity of commercial entities permits them to pursue any social mission.[17] Similarly, any

15 A. Bekirova, 'Kazahstanskie NPO vyhodyat na tropu social'nogo predprinimatel'stva' [Kazakhstani NPOs Enter the Trail of Social Entrepreneurship], 31 May 2016, http://cso-central.asia/kazaxstanskie-npo-vyxodyat-na-tropu-socialnogo-predprinimatelstva/.

16 Civil Code, Arts 34 and 36.

17 Civil Code, Art. 35, section 1.

individual who performs as an individual entrepreneur is capable of engaging in any activity not prohibited by law.[18] Therefore, as a general rule, any individual entrepreneur is also permitted to pursue a social mission.

In contrast, the legal capacity of NPOs is restricted to only the specific goals of an organisation's activities, such as social, cultural, scientific, educational, charitable, managerial or other goals aimed at ensuring the public good and the good of its members. Pursuit of a social mission is required to be an NPO's main goal (among certain other mission-driven purposes).[19]

2.2. DISCRETION TO SERVE THE INTERESTS OF STAKEHOLDERS OTHER THAN INVESTORS

Any legal entity is obliged to observe established or recognised rights of its participants, creditors and employees and avoid unlawful infringement of those rights. It is also a common duty for all to observe the public interest and not violate *ordre public*. Where certain rights and interests of stakeholders are guaranteed and protected by a contract, they can be enforced in accordance with the Civil Code based on one of its basic principles that 'an obligation must be duly implemented in accordance with its terms and requirements of legislation'.[20] Employees' rights are protected in accordance with the Labour Code. Companies (whether they are joint stock companies or limited liability companies) may also adopt their own codes of corporate governance.[21] If such a code is drafted in accordance with globally recognised good practice and the RK's national standards of corporate governance, it may regulate specific issues of stakeholders' engagement and stakeholder rights protection. Violation of any of these rights (whether they are established by law, a contract or otherwise) can be challenged in court, including rights and interests of stakeholders of any legal entity, be it a social business or not.

That said, no restrictions obligate any organisation to independently identify and map its stakeholders. Only if it undertakes to create rights or serve specific interests of its specific stakeholders or otherwise engage them in its governance (which is not prescribed or otherwise regulated by law) is the company expected to duly implement those obligations.

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18 Civil Code, Arts 14 and 19.

19 Civil Code, Art. 35, section 5; as well as Law of the RK of 16 January 2021, No. 142-II, 'On Non-Profit Organisations', as amended, Art. 4, https://adilet.zan.kz/rus/docs/Z010000142_ (Law on NPOs).

20 Civil Code, Art. 272.

21 The Code of Corporate Governance of the RK approved as the national standard of corporate governance by the Presidium of the National Chamber of Entrepreneurs 'Atameken' (decision dated 27 April 2021, No. 4), section B of the Introduction, https://online.zakon.kz/Document/?doc_id=36571188&pos=34;-57#pos=34;-57.

2.3. NON-EXISTENCE OF SPECIFIC ORGANISATIONAL LEGAL FORMS FOR SSEs

The current legal framework for social enterprise in Kazakhstan is focused on specific types of activity that qualify as SSEs, rather than adopting any particular organisational legal form for it. The law does not provide for any specialised legal forms for social entrepreneurship. Similarly, no special requirements concerning organisational structure are set forth in the law for those who engage or intend to engage in social entrepreneurship.

2.3.1. Elements of Traditional Legal Forms of Commercial Organisations

The Civil Code allows a commercial organisation to be set up as a general partnership, a limited partnership, a company with limited liability (LLC) or with additional liability, a joint stock company (JSC), a production cooperative or a state enterprise.[22] For commercial organisations, this list of available organisational legal forms is established as a *numerus clausus*. A state enterprise is not compatible with social entrepreneurship in that, since the times of the USSR, it belongs to the state property used for the economic activities of the state but not for private entrepreneurship or any activities of individuals.[23] All the rest of the listed forms are designated for private entrepreneurship and are bodies corporate, even if the state participates in the capital of a company. The Entrepreneurial Code suggests that any of these types of commercial organisation can be a social entrepreneur and any form of commercial organisation regulated by law, with the exception of a state enterprise, can be used for social entrepreneurship.[24]

Any commercial corporation is the owner of the property it possesses, and all such property shall serve as a basis of the corporation's obligations and liability. Participants in corporations, however, have limited liability. With the exception of cases provided for by law, no participant in a legal entity is liable for the obligations of the legal entity.[25] The term of activity of any commercial legal entity is not limited, and a firm can be established for an indefinite period. The term can also be limited by achieving the goal of the organisation or by the

22 Civil Code, Art. 34, section 2.

23 This form will cease to be recognised by the RK law soon according to the concept of the draft Law of the RK 'On amendments and additions to certain legislative acts of the Republic of Kazakhstan on the development of the quasi-public sector', January 2023, https://online.zakon.kz/Document/?doc_id=33808420.

24 Entrepreneurial Code, Art. 79-1.

25 Such exceptions include a subsidiary liability of general partners in a partnership for the latter's debts, a parent organisation for obligations and debts of its subsidiary in specific cases, as well as members of a production cooperative for obligations of the cooperative (Civil Code, Arts 70, 94 and 96).

expiration of the period for which it was created; however, this practice is very rare. When a finite term is established, it must be indicated in the entity's charter.

Governance obligations vary across the commercial forms. Participants in any company hold the right to participate and vote in general meetings, and the law does not provide for the similar right of other investors and stakeholders of a company. In limited and general partnerships, participants also bear full responsibility for the partnership's management and operation, though they can delegate certain responsibilities to hired managers. As for a production cooperative, only its members can be members of its supervisory board and management body. Moreover, the members of the cooperative are charged with the statutory obligation of labour participation, meaning they must work in the cooperative, although outside workers/employees are not prohibited.

Outside the partnership and cooperative contexts, the law does not provide for mandatory participation of a company's employees or participants in its management through their mandatory election to the board of directors, supervisory board, or executive or management body. Nor does it prohibit employee or participant involvement in the day-to-day management of a commercial corporation. In JSCs, shareholders and representatives of shareholders can be elected to the board of directors and become members of its management body. Similarly, no restrictions on employee or participant participation in the strategic or operational management apply to a company formed as an LLC.

Only the Law on JSCs imposes an explicit duty of loyalty and a duty of care on corporate officers and sets standards of conduct for directors and managers of the company,[26] although the Law on LLCs does prohibit conflicts of interest by company's managers.[27] Both Laws provide for the possibility of a derivative action against directors and managers of a company to compensate losses caused to the company as result of their actions, inaction or corporate decisions.[28]

Shares and participatory interest in a company, business partnership or production cooperative can be transferred in accordance with the law. The degree of transferability of the participation rights depends on the form of the legal entity.[29]

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26 Law of the RK dated 13 May 2003, No. 415, 'On Joint Stock Companies', as amended, Art. 62, https://adilet.zan.kz/rus/docs/Z030000415_/z030415.htm (Law on JSCs).

27 Law of the RK dated 22 April 1998, No. 220-1, 'On Companies with Limited and Additional Liability', as amended, Art. 55, https://adilet.zan.kz/rus/docs/Z980000220_#z115 (Law on LLCs).

28 Law on JSCs, Art. 63; Law on LLCs, Arts 52, 55 and 57.

29 Shares in a JSC are freely transferrable, while transfer of shares in an LLC is subject to the pre-emptive rights of its other participants. Participatory interest in partnerships may be transferred only with the consent of its all other general partners. Similarly, shares in a production cooperative can be transferred either to another member of the cooperative or, with the consent of other members of the cooperative, to a third party.

As independent entities, all commercial organisations are recognised as taxpayers in Kazakhstan, and must carry out relevant tax reporting and pay relevant taxes. These taxes include corporate income tax, property tax, land tax, value-added tax, other stipulated taxes and mandatory payments to the budget, which are regulated by the Tax Code.[30]

Shareholders of and participants in a company or partnership must pay income tax on dividends, as well as on capital gains when they dispose of shares or participatory interests. Under certain conditions, their contributions to the authorised capital of a legal entity are recognised as taxable income of the company.[31]

Legal requirements for the disclosure of information or the submission or publication of financial and non-financial reports by companies are very strict in relation to JSCs and other issuers of non-government securities. These requirements are established in the Law on JSCs, as well as in the laws on the securities market, accounting and financial reporting.

All JSCs and state enterprises (by virtue of their organisational form) and some categories of LLCs (by virtue of their type of activities) are also classified as organisations of public interest (OPIs). As such, they are required to maintain accounting records in accordance with International Accounting Standards (IAS) and carry out financial reporting in accordance with International Financial Reporting Standards (IFRS). However, the JSC form is used almost exclusively by large businesses, and companies that achieve this scale cannot be recognised as SSEs according to the definition of social entrepreneurship established in the Entrepreneurial Code. While the law does not preclude SSEs from existing as JSCs, the costs of creation and maintenance of any JSC are so high that it makes unreasonable for social entrepreneurship to operate in the form of a JSC. Generally, it is very unlikely that an SSE could be recognised as an OPI under the current law. The strict OPI accounting and financial reporting requirements do not apply to commercial organisations other than those mentioned above, and therefore SSEs will generally not be obliged to comply with them.

It bears repeating that the main goal of any commercial organisation under RK law is to generate income to meet investment expectations of its participants. The Civil Code serves as a legislative source of the shareholder primacy position in the case of commercial companies, which is supported by the Law on JSCs and the Law on LLCs, regulating the right of the company's participants or shareholders to decide on distribution and reinvestment of the company's net

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[30] Code of the RK on Taxes and Other Mandatory Payments to the Budget dated 25 December 2017, No. 120-VI, as amended, https://adilet.zan.kz/rus/docs/K1700000120 (Tax Code).

[31] For example, as provided for in Arts 228 and 333 of the Tax Code.

income. In particular, the Laws establish that the company's general meeting has the power (as its exclusive competence) to annually decide on what the company shall do with its net income, whether it should declare and pay dividends or reinvest it into the company. The company must report and publicly disclose such decisions of its general meeting.

2.3.2. *Elements of Traditional Legal Forms of Non-Profit Organisations*

General provisions of the law concerning all legal entities also apply to NPOs. Particularly, like all legal entities, any NPO (with the exception of those created in the form of an institution) is the owner of its property and is managed by its bodies formed in accordance with the legislation and acting in accordance with their established competence.

The Civil Code provides for the possibility of establishing an NPO in the forms of an institution, public association, non-commercial JSC, consumer cooperative, foundation, religious association or in other forms stipulated by legislative acts.[32] In accordance with the Law on NPOs, more than 20 different organisational legal forms for NPOs are regulated and the list of such forms is not closed-ended.[33] For each particular organisational form of NPOs, legislation provides for a special organisational structure, separate conditions for and procedures of formation of its managing bodies, and distribution of their competence.

As noted earlier, two peculiarities of NPOs unite organisations across all these forms and fundamentally distinguish any NPO from any and all commercial organisations. The law limits the permissible goals of NPOs' activities. The NPO regulatory regime also significantly limits opportunities for NPOs to conduct entrepreneurial activities aimed at making a profit. NPOs may engage in entrepreneurial activity only as long as it is consistent with those goals of its activity declared in its constituent documents (a charter).[34] All income received by an NPO as a result of its commercial activity is to be directed to finance activities of the NPO. It cannot be used for any kind of distribution among its founders or other members. However, public and religious associations, as well as foundations, are allowed to use their funds for charitable assistance.[35]

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[32] Civil Code, Art. 34, section 3.

[33] Law on NPOs, Arts 6 and 17.

[34] Law on NPOs, Art. 33(1). This legislative provision reads as NPOs being allowed to undertake only related entrepreneurial activity. However, this criterion is reasonably criticised by scholars and legal practitioners as being insufficiently clear (or unnecessary and even groundless) and, therefore, complicates business practice and causes disputes between tax authorities and NPOs.

[35] Law on NPOs, Art. 33, section 5.

Moreover, legislation establishes additional restrictions on the entrepreneurial activity of NPOs of certain organisational forms.

The law does not specifically address fiduciary duties of NPOs' officers and managers. However, the Law on NPOs applies the concept of conflict of interest in related-party transactions between the organisation and members of its management, other related parties who can influence the disposal of the NPO's assets, and their relatives.[36] These provisions regulate and impose conditions and procedures for such related-party transactions.

All NPOs are taxpayers, though they benefit from tax advantages which make their taxation considerably different from that of commercial organisations. Particularly, since NPOs are restricted in distributing their income and their assets to/among their members, no relevant taxation regime exists to apply to NPOs' members. In addition, any income an NPO receives for free (such as in cases of charity, sponsorship or provision of grants) shall be excluded from the NPO's taxable income. Earnings from entry fees and membership fees paid to NPOs by their founders and members shall also be excluded from NPOs' income. Only income received by NPOs in result of their allowed entrepreneurial activity shall be subject to taxation in accordance with the Tax Code,[37] and in that case NPOs are entitled to decrease their taxable income by 4%. When an SSE is organised as an NPO, all these benefits apply to the SSE. In addition, some benefits have been set out in the Tax Code since 2021 specifically for SSEs (as described in section 4.1 below).

Among organisational forms available to NPOs in Kazakhstan, the consumer cooperative merits additional attention. A consumer cooperative is defined as a voluntary association of individuals on the basis of membership to meet the material and other needs of its members, carried out by combining property (share) contributions by its members. The form is mostly used by organisations of homeowners, users of water and the like to manage their common property and protect their common interest in the property. However, the existing legal framework for cooperatives can deter founders from using the form for firms with specific social purposes. The law establishes an obligation for cooperative members to cover any losses through additional contributions within three months after the approval of the cooperative's annual balance sheet. If such obligation is not fulfilled, the cooperative may be liquidated in court at the request of creditors.[38] This regulation does not contribute to confidence in the sustainability of the cooperatives' activities, which detracts from its suitability for social entrepreneurship.

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36 Law on NPOs, Arts 36 and 37.
37 Law on NPOs, Art. 33, section 4.
38 Law on NPOs, Art. 14, section 5.

3. LIFECYCLE

3.1. FORMATION

In order to be recognised as an SSE, an organisation or an individual must already exist as a legal entity or be registered as individual entrepreneur respectively. Any legal entity acquires its legal personality by registration in the legal entities' state register.[39] An individual who wishes to start entrepreneurial activity without formation of a legal entity must register as an individual entrepreneur with the local tax authorities.[40] These and other general requirements of the law concerning setting up a legal entity (including, among others, specific procedures for foundation and registration of legal entities of each particular type and legal form) and starting individual entrepreneurial activity apply regardless of whether an entity or individual is or wishes to become an SSE.

3.2. RECOGNITION AS AN SSE

If an existing legal entity or individual business meets the established criteria, as a small or medium-sized enterprise, operating a social mission-driven business or employing a sufficient number of vulnerable people, it may apply to be formally recognised as an SSE. Formal recognition is carried out by inclusion of a record of the organisation or individual entrepreneur in the Register, an electronic database created and maintained by the Ministry of National Economy of the RK in accordance with the Rules of Maintenance of the Register of Subjects of Social Entrepreneurship ('the Rules').[41] Each listing includes the SSE's name, the date of its state registration as a legal entity or individual entrepreneur, its individual or business identification number, its registered address (location), its field of business/activity, which category of SSE it belongs to, and the date of entry in the Register.

In order to be included in the Register, an organisation or individual business must submit an application and supporting documents (on paper or in an electronic form) to the respective local state administration following its invitation to apply for inclusion in the Register. Invitations must be published by

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39 Civil Code, Art. 42.

40 Tax Code, Arts 79–81.

41 Rules of Maintenance of the Register of Subjects of Social Entrepreneurship approved by Order of the acting Minister of the National Economy of the RK dated 17 July 2023, No. 140 (replaced similar Rules adopted in 2021 by the RK Government), http://zan.gov.kz/client/#!/doc/184095/rus.

the administration in the respective local mass media and on the official websites of the local administrations issuing the invitations.

The supporting documents required depend on the category of SSE to which the applicant is seeking to be assigned; they should confirm that an applicant meets the quantitative indicators established by the Entrepreneurial Code with respect to one or more of the four categories of SSE.[42] For example, an application for recognition as an SSE of the first category should be supported by a copy of the applicant's current staffing table, information on how many employees the applicant has and their wages, copies of the applicant's employment contracts with each of the relevant vulnerable people, copies of documents confirming that those employees are officially recognised as vulnerable people and copies of their consents to processing their personal data. The Rules also approve specific forms for each type of supporting document.

A special commission formed by the relevant local state administration considers each application and opines on whether an applicant meets the established qualification criteria and quantitative indicators.[43] It reviews the completeness of the submitted documents/information and verifies the accuracy of the information received by comparing it with relevant data received from tax authorities and other state agencies. Based on the conclusion of the special commission, the local administration makes a recommendation to the Ministry on whether to include an applicant in the Register, which is published on the Ministry's official website.[44]

The Register can be updated quarterly, allowing new SSEs to be registered in due course. It also must be updated annually by continuing the record of earlier recognised SSEs and/or including new SSEs following confirmed compliance with the established criteria and quantitative indicators. The procedure for such updates is similar to the one applicable for initial inclusion in the Register. Although the Register is formed for the purpose of allowing 'use of data on the categories of social entrepreneurship entities',[45] its greater significance lies in the fact that only those who are included in the Register may enjoy established measures of state support of social entrepreneurship (described in more detail in sections 4.1 and 4.2 below).

[42] Lists of the documents with respect to each category are indicated in sections 5–9 of the Rules.

[43] Regulation on the Special Commission and the Rules on Formation of the Special Commission approved by Order of the Minister of the National Economy of the RK dated 10 July 2023, No. 134 (replaced similar Rules and Regulations adopted in 2021 by the RK Government), https://online.zakon.kz/Document/?doc_id=35858373.

[44] Currently the Register is located at the Ministry's website as follows: https://www.gov.kz/memleket/entities/economy/documents/details/299951?lang=ru.

[45] Entrepreneurial Code, Art. 79-4, section 1.

3.3. MAINTENANCE

Once an entity or individual business is included in the Register, it remains recognised as an SSE of the respective category for the remainder of the entire calendar year. SSEs are not required to file any reporting during the period of their registration. The law does not provide for audits of SSEs, nor does it establish requirements for their activities or procedures to track them. The functions performed by local administrations and the Ministry to form and maintain the Register do not extend to more general regulation of social entrepreneurship or oversight over SSEs. Therefore, it cannot be said that a dedicated regulator for social enterprises exists in Kazakhstan.

3.4. EXIT

The only route to exit SSE status is for an entity or individual business to cease being included in the Register. This may occur at the end of a year when an SSE fails to file an application with relevant supporting documents for extension of its registration. However, there is no regulation addressing the situation where an entity or individual business ceases operating as an SSE during a year of its registration, or on the consequences of cancellation of or failure to extend records in the Register. If a record is not extended, the entity or individual business may continue its operations as an ordinary business or NPO, and no specific conversion or reorganisation is required.

Any decision to continue, modify or terminate operations as an SSE, disposal or use of its assets, etc. can be made based on the SSE's charter and/or internal documents governing its structure and decision-making. No approval of any state agency for those kinds of decisions is required. Specific types of state support provided to SSEs could contractually or even legislatively restrict certain corporate or managerial decisions at the level of an enterprise; however, the legislative and regulatory framework for social entrepreneurship has not yet developed such restrictions.

3.5. PRIVATE DESIGNATIONS OR CERTIFICATIONS AND IMPACT MEASUREMENT

Except for those formalities to be implemented for inclusion in the Register, no governmental or private designations and certifications for SSEs exist in the RK at this moment. Nor have legal rules been established for measuring the impact of either particular SSEs or of social entrepreneurship generally. Again, however, this is a promising area for future development.

4. SUBSIDIES, INCENTIVES AND BENEFITS

4.1. THE MEASURES IN GENERAL

All the support measures addressed to any private entrepreneurs and, particularly, to small and medium-sized businesses (SMEs) are also available to SSEs. These include financial and property, infrastructural, institutional and informational supports, as well as others. A guaranteed purchase of certain amounts of goods produced by an SSE, provision of state budget loans and loan guarantees, organisation of loan provision via banks and national development institutions, etc., are some examples of such supports.[46]

In addition, employers are entitled to reimbursement by the state of their costs for equipping special workplaces for persons with disabilities, and (starting from 2023) employers may be subsidised from local budgets for payment of wages to their disabled employees and employed people of pre-retirement age (i.e. two years before retirement). These measures are regulated by the Ministry of Labour and Social Protection of Population and provided for based on employment law, not as part of specific support for social entrepreneurship, though they could also apply to SSEs employing vulnerable people from these two groups.

4.2. SPECIFIC MEASURES OF STATE SUPPORT FOR SSEs

The Entrepreneurial Code provides for state support of social entrepreneurship specifically (in addition to support measures available to all private entrepreneurs and SMEs) as follows:

- ensuring existence of an infrastructure of the support for SSEs;
- tax incentives and preferences;
- provision of financial support (which currently includes subsidising bank loans interest and subsidies for lease payments);
- leasing of state property on certain preferential terms and conditions in accordance with the law on the state property;
- provision of informational support;

[46] The Entrepreneurial Code (Arts 91–97) indicates those financial and property measures established to support private entrepreneurship. It also explains how the support measures shall apply specifically with respect to SMEs, as well as clarifying what property support of SME businesses means. Procedures, terms and conditions for rendering most types of such support are regulated by various rules approved by the Government of the RK and focused on each separate such supportive measure.

- provision of consultative and methodological support, experts' support, acceleration programme development (including such on the matters of fund raising and participation in procurement procedures);
- assistance in development of interregional cooperation and finding business partners;
- organisation of professional education and supplemental trainings; and
- provision of state grants for organisation and implementation of socially important projects in different branches of the economy.

These measures are regulated in more details by the Implementation Measures Rules approved by the RK Government based on respective provisions of the Entrepreneurial Code and have been in place since January 2022.[47]

The Tax Code also provides for incentives and benefits established to support SSEs specifically, which have been available starting from January 2022. Two of the most important involve income and property tax concessions. SSEs are entitled to decrease their taxable income by deducting a capped amount of their expenses incurred to pay for acquiring professions by and professional training, retraining or advanced training of their employees who belong to a category of vulnerable people.[48] SSEs also pay property tax at a lower rate (0.5% of a taxable amount) than the generally applicable tax rate (which is 1.5% of a taxable amount).[49]

In addition to these special tax benefits for SSEs, any taxpayer has the right to reduce its taxable income by an amount equal to double the amount of expenses incurred for the remuneration of persons with disabilities and by 50% of the amount of the calculated social tax from wages and other payments to persons with disabilities.[50] Since certain categories of SSEs are recognised as such because they employ a certain number of people with disabilities and a certain portion of their expenses are used to pay salaries to such employees, this can also be viewed as kind of tax incentive for SSEs (though not established specifically for them).

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47 Rules for Implementation of Support of Initiatives for Development of Social Entrepreneurship by State Agencies, National Holdings, National Development Institutions and Other Organisations approved by the Resolution of the Government of the RK dated 9 November 2021, No. 795, as amended, https://adilet.zan.kz/rus/docs/P2100000795#z9.

48 The maximum amount of such deduction cannot exceed 120 amounts of the monthly calculation index (MCI). The MCI is an indicator used in Kazakhstan for calculating pensions, benefits and other social payments, as well as for applying penalties, calculating taxes and other payments in accordance with the legislation of the RK; its amount is calculated based on an expected rate of inflation in the forthcoming year and established annually by the Law on the Republican Budget. From January 2023, the MCI amount equals to 3,450 Tenge (approximately $8). Thus, in 2023 the maximum such allowed deduction from the amount of an SSE's taxable income in this case will be around $960.

49 Tax Code, Arts 288 and 521.

50 Tax Code, Art. 288.

Similarly, any legal entity (be it a commercial or non-commercial organisation) is entitled to decrease its taxable income (3–4% of it, depending on whether the entity is recognised as a large taxpayer) when (i) it transfers any property for free to a NPO, or (ii) it provides charity, at request, to other entities.[51] This benefit is available to donors to SSEs formed as NPOs or engaged in charitable activities even if established as commercial enterprises. Yet there are no specific subsidies or tax preferences specifically for SSE investors/contributors and the law has not distinguished a separate category of SSE investors or contributors with the aim of offering them any specific incentives.

5. PRIVATE CAPITAL AND ROLE OF STAKEHOLDERS

5.1. SOURCES OF FUNDING

Sources of funding for social entrepreneurial projects are similar to those available to any other types of SME businesses and include capital investments by founders and other participants, proceeds of the entity's own commercial activity, grants and private loans. Use of proceeds of trading operations, as well as contributions to the capital or property of SSEs, regardless of whether such contributions are provided directly by the founders and participants or made out of income received by SSEs, remain the most common sources of funding for social businesses using both for-profit and non-profit forms. No restrictions exist with respect to ownership participation and capital investments in SSEs by individuals and legal entities, other than the general limitation of the participation of the state, as well as the prohibition of the participation of civil servants, in privately held commercial organisations.

Similarly, no restrictions limit the funding of SSEs' activities by third-party providers of funds in the form of private loans, donations or grants. Any SSE can receive grants from external sources, though, as explained earlier, the taxation regime applicable to such receipts differs depending on whether the SSE operates as a commercial or non-commercial organisation. And, therefore, for those SSEs adopting a non-profit form, grants can likely be a principal source of financing.

No special securities regulation applies to SSEs and no securities exchanges operate to list securities issued by SSEs. At this time, there are no known SSEs which issue investment securities listed on a public stock exchange. Generally, access to the securities market for SMEs and SSEs is very limited. Capital investments can be attracted on securities markets only by placement of shares issued by JSCs, and this legal form is not generally affordable for SMEs and SSEs to operate. In turn, only those entities which have the legal form of an LLC

[51] Ibid.

and comply with the very strict and costly requirements of the securities market regulations can try to issue private debt securities. In most cases, this route is also not affordable for SMEs and SSEs. Thus, no specific investment landscape for businesses with a social mission can be said to exist in the RK.

5.2. ROLE OF INVESTORS, EMPLOYEES AND OTHER STAKEHOLDERS

There are no restrictions on any SSE and/or its owners creating specific mechanisms for stakeholders' engagement in governance of the enterprise and/or instruments which such stakeholders can use to ensure its commitment to a social mission. Yet RK law does not specify a role for investors, customers, employees or other stakeholders in preserving the mission of SSEs. SSEs can establish internal policies and governance rules to interact with their employees or discuss current affairs and business development prospects with them and other stakeholders. Indeed, in some existing SSEs, employees play a prominent role, but such practices are purely voluntary. Their utilisation depends entirely upon the will of SSE owners, participants and employees, and not on the requirements of the law.

6. PROPOSED DEVELOPMENT OF THE LAW

The legal framework for development of social entrepreneurship in Kazakhstan is currently very basic and at an early stage of formation. A thoughtful and consistent state policy on promoting the development of social entrepreneurship, approved and implemented to ensure that social business truly represents (together with the activities of state-controlled and private enterprises as well as non-governmental organisations) an important sector of the national economy contributing to its strength and sustainability. Appropriate development of social entrepreneurship should be based on a systemic and sound legal framework to ensure effective work and social integration of vulnerable people. Such development should also help to decrease the level of dependent behaviour of citizens in relation to the state and promote their more active participation in organising their own lives.

The legislature should begin by revising the Civil Code's concept of legal entities. It is important to find a place for social enterprises as a separate type of legal entity, along with commercial organisations and NPOs. This new category would involve firms that, on a regular and systematic basis, carry out profitable economic activities effectively contributing to the work and/or social integration of vulnerable or disadvantaged people, as well as to improvement of conditions of their lives. In addition, it would be helpful for the Civil Code to enumerate

the permissible organisational legal forms for SSEs in a short and closed-ended list. Such forms should both encourage development of SSEs and allow for preservation of their social mission over the long term.

The system of state support for social entrepreneurship must also further develop. Certainly, given the short period of time since legislative recognition of the concept of social entrepreneurship and declaration of a set of state supports for social enterprises, it is very difficult to assess the relevance and effectiveness of the support measures and the actual impact of social business itself on socio-economic development of Kazakhstan.[52] But no doubt this will require the creation of an effective methodology and systems to assess the functioning of SSEs, their compliance with their declared goals and their methods of carrying out their activities. This effort will require the creation of a constellation of governmental and private monitoring of SSEs' activities and impact, addressing both individual SSEs and the social entrepreneurship sector as a whole.

Development of the concept of 'social finance' as known in the European Union will also be helpful.[53] Creating a framework to stimulate those who are ready to create new social enterprises or increase their participation in existing SSEs seems expedient. And generally, that should help to shift financing of social businesses from mainly grant funding to sustainably earned income. In addition, a variety of models for financing activities of social enterprises and different categories of private providers of funds (using different instruments) to support viability and ensure sustainability of SSEs should be encouraged.

A call for the existence of proper conditions for social entrepreneurship in the country can clearly be seen, and expectations (both of people and businesses) of the state's further efforts to develop a meaningful legal and organisational frameworks seem to remain very high. In further developing and improving the law on social entrepreneurship in Kazakhstan, foreign countries' experience in creating a favourable environment for social entrepreneurship is of great value.

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52 That seems to be mostly due to the lack of relevant and reliable statistics, analytics or official or commonly acknowledged impact assessment methodologies and tools, but also because of a low level of awareness on the part of state authorities, ordinary people and businesses about the very meaning and significance of social entrepreneurship, and its advantages both for an individual person and society.

53 G. Glänzel, B. Schmitz and G. Mildenberger, 'Report on Social Finance Investment Instruments, Markets and Cultures in the EU. A deliverable of the project: "The theoretical, empirical and policy foundations for building social innovation in Europe" (TEPSIE)', European Commission – 7th Framework Programme, European Commission, DG Research, Brussels 2021, pp. 6–12.

SOCIAL ENTERPRISES IN NEW ZEALAND

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1. WHAT IS A SOCIAL ENTERPRISE?

When should a business offset carbon emissions? When should a business pay a living wage to its employees? When should a business turn away clients or customers?

The tensions inherent in these questions have shifted over the last few decades. The justifications for business being conceived of solely as a mechanism for maximising financial returns for current shareholders, disregarding social or environmental goals, have waned.[1] In response, some businesses have sought to position themselves alongside various social causes. For some, it may only be

[1] See for example C. Mayer, 'The Future of the Corporation and the Economics of Purpose' (2021) 58 *Journal of Management Studies* 887; Business Roundtable, 'Statement on the Purpose of a Corporation' (19.08.2019), https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporationJuly2021.pdf.

a marketing ploy, but others see rising consciousness of social and environmental causes presenting broader opportunities.

The concept of a social enterprise has risen out of the awareness of social and environmental causes. Social enterprises aim to pursue financial maximisation, but alongside broader social or environmental objectives. In some jurisdictions, they have taken a new form: in the United States B Corps, or the United Kingdom's community interest companies. In New Zealand, despite advocacy, no comparable form is available. Even so, New Zealand has experienced a blossoming of businesses calling themselves social enterprises.

In 2018, the thinktank Business and Economic Research Limited (BERL) estimated that there were 2,589 social enterprises in New Zealand.[2] Although this number has increased quickly in the last few decades, it has not grown at the same rate as other countries. 2,589 social enterprises equates to about 0.0005 per head of population in New Zealand.[3] Other jurisdictions appear to have far more; for example, one report has neighbouring Australia's count at about 0.0008 per head of population,[4] and the UK's at a whopping 0.007 per head of population.[5] Some of this disparity can be put down to definitional differences. For example, New Zealand's report only counted businesses with 75% of revenue or higher from trade – but the UK's report required only 50% or higher.[6] Nevertheless, awareness of social enterprises in New Zealand remains low.

The predominant vehicle for business in New Zealand is the one-size-fits-all incorporated company form. Social enterprises in New Zealand battle the traditional split of companies being perceived as the vehicle for pursuing financial

2 K. Hurren, H. Dixon and G. Nana, 'M4king Sen5e of 7he Numbers: The Number and Characteristics of Social Enterprises' (2018) Business and Economic Research Limited, www.dia.govt.nz/diawebsite.nsf/Files/Social-Enterprise-report/$file/The-number-and-characteristics-of-Social-Enterprises-BERL-Report-November-2018.pdf.

3 The calculation uses an approximate New Zealand population of 5 million as at 2018, sourced from Statistics New Zealand, 'Population', https://www.stats.govt.nz/topics/population.

4 J. Barraket, C. Mason and B. Bain, 'Final Report' (2016) Finding Australia's Social Enterprise Sector (Joint Initiative between Social Traders and the Centre for Social Impact Swinburne), www.csi.edu.au/media/uploads/FASES_2016_full_report_final.pdf, p. 3. The calculation uses an approximate Australian population of 24 million as at 2016, sourced from the Australian Bureau of Statistics, '3101.0 – Australian Demographic Statistics, Dec 2016', www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/3101.0Main+Features1Dec%202016?OpenDocument=.

5 'Social Enterprise: Market Trends 2017' (2017) Department for Digital, Culture Media & Sport and Department for Business, Energy & Industrial Strategy, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/644266/MarketTrends2017report_final_sept2017.pdf, p. 8. The calculation uses an approximate UK population of 66 million as at 2017, sourced from the Office for National Statistics, 'United Kingdom Population Mid-Year Estimate', www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/timeseries/ukpop/pop.

6 'Social Enterprise: Market Trends 2017' (2017) Department for Digital, Culture Media & Sport and Department for Business, Energy & Industrial Strategy, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/644266/MarketTrends2017report_final_sept2017.pdf, p. 7.

objectives, and charities being understood as the vehicle for pursuing social or environmental objectives. The perception of businesses as solely financial remains strong. This perception has created problems for social enterprises which want to access capital or philanthropy, and also with customers, who do not always understand the difference between a company that is a social enterprise and a company that has a sole focus on shareholder wealth maximisation.

Consequently, New Zealand has seen a shift towards the social enterprises which can marry financial and social or environmental objectives together, with little trade-off and in a way which 'locks' in the broader mission. The assurance provided by a distinct legal form in other jurisdictions, such as a benefit corporation or community interest company, is instead provided by the form's essential components. Often the nature of the business structure makes it impossible to separate the financial and social or environmental objectives. Eat My Lunch Ltd, a limited liability company incorporated under the Companies Act 1993, was perhaps New Zealand's best-known social enterprise.[7] It operated a buy-one-give-one model with its point of difference in the marketplace being that it provided a free lunch to those in need for every lunch purchased. Without providing a free lunch to those in need, Eat My Lunch Ltd loses the core reason consumers bought its product. So, the financial and social objectives intertwined, and the broader mission was protected.

Those social enterprises that struggle to marry their financial and social or environmental objectives struggle to survive. The lack of assurance that their financial returns are prioritised undermines investor confidence, and the lack of assurance that philanthropic funds are not being used for personal enrichment undermines the confidence of philanthropists. So, the story of the social enterprise in New Zealand is a story about perceptions. A social enterprise's success or failure is intimately connected to its ability to preserve and communicate its mission.

2. FORMS OF ORGANISATION FOR SOCIAL ENTERPRISES

One way for founders of social enterprises to preserve and communicate their mission is via the form they choose to operate through. One entity alone often will not provide sufficient assurance to investors or philanthropists, so a complex web of structures might be used. The final legal structure a social enterprise adopts depends on the particular aims of the founders. If the social enterprise will be funded by the founders personally, often a limited liability company alone

[7] Eat My Lunch Ltd closed down on 16 December 2022 as a result of market impacts due to COVID-19. Despite its closure, it likely remains New Zealand's largest and most successful social enterprise.

is adequate. On the other hand, if the social enterprise will rely on charitable donations, a registered charity (which is sometimes a charitable trust in New Zealand) may be required.

The final mix of entities also depends on the extent of 'mission lock' required in the business. For example, Eat My Lunch, mentioned above in section 1, was unlikely to change its business model to remove the social mission, because to do so would undermine the business. In contrast, other social enterprises operate with less integration. Simplicity, a KiwiSaver and investment fund provider which also calls itself a social enterprise, donates 15% of the fees it takes to social or environmental causes.[8] Although the charitable element is a point of difference to other investment fund providers, Simplicity also charges extremely low management fees. Because the social goal is not essential to its business model, the protection of the charitable purpose needs to be stronger to protect it from future dilution. Simplicity (the company) is wholly owned by the Simplicity Charitable Trust – since the intrinsic protections are weaker, the legal protections are stronger.[9]

The ultimate structure arrived at depends on the extent of 'mission lock' required going forwards. Most social enterprises in New Zealand use one or more of four standard forms: a standard limited liability company incorporated through the Companies Act 1993, a cooperative, a charitable trust, or an incorporated society. The next sections explain the features, advantages and disadvantages of each form of social enterprise.

2.1. COMPANY

The most common form of legal structure for social enterprises in New Zealand is a standard company. Companies in New Zealand are all incorporated under the Companies Act 1993, although there are additional requirements for some found in other legislation. Under the Companies Act 1993, companies can be incorporated online, and are only required to have a name, one director and one shareholder, and NZ$1 is sufficient share capital.[10] Once established, the company is a separate legal entity to its shareholders, and shareholders can have limited or unlimited liability.[11]

Companies are particularly simple to incorporate in New Zealand. In fact New Zealand has been ranked first in the World Bank's Ease of Doing Business

8 KiwiSaver is a government sponsored superannuation and savings scheme.
9 Charities Services, 'Charity Summary: Simplicity Charitable Trust', https://register.charities.govt.nz/CharitiesRegister/ViewCharity?accountId=01ab9cbf-4228-e611-a7b2-00155d0cccdc&searchId=64c92b12-c1b2-4950-9b1d-cb0f38fe767b – see annual returns.
10 Companies Act 1993, s. 10.
11 Ibid., s. 15.

Report for four years in a row.[12] In the ease of starting a business category, based on compliance costs and time to start a company, New Zealand has been ranked first in the world for 12 years in a row.[13] It is no surprise that many social enterprises choose to adopt this legal structure. But the ease of setting up a company belies its usefulness. The company was not created for a social enterprise and there are several key areas of tension.

First, investors' perceptions of companies can present problems for social enterprises in two ways. On one hand, the investor may expect a company to maximise financial returns, and only view social and environmental goals to the extent they contribute to the financial bottom line. The prioritisation of financial returns is more problematic for some social enterprises than others. For example, a social enterprise where the social or environmental goal is 'baked into' the business model, such as Eat My Lunch (described above in section 1), may face less of a trade-off between their financial and social or environmental goals. But it is important to recognise that even social enterprises with a 'baked in' social or environmental goal can experience this tension – hypothetically, it would conflict with Eat My Lunch's social mission to lower the quality or quantity of the food they provide to at-need communities, but an investor may push for it to maximise the bottom line by doing so. On the other hand, some investors will invest in social enterprises specifically for their social impact. These investors can present the opposite problem, where the goal of financial maximisation is watered down in favour of social or environmental goals.

Second, and continuing with the theme of perceptions, customers and suppliers' perceptions of companies can present difficulties for social enterprises. Customers or suppliers who are attracted to doing business with a social enterprise because of its social or environmental goal can sometimes feel deceived when they find out the social enterprise is a profit-making company. The tensions with customers or suppliers led Eat My Lunch to conduct detailed reporting of their social contribution.[14]

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[12] New Zealand Companies Office, 'NZ Ranks First for Ease of Doing Business for the Fourth Year', www.companiesoffice.govt.nz/insights-and-articles/nz-ranks-first-for-ease-of-doing-business-for-the-fourth-year/. See also The World Bank: Doing Business – Measuring Business Regulations, 'Ease of Doing Business in New Zealand', www.doingbusiness.org/en/data/exploreeconomies/new-zealand. Granted that the report has recently come under some scrutiny for data manipulation, and has now been cancelled, but the relevant issues do not concern New Zealand, and this demonstrates the point that it is simple to create a company in New Zealand.

[13] Ibid.

[14] H. Oliver, 'A Fierce Argument For and Against Eat My Lunch' (26.07.2018) The Spinoff, https://thespinoff.co.nz/business/26-07-2018/a-fierce-argument-for-and-against-eat-my-lunch; R. Stock, 'Do Good Businesses Must Prove Their Heart' (21.07.2018) Stuff, www.stuff.co.nz/business/money/105593807/dogood-businesses-must-prove-their-heart; M. Jennings, 'Eat My Lunch Bites Back After Criticism' (14.09.2018) Newsroom, www.stuff.co.nz/business/industries/107078050/eat-my-lunch-returns-serve-after-criticism.

Third, perceptions from inside the business can present tensions for social enterprises. Directors of social enterprises may believe that they are legally required to maximise financial returns – a consequence of the corporate form. Whether this is true in reality is another question: the Companies Act 1993, which sets out (in conjunction with case law) directors' duties, only requires directors to act in good faith and in what they believe to be the best interests of the company.[15] In any case, the traditional view, still held by some directors, is that to forego financial returns would breach their duty to shareholders. Directors with this traditional view will exercise their influence over a social enterprise to nudge it towards maximising financial returns.

In response to fears of being influenced to forego their social or environmental mission, social enterprises have attempted to adapt the traditional company form to suit their goals more closely. The process of securing the social or environmental objective is called 'mission lock'. While various tactics have been tried to 'lock' the mission into social enterprises, the 1993 Act company was not designed with 'mission lock' in mind. The flexibility which makes the modern company so adaptable can also undermine attempts to 'lock' the social or environmental mission into the social enterprise. For example, often the constitution of a company is changed to require directors to have regard to the social or environmental mission of the social enterprise. But, in many cases, constitutions can be changed or watered down by other shareholders,[16] and requiring directors to have regard to the broader mission does not necessarily mean that directors will prioritise the mission in the same way that the founders would have. In response, founders may retain a significant shareholding in the company, or they may issue shares to investing shareholders which, for example, may not have voting rights on constitutional changes. But non-standard shares or minority shareholdings may turn investors away.

Other social enterprises look to alternative legal forms for their 'mission lock', seeking to mix-and-match entities in complex legal structures. Simplicity, the investment platform, is a 1993 Act company which is wholly owned by a charitable trust.[17] However, again, a complex legal structure that minimises rights for investing shareholders may deter investment.

So, social enterprises with ambitions to grow, which require capital injections, are faced with the dilemma of whether to lean 'investor friendly' or 'mission

15 Companies Act 1993, s. 131. Directors' duties are examined in more detail in section 3.1 below.

16 Note it is possible to entrench a purpose in a company's constitution under the 1993 Act, but not all social enterprises will do so for a variety of reasons. Just a few may include to encourage investment, to maintain the flexibility for the original founders to change the purpose, and to maintain the ability to broaden or narrow the original purpose going forwards.

17 Charities Services, 'Charity Summary: Simplicity Charitable Trust', https://register.charities.govt.nz/CharitiesRegister/ViewCharity?accountId=01ab9cbf-4228-e611-a7b2-00155d0cccdc&searchId=64c92b12-c1b2-4950-9b1d-cb0f38fe767b – see annual returns.

friendly'. The most successful social enterprises in New Zealand are those which manage to marry the two.

2.2. COOPERATIVES

Some social enterprises opt for a cooperative model rather than a standard company. In contrast to the company, which is quick and simple to set up online, a cooperative structure is more difficult to establish. Cooperatives are required to register as companies and, either simultaneously or after registering as a company, register as a cooperative company.[18]

An application to become a cooperative company may be approved only under certain conditions, with the general idea being that the company provides a benefit to its shareholders, other than in the form of dividends or changes in share price.[19] Often cooperatives engage in commercial transactions with their shareholders and provide them certain benefits such as insurance, guaranteed purchases and other services. One further requirement is that 'transacting shareholders', which are the shareholders who receive the benefits, hold more than 60% of the voting rights.[20]

In New Zealand, cooperatives were historically limited in the sectors they could operate in. Most related to agricultural businesses, including egg marketing companies, fertiliser manufacturing companies, fish marketing companies, milk marketing companies and pig marketing companies, as well as other specialised industries such as education services and energy.[21] But in recent times the advantages of being a cooperative, including the ability to provide rebates to shareholders,[22] and a legal change to make the structure more widely available, have led to some 'community-oriented' social enterprises adopting the form.

One social enterprise which has benefited from the cooperative model is Loomio. Loomio is a Software as a Service (SaaS) business which exists to assist groups with inclusive decision-making. It offers systems which empower people who may not feel comfortable speaking up, for example by incorporating silent polls into decision-making, and help groups to collaborate between time zones. Loomio is 'founded on principles of inclusion and diversity',[23] so it made sense to opt for a worker cooperative model – a model where workers are empowered.

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[18] Co-operative Companies Act 1996, ss. 6 and 7.

[19] Ibid., s. 3.

[20] Ibid., s. 2.

[21] Ibid.; Co-operative Education Services Companies Order 1990 (SR 1990/158); the Co-operative Energy Companies Order 1993 (SR 1993/148).

[22] Co-operative Companies Act 1996, s. 30.

[23] Loomio, 'About', www.loomio.com/about.

But, while the worker cooperative model aligned with Loomio's values, it also hindered growth.

In a report released in 2019, an interview was conducted with Michael Elwood-Smith, Loomio's executive director, in which he explained the value of the cooperative structure:

> We've pioneered in so many ways. We are a little worn out from pioneering, and now focusing on making a sustainable business. However, I don't think we would have survived if we didn't have the cooperative structure and conscious development of values, culture and working practice. It's that practice of building, and the principles of collaboration that have been fundamental.[24]

But there came a point where the need for capital made the structure unviable:

> And so, I think this is why it's interesting to have this conversation about legal structures now, because when we've gone out seeking investment, we've tried almost everything under the sun, except normal, ordinary equity in the company. And the feedback that has come from investors has pretty much been 'we like what you're doing, we can see the growth that's happening, we'd like to invest, but we can't invest in that structure.'[25]

The lack of access to capital is about more than delaying growth or foregoing profit – it biases the market towards businesses which maximise their financial returns. This is particularly relevant in the SaaS sector, which is characterised by fast development and product cycles – lack of access to capital means a lack of investment, and ultimately, a lack of customers. Michael Elwood-Smith recognised the market pressures in his interview:

> The hard facts are, that we're a software company, operating in one of the fastest and most fiercely competitive markets in the world. And so, when people are looking at Loomio software, they're comparing it against Slack, against Microsoft, against Google, against Facebook. The reality is that when people are choosing to implement software in their organisation, you don't have a chance to be second best, you've got to be up there, and competitive with the best. Now, to do that, means that the company needs to continually invest in developing the product. Software does not stand still. It's constantly changing. And so that's why … in retrospect, a cooperative, while it has enshrined the values, has been difficult structure to grow a software company in.[26]

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24 J. Horan et al., 'Structuring For Impact: Evolving Legal Structures for Business in New Zealand' (2019) New Zealand Law Foundation and The Impact Initiative, www.theimpactinitiative.org.nz/publications/structuring-for-impact, p. 16.

25 Ibid., p. 56.

26 Ibid.

So, Loomio resorted to 'creative lawyering' to make their structure work, creating a for-profit company owned by the worker cooperative.[27] Ownership by the worker cooperative creates a 'mission lock', ensuring they retain their broader social objectives.

2.3. CHARITABLE ENTITIES

Many of the social enterprises in New Zealand operate with a complex legal structure. The structure is required to provide assurance to investors or philanthropists that their money is being used appropriately. For Loomio, described above in section 2.2, the impact was entwined with the business model. Their product is designed with inclusive collaboration in mind, and the 'inclusive' part is their point of difference. Their status as a worker cooperative also enshrines their community values. But other social enterprises have financial and social or environmental goals which are less 'embedded' in the nature of their business. So, in an effort to prove their contribution, they turn to legal forms which enshrine contributions to broader social or environmental goals.

Traditionally the legal entity which is designed to contribute to social or environmental goals is the charity. In New Zealand it is important to distinguish between a charitable trust, which is a legal entity, and an entity with charitable status. Any entity can apply for charitable status, including companies, cooperatives, trusts and incorporated or unincorporated societies. Often a charitable trust (which is an entity) will have charitable status.

Charitable status bestows certain privileges and obligations on the entity which has it. The benefits include being exempt from some or all income tax and being able to be called a charity. The signalling benefits of being called a charity should not be underestimated – access to philanthropic funds may improve, the word charity can be used in marketing, and being classed as a charity may help form favourable relationships with others. The signalling benefits may be more important than access to external funding for some social enterprises, particularly those which earn significant income from trading, or have ready access to capital. At times the signalling benefits of charitable status will help a social enterprise avoid being criticised for being 'for-profit'.[28]

While charitable status may improve perceptions of the social enterprise, it comes with its own challenges. Foremost are the reporting requirements. Most charitable entities are required to submit annual reports, prepared in

[27] Loomio, 'About', www.loomio.com/about.

[28] Note that charities cannot be operated for pecuniary profit which benefits any private individual or non-charitable organisation, but if a charitable entity is owned by a company, the company can. Charities Act 2005, s. 13(1).

compliance with Generally Accepted Accounting Standards (GAAP)[29] – for many social enterprises this means they will have to prepare annual reports for both the company which trades and makes pecuniary profit, as well as for a separate charitable entity. They must also notify the Charities Register of any changes to their rules, officers or address,[30] as well as operate exclusively for a public benefit (a prohibition on making personal profit), amongst other things.[31] These restrictions push many social enterprises to set up multiple entities, one for trading, which can make a pecuniary profit, and one to manage their 'for-good' element.

At times the benefits will outweigh the costs. Many social enterprises may require significant initial capital, and without an entity with charitable status it can be difficult to secure philanthropic funds. Charitable status also serves as a form of 'mission lock', meaning that as the social enterprise grows its status as a charitable entity can prevent its 'for-good' aims from being watered down.

Depending on the social enterprise involved, the 'mission lock' may be more or less important. Lisa King, the founder of Eat My Lunch, explains:

> [Charitable status is] restrictive, there's a lot of red tape, bookkeeping, we didn't want to have to run two sets of accounts, two sets of legal processes or literally two organisations running alongside each other. So really it was the simplicity and ease of operation that drove us to choose [a company]. And also, because we felt that that was the best way [to run our] buy-one-give-one model, so when someone buys a lunch, 'The Give' [what Lisa refers to the free lunch aspect of the model as] is intrinsic in that, so [buying a lunch] always activates a give. So, we built it into the cost of goods of delivering a buy-lunch and we felt that was actually the most genuine and true to the proposition of buy-one-give-one.[32]

The 'for-good' element of Eat My Lunch was embedded into the business model, so the 'mission lock' was less significant. But in rejecting a charitable entity, social enterprises face a clash of perceptions. Consumers may retreat to the traditional binary of charities as doing good, and companies as making profit, leading them to question how much 'good' a social enterprise is doing. A more nuanced understanding of social enterprises by consumers would avoid the criticism that social enterprises make money too. But even a broad understanding would not entirely solve the problem.

Without a legal definition of a social enterprise, all manner of businesses are free to make use of the category, and a broader understanding by consumers

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29 Charities Act 2005, ss. 41–42A.
30 Ibid., s. 40.
31 Ibid., s. 13.
32 J. Horan et al., 'Structuring For Impact: Evolving Legal Structures for Business in New Zealand' (2019) New Zealand Law Foundation and The Impact Initiative, www.theimpactinitiative.org.nz/publications/structuring-for-impact, p. 17.

would only increase the incentive to claim that a business is a social enterprise. Geoff Walker, the finance manager of Trade-Aid,[33] explains:

> I guess the risk for us is that because there is a lack of a wholehearted definition … we risk association with other businesses who can say they are [social enterprises] but don't follow through. So, for example we have the same issue with fair trade, or with organic, so we pick certification bodies where we can say these entities have recognised that we actually are this, and we can certify it. So, having some degree of something that proves it, I think that's quite important.[34]

So, even the social enterprises which opt not to apply for charitable status are often required to provide some assurance of their impact. The various ways in which social enterprises attempt to provide that assurance are discussed further in section 4.

2.4. INCORPORATED SOCIETIES

Some social enterprises opt to form as incorporated societies. Incorporated societies are regulated under the Incorporated Societies Act 2022. The 2022 Act is a long-awaited update to the Incorporated Societies Act 1908, which has shaped the context in which incorporated societies operated in New Zealand.

Establishing an incorporated society is a similar process to establishing a company in New Zealand. Incorporation allows a group of people to come together and form an entity with a separate legal personality – and take advantage of the perpetual succession and limited liability that traditionally come with a separate legal personality.[35]

Incorporated societies are heavily restricted in what they can do. The society cannot operate for financial gain; it must have some other object.[36] As such, often they are set up to manage sports clubs or community organisations. An incorporated society must have a minimum of 10 members,[37] and a constitution is registered.[38] Under the previous Act, the society was also required to operate in accordance with its purpose; it could not for example donate to a charity to alleviate homelessness if its purpose was environmental.[39] While this provision

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33 Trade-Aid is a social enterprise working to promote fair trade products.

34 J. Horan et al., 'Structuring For Impact: Evolving Legal Structures for Business in New Zealand' (2019) New Zealand Law Foundation and The Impact Initiative, www.theimpactinitiative.org.nz/publications/structuring-for-impact, p. 17.

35 Incorporated Societies Act 2022, ss. 16 and 78.

36 Ibid., s. 23.

37 Ibid., s. 74.

38 Ibid., s. 25.

39 Incorporated Societies Act 1908, s. 19.

has not been carried over to the 2022 Act, it would be strange for a society to do so – perhaps the new Act contemplates societies considering these issues internally. It provides for dispute resolution requirements,[40] and requires the society to have a committee (which acts akin to the board of a company).[41]

Why then would a social enterprise register as an incorporated society rather than operate through the more flexible corporate structure? For some social enterprises, the rigidity of the incorporated society is actually an advantage: it serves as a form of 'mission lock', providing founders with assurance that the social or environmental objects will not be watered down over time. Organisations which struggle to embed their social or environmental goals into their operating structure turn to incorporated societies to artificially embed them via external authority.

One example is Community Business & Environment Centre (CBEC).[42] CBEC runs several businesses and environmental programmes in Kaitaia. It was established during a time of rising unemployment and social stagnation in the town and aims to run sustainable businesses which provide employment and training opportunities for the local community.[43]

The businesses CBEC runs may not all be considered social enterprises by themselves. One runs a network of swimming pools and another makes outdoor events equipment (such as marquees, outdoor chairs and tables) available for hire. Others could be characterised as social enterprises, such as one which runs public transport services, or another which delivers environmental education projects.[44] The thing that draws all the businesses together is CBEC's focus on community and sustainability. CBEC's registration as an industrial and provident society prevents any of the businesses from straying from the core mission: it serves as a 'mission lock'.

The 'mission lock' is useful to provide assurances to the founders of CBEC, but it is also useful because it shapes the community's perception of CBEC. A report from 2019 concluded that:

> A simple [company] structure would not work for CBEC because this would not be perceived as community-focused enough and would therefore compromise the

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[40] Incorporated Societies Act 2022, s. 26(j).

[41] Ibid., s. 26(f). The Registrar can bring actions to enforce the constitution, which includes the society's purpose under s. 132 – but must have regard to the principles that 'societies are organisations with members who have the primary responsibility for holding the society to account' and 'societies are private bodies that should be self-governing … and should be free from inappropriate government interference' under s. 150.

[42] Note that CBEC is actually registered under the Industrial and Provident Societies Act 1908, but the entity is broadly analogous to the incorporated societies discussed in this section.

[43] CBEC, 'Our Story', www.cbec.co.nz/.

[44] CBEC, 'CBEC Businesses', www.cbec.co.nz/cbec-businesses/. See respectively, 'Swim Zone', 'North Hire Marquees', 'FarNorth Link', and 'EcoSolutions'.

> credibility of the organisation that is so critical to driving engagement with their community.[45]

The struggle to give CBEC's focus on community and sustainability credibility has created financial challenges. In the same report, Cliff Colquhoun, CEO of CBEC, relays that:

> One of the biggest issues for me has been getting people outside of the organisation to understand we can trade as a CE cooperative with charitable status, but if we want to borrow money, suddenly the doors close all over the place really quickly because CBEC has no individual owner. There's a community that owns it.[46]

3. OTHER CONSTITUENCIES

Entities such as CBEC are hindered by perceptions. A standard company has flexibility, but it lacks the 'mission lock' features which provide credibility in respect of their social and environmental goals. In response, social enterprises have turned to complex legal structures to embed their broader goals alongside their financial goals. But even that presents problems with access to financing. And, as explained in section 2.2, the viability of many businesses is threatened without access to capital.

3.1. ABILITY FOR A COMPANY TO PRIORITISE SOCIAL OR ENVIRONMENTAL GOALS

The central tension for social enterprises in New Zealand is managing perceptions. But where do those perceptions come from? This section examines New Zealand's legal framework for directors' decisions about companies and its shaping of perceptions about the legal form.

Directors of companies in New Zealand are required to 'act in good faith and in what the director believes to be the best interests of the company'.[47] The 'best interests of the company' has traditionally been interpreted as maximising financial value for shareholders.[48] This 'shareholder primacy' model has been

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45 J. Horan et al., 'Structuring For Impact: Evolving Legal Structures for Business in New Zealand' (2019) New Zealand Law Foundation and The Impact Initiative, www.theimpactinitiative.org.nz/publications/structuring-for-impact, p. 14.

46 Ibid., p. 22.

47 Companies Act 1993, s. 131.

48 A. Heath, 'Achieving Long-Term Value Through Stakeholder Theory: Proposed Amendments to the Companies Act 1993' (2020) 10 *VUW Legal Research Papers* 43, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3651561.

dominant in New Zealand until recently.[49] Directors in New Zealand may prioritise the interests of current shareholders because their appointment is controlled by the shareholders. Second, shareholders can be authorised to take legal action against directors for breach of the duty to act in good faith.[50] Shareholders' right to take action against directors should not be read as a legal endorsement of the shareholder primacy model – the action taken is a derivative action 'in the name and on behalf of the company'.[51] Nevertheless directors may feel either compelled or at the very least obliged to focus on the interests of the company's shareholders at any time if they believe the company to be comprised of those shareholders. Third, in contrast to many other commonwealth countries, in New Zealand, although courts defer to the business judgment of directors, there is no codification of the business judgment rule. A statutory rule supports director discretion by creating a legal presumption that directors' actions are carried out in good faith, with directors, in their decision-making, knowing that they are protected by that rule.[52]

Under the shareholder primacy model the corporate form is inappropriate for social enterprises, because social enterprises are effectively constrained if they face a trade-off between their financial and social or environmental goals. The pressures on directors to prioritise the maximisation of shareholder value at all times have broader social implications by shaping the public's perception of companies as vehicles for financial gain. It is no surprise that the most successful social enterprises in New Zealand are those that face little to no trade-off between their social and environmental goals. If they face little trade-off, they have little need to 'lock' in their social or environmental goals, enabling them to forego lesser-known forms in favour of the company form.

But perceptions can change. Other models of corporate governance have been recognised by the Supreme Court in New Zealand:[53] stakeholder governance and entity maximisation. Importantly, the statutory requirement for directors does not prescribe either shareholder or stakeholder primacy; it instead centres on the entity itself as the subject of directors' duties. As mentioned, directors are required to 'act in good faith and in the best interests of the company'.[54]

The stakeholder approach has gained some traction – in 2021 New Zealand's Institute of Directors (NZID) partnered with the law firm MinterEllisonRuddWatts to release a white paper calling for a review of directors' duties to embed

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49 S.M. Bainbridge, 'Director Versus Shareholder Primacy: New Zealand and USA Compared' [2014] *New Zealand Law Review* 551, 563–64.

50 Companies Act 1993, s. 165.

51 Ibid. See also Companies Act 1993, s. 169(3).

52 See L.A. Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public*, Berrett-Koehler Publishers, San Francisco 2012, pp. 29–31.

53 *Madsen-Ries (as liquidators of Debut Homes Ltd (in Liq.)) v. Cooper* [2020] NZSC 100; [2021] 1 NZLR 43, [28]–[31].

54 Companies Act 1993, s. 131.

stakeholder governance.[55] However, stakeholder governance is not a panacea. The NZID paper was criticised because of the looseness in conceptions of what a stakeholder is and what obligations directors may owe to stakeholders.[56] Taken to the extreme, stakeholder governance causes similar problems for social enterprises as shareholder primacy models of corporate governance – directors may exercise caution in promoting the financial objectives of the social enterprise when it conflicts with the social or environmental objectives. A movement towards stakeholder governance will not necessarily resolve the problems that social enterprises have with companies.

The concept of the 'best interests of the company' is consistent with a third developing conception: that the company is an entity with the obligations of directors owed to the entity itself separate from shareholders that at the same time holds the interests of shareholders as capital.[57] This conception provides a basis for the directors to take a long-term perspective and value-intangible elements, such as reputation or broader social or environmental goals, that attach to the entity when they make decisions.[58] Such a conception of directors' duties may adjust the perception of the corporate form. By viewing the interests of shareholders as capital held in the entity separate from the shareholders themselves at any time, it may also provide a basis for directors of social enterprises to act in the long-term interests of the social enterprise, rather than the short-term interests of current shareholders. A focus on the entity may be less challenging than attempting to balance the interests of stakeholders.

There is increasing recognition that companies can play a more nuanced role in society than simply acting as vehicles for financial maximisation for their shareholders at any time. An alternative view is that the company is a form of social organisation, which has power bestowed on it by the state.[59] In this conceptualisation directors are analogous to guardians or trustees of a fund of different forms of value including social value. This conceptualisation finds support in the New Zealand Companies Act, which has as its purpose 'to reaffirm the value of the company as a means of achieving economic and social benefits'.[60]

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55 Institute of Directors New Zealand, 'Stakeholder Governance – A Call to Review Directors' Duties' (30.07.2021), www.iod.org.nz/resources-and-insights/research-and-analysis/stakeholder-governance/#.

56 P. Watts, 'Directors' Duties Review "A Pandora's box of misery"' (31.07.2021) *National Business Review*.

57 *Madsen-Ries (as liquidators of Debut Homes Ltd (in Liq.)) v. Cooper* [2020] NZSC 100; [2021] 1 NZLR 43, [30].

58 S. Watson, 'What More Can a Poor Board Do? Entity Primacy in the 21st Century' (2017) 23 *New Zealand Business Law Quarterly* 142, 159–60.

59 C. Noonan and S. Watson, 'The Foundations of Corporate Governance in New Zealand: A Post-Contractualist View of the Role of Company Directors' (2007) 22 *New Zealand Universities Law Review* 649, 676–80.

60 Companies Act 1993, purpose.

The law increasingly mandates this approach. In New Zealand, many companies will soon be required to make 'climate change disclosures'.[61] It is effectively accepted that directors may act in the interests of future shareholders,[62] a concept which acknowledges the need to maintain the value of the corporate fund, although its phrasing is perhaps as a sop to shareholder primacy conceptions. And there is currently a Bill being brought to Parliament to clarify that directors may consider matters other than the maximisation of profit, which would include social and environmental objectives.[63] At a broader level and internationally, there is increasing recognition that the purpose of business is not simply to maximise shareholder value within the strict confines of the law. In 2019 the Business Roundtable released a statement on the purpose of a corporation in which some of the largest global businesses affirmed a 'fundamental commitment to *all* of our stakeholders'.[64]

Stakeholder theories have been criticised for their imprecision, amongst other things, but the appetite for change is also seen in the movement towards companies serving broader purposes.[65] In the past, incorporation was a concession granted by the state with the requirement that companies have a public purpose;[66] in the same vein, today Colin Mayer advocates for a reconceptualisation of business to incorporate a broader purpose.[67] If such a reconceptualisation of businesses occurred, the corporate form would not be inappropriate for social enterprises, as perceptions of companies would likely change. So, the ultimate solution for social enterprises could be the realisation of the potential of companies as contributors to society by the maximisation of social value, with growth in economic value a consequence rather than the sole focus.

3.2. THE CONTRIBUTION OF A NEW LEGAL FORM?

As seen above in section 3.1, the corporate form is flexible enough to accommodate social enterprises. Directors owe their duties to the entity itself,

[61] Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021, ss. 22–31.

[62] C. Noonan and S. Watson, 'The Foundations of Corporate Governance in New Zealand: A Post-Contractualist View of the Role of Company Directors' (2007) 22 *New Zealand Universities Law Review* 649, 650.

[63] Companies (Directors Duties) Amendment Bill 2021 (75–1). The Bill is discussed in greater detail in section 6.

[64] Business Roundtable, 'Statement on the Purpose of a Corporation' (19.08.2019), https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporationJuly2021.pdf.

[65] C. Mayer, 'The Future of the Corporation and the Economics of Purpose' (2021) 58 *Journal of Management Studies* 887, 888.

[66] S. Watson and L. Taylor, 'Introduction' in S. Watson and L. Taylor (eds), *Corporate Law in New Zealand*, Thomson Reuters, Wellington 2018, p. 18.

[67] C. Mayer, 'The Future of the Corporation and the Economics of Purpose' (2021) 58 *Journal of Management Studies* 887.

and the entity can incorporate purposes other than financial maximisation in its constitution.

That is not to say that a new specialised legal form would have no value. While the shareholder primacy model shapes the perceptions of companies, as it traditionally has, incorporating as a company presents signals which undermine a social enterprise's social or environmental mission. So, incorporating as a company has been most successful for social enterprises which can 'embed' their impact into their business model in New Zealand. When the social or environmental impact is essential to the business model, there is less need to prop up credibility via external authorities, like the Charities Commission. This allows those social enterprises where impact is embedded in their business model to adopt legal forms which are more widely accepted, and also to provide stronger assurances to capital providers that the financial and social or environmental goals do not conflict – because the social or environmental goals are the driving force behind the financial goals.

But there are many social enterprises which cannot marry their multiple purposes in an integrated holistic business model. If the shareholder primacy model continues to shape perceptions about the company, a specialised social enterprise legal entity would contribute to these social enterprises the most by signalling that the social enterprise has both financial and social or environmental objectives. In short, it would shape perceptions.

New Zealand does not have a distinct legal entity for social enterprises. So, the next section examines how social enterprises in New Zealand have attempted to shape and reshape perceptions themselves.

4. STATE/PRIVATE CERTIFICATIONS AND METRICS

The usefulness of a distinct social enterprise legal entity comes from its ability to shape perceptions. Whereas traditionally a company is viewed as a tool solely for financial maximisation, and a charity as tool to achieve social or environmental goals, a distinct entity would signal that a business aims to combine the two. This section examines how social enterprises in New Zealand have attempted to signal their contribution to social or environmental goals, alongside their financial goals.

In New Zealand, in contrast to some other jurisdictions, there are no state-sponsored certification regimes which specifically target social enterprises. The closest certifications available include the assurances from holding charitable status. These include financial reporting requirements and performance reports. The assurances associated with becoming a registered charity are what lead many social enterprises in New Zealand to fold a charitable entity into their legal structure.

Other social enterprises use private certification schemes to provide credible assurances of their impact. Benefit corporations (B Corps) are used globally and have gained hold in New Zealand. Advantages of becoming a B Corp include the broad global recognition and the flexibility that their standard incorporates. Alongside the B Corp certification regime, there are also certifications developed specifically in the New Zealand context. Perhaps the most well known is the Ākina Foundation's 'impact supplier' initiative.[68] Their impact supplier certification scheme allows entities to gain independent endorsement of their positive impact. Notably, and reflecting the diversity of legal forms used by social enterprises in New Zealand, any legal form except an unincorporated business is able to apply for impact certification. The impact supplier certification also includes broader support for social enterprises – one of the benefits is access to a 'Social Procurement Programme' to connect with other impact suppliers or impact buyers. Taking an ecosystems approach, the Ākina Foundation works with organisations to pair suppliers and buyers with similar 'impact-oriented' objectives. The organisations are not necessarily social enterprises; for example, a large bank, ANZ, has worked with the Ākina Foundation to improve the social impact that its procurement has.[69]

Other social enterprises have forged their own path by reporting on their social or environmental goals themselves. Eat My Lunch, one of the largest social enterprises in New Zealand, produced an 'impact report' which detailed its progress towards social goals.[70] However, a comprehensive report is generally unfeasible for smaller social enterprises, so 'self-certifying' is not a common occurrence in New Zealand.

5. PRIVATE CAPITAL

Certifications and other forms of assurance which social enterprises in New Zealand seek out are attempts to shape the perceptions of their stakeholders. This section examines New Zealand's landscape with respect to one stakeholder in particular: private capital providers. In this section, the landscape is segmented into three players, who each have different goals when they provide private capital to social enterprises.

First are those whose investment is driven by the social or environmental goal of the social enterprise. These may include high-net-worth individuals,

[68] Ākina Foundation, 'Become an Ākina Impact Supplier', www.akina.org.nz/social-enterprises/impact-certification.

[69] Ākina Foundation, 'Deliver Impact Through Procurement', www.akina.org.nz/corporate-government/social-procurement.

[70] Eat My Lunch, 'Our Story', https://web.archive.org/web/20220815183434/https://eatmylunch.nz/pages/our-story.

impact investment funds and philanthropists. Major impact investment funds in New Zealand include Soul Capital, Impact Enterprise Fund, Purpose Capital Impact Fund, Community Finance, New Zealand Green Investment Finance, Te Puna Hapori and Accident Compensation Corporation's Impact Investment Fund.[71] Some of these are government funded. For example, New Zealand Green Investment Finance was incorporated under statute and provided an initial NZ$100 million in investment capital.[72] It exists to 'accelerate investment that can help to reduce greenhouse gas emissions in New Zealand'.[73] Others are funded by philanthropists and the private sector.

Second, the financial sector also directly invests in social enterprises. Often this investment is not driven by the social or environmental goal of the social enterprise; the investor simply seeks a financial return.[74] Ease of access to these investors is an advantage which social enterprises that manage to marry their financial and social or environmental goals have in comparison to those which cannot. The private capital landscape for these businesses is broadly similar to that for traditional (non-social) enterprises. For fast-growing social enterprises, which may seek venture capital investment, New Zealand's venture capital landscape is comparatively underdeveloped.[75] However, it has recently seen an influx of capital.[76]

Finally, there are those alternative investors who may have undefined or flexible objectives. This group funds social enterprises when social enterprises use non-traditional means to capitalise – such as crowdfunding. For example, Eat My Lunch issued 'Lunch Bonds' in 2019 to raise NZ$500,000 in a crowdfunding campaign.[77]

Crowdfunding in New Zealand is very accessible, including to social enterprises. Schwartz suggests that this success is due to the efficiency of the New Zealand system, which imposes very few restrictions on the practice (as opposed to the United States, for example, which has a more inclusive but less efficient

[71] Centre for Social Impact, 'Overview of Impact Investing in Aotearoa' (2020), www.centreforsocialimpact.org.nz/media/1703/impact-investment-overview-_01.pdf, p. 8.

[72] Public Finance Act 1989, Schedule 4A.

[73] New Zealand Green Investment Finance, 'Who We Are', https://nzgif.co.nz/about-us/who-we-are/.

[74] This does not mean that the social or environmental goal is ignored, just that the primary motivation for investment is to seek a financial return.

[75] A.A. Schwartz, 'The Gatekeepers of Crowdfunding' (2018) 75 *Washington and Lee Law Review* 885, 922.

[76] 'Venture Capital Flows Into New Zealand Startups' Radio New Zealand (14.05.2021), www.rnz.co.nz/news/business/440439/venture-capital-flows-into-new-zealand-startups.

[77] A. Nadkarni and C. Hutching, 'Investors Line Up for $2m Share Issue to Fund Eat My Lunch Expansion' (20.05.2019) Stuff, www.stuff.co.nz/business/112843582/investors-line-up-for-2m-share-issue-to-fund-eat-my-lunch-expansion; Pledge Me, 'Eat My Lunch | Lunch Bonds', www.pledgeme.co.nz/loans/5-eat-my-lunch-lunch-bonds.

crowdfunding system).[78] This efficiency is likely due to the liberal regulatory landscape in New Zealand, with the Financial Markets Conduct Act 2013 governing equity crowdfunding and the Financial Markets Authority (FMA) acting as the primary regulator. Broadly speaking, there are only two significant restrictions imposed on a crowdfunding provider: it must be licensed by the FMA and it must limit equity raised in any 12-month period to NZ$2 million. The FMA does not review or approve the companies listed on crowdfunding platforms, there are no mandated disclosure requirements and there is no investor cap.

New Zealand's equity crowdfunding landscape is over-developed therefore, even in comparison to financial heavyweights such as the United States.[79] And crowdfunding in New Zealand has taken a significant lean towards social enterprises – about one-third of companies that succeed in raising capital are social enterprises.[80] So, in New Zealand alternative forms of raising capital are important for social enterprises. It could be argued that this also relates to perceptions about social enterprises – particularly if the public are more willing to fund businesses with both social or environmental goals alongside financial maximisation.

6. PROSPECTIVE CHANGES IN THE LAW

Two possible prospective changes in the law may be relevant to social enterprises because they may shape perceptions about different entities.

First, a Bill has recently been introduced to Parliament to clarify directors' duties. As explained in section 3.1, although increasingly less prevalent, the traditionally narrow interpretation of directors' duties in New Zealand's legislation is one reason why directors of companies take a conservative approach and seek to maximise shareholder value over other environmental or social goals. Perceptions of companies have developed accordingly, and they are seen primarily as vehicles for financial maximisation for current shareholders.

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78 A.A. Schwartz, 'The Gatekeepers of Crowdfunding' (2018) 75 *Washington and Lee Law Review* 885, 920.

79 Ibid., p. 929: 'When comparing New Zealand and American crowdfunding, one must account for the fact that the American economy is about 100 times as large as that of New Zealand. If we scale the New Zealand crowdfunding numbers up by a factor of 100, then the number of campaigns would have been 2,700 (2,100 of which were successful), and the successful campaigns would have raised a total of US$1 billion. Recall that the United States had only 211 campaigns (112 successful ones), raising a total of $35 million. In other words, scaled for the size of its economy, New Zealand had about thirteen times as many campaigns as the United States; New Zealand companies had a success rate of nearly 80%, compared to the American rate of about 50%; and New Zealand issuers raised about thirty times as much money as did their American counterparts. These numbers are remarkable' (footnotes omitted).

80 Ibid., p. 955.

The approach of financial maximisation was termed the 'shareholder primacy' model of corporate governance, and was contrasted with the 'stakeholder' model of corporate governance, as well as the entity maximisation model. Under the stakeholder model and entity maximisation model, directors have greater discretion to balance financial maximisation with social or environmental goals. The new Bill seeks to provide support for directors who incorporate social or environmental goals into their evaluation of company performance. Under the new Bill:

> a director, in acting as the mind and will of the company, can take actions which take into account wider matters other than the financial bottom-line. This accords with modern corporate governance theory that recognises that corporations are connected with communities, wider society, and the environment and need to measure their performance not only in financial terms, but also against wider measures including social, and environmental matters.[81]

The Bill is currently going through the standard legislative process, but it is likely to pass because it has the support of the majority Labour government.[82] That being said, the exact wording of the Bill is not finalised and there are significant hurdles still to be resolved.[83] Questions remain about the extent to which the law, if passed, will encourage a movement towards placing financial goals alongside social and environmental goals. But if it has a significant effect, New Zealand may see more social enterprises choosing to incorporate as companies and a movement away from the complex legal structures that are so common now.

The second possible prospective law change is the development of a new specialised entity for social enterprises. Advocacy for a new legal entity had been building for many years, driven in part by the work of the Ākina Foundation (which is a cornerstone of the social enterprise ecosystem in New Zealand). The advocacy culminated in the production of 10 white papers, each with a recommendation to government about the development of the social enterprise landscape in New Zealand.[84] One of these white papers advocated for the

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81 Companies (Directors Duties) Amendment Bill 2021 (75–1), Explanatory Note.

82 I. Llewellyn, 'Directors' Duties: MP's to Weigh Purpose Before Profit' (23.09.2021), https://businessdesk.co.nz/article/law-regulation/directors-duties-mps-to-weigh-purpose-beyond-profit. Note New Zealand operates a mixed-member proportional parliamentary system. The Labour Party currently holds a majority in Parliament so can pass legislation without coalition partners.

83 See for example J. Windmeyer, 'Amending Directors' Duties for Company Stakeholders' (04.10.2021) Russell McVeagh, www.russellmcveagh.com/insights/october-2021/amending-directors-duties-for-company-stakeholders; E. Geard, 'The Directors' Duties Member's Bill – Another Distraction from Real Climate Action?' (03.11.2021) Lawyers for Climate Action New Zealand, www.lawyersforclimateaction.nz/news-events/the-directors-duties-members-bill-another-distraction-from-real-climate-action.

84 The Impact Initiative, 'The White Papers: The Detail Behind the Programme Recommendations to the Government', www.theimpactinitiative.org.nz/publications/white-papers.

development of a specialised legal entity for social enterprises which would balance the flexibility and 'mission lock' requirements of social enterprises.[85]

The Ākina Foundation proposed an amendment to the Companies Act 1993 to create a specialised legal entity for social enterprises known as an 'Impact Company'. This proposal only provides high-level details.[86] On applying to register a company under the Companies Act 1993, the applicant could elect (by opting in) to incorporate as an Impact Company. Existing companies could also opt in at any point. An Impact Company would be a for-profit structure that prioritises impact. Impact would be manifested in two key ways – 'impact mandate' and 'impact reporting'. The impact mandate could allow for the prioritisation of mission in decision-making, as an Impact Company must adopt a constitution which includes a 'statement that sets out the impact the entity is seeking to achieve and the prioritisation of impact alongside distribution of profits'.[87] This statement would subsequently guide director decision-making, inform the organisation's culture and so on. An Impact Company would also be required to publish an annual report detailing its impact mission performance (this would be the impact reporting element).

However, work in the area has stalled and it now seems unlikely that a specialised legal form will be developed. Instead, work has shifted towards clarifying directors' duties as discussed above, and other ways the government can support social enterprises.[88] Nevertheless, it seems important to note this programme of work in the broader context.

7. CONCLUSION

The story of the social enterprise in New Zealand is a story of managing perceptions. The perceptions of customers, suppliers, investors and other stakeholders can shape the prospects of a social enterprise. Recent developments aiming to reconceptualise businesses generally, and the company in particular, may alter perceptions of the corporate form. But while the shareholder primacy model persists, social enterprises in New Zealand have to shape perceptions proactively. This report describes some of the ways that social enterprises in New Zealand do so, including by adopting various complex legal structures, seeking external certification, or self-reporting on progress towards their

85 J. Horan et al., 'Structuring For Impact: Evolving Legal Structures for Business in New Zealand' (2019) New Zealand Law Foundation and The Impact Initiative, www.theimpactinitiative.org.nz/publications/structuring-for-impact, pp. 29–32.

86 Ibid.

87 Ibid., p. 31.

88 This information comes from an interview conducted with Jackson Rowland, Director of Ākina Invest as part of the research for this report.

social and environmental goals. Doing so may provide social enterprises with access to philanthropic gifts or impact investment. Access to capital, however, remains skewed towards those social enterprises which can interweave their social or environmental goals with their financial goals. Social enterprises in New Zealand are increasingly leveraging their 'social' status to their advantage in alternative systems for capitalisation – particularly in New Zealand's highly successful equity crowdfunding sector. Despite a regulatory environment that is at best agnostic towards them, social enterprises in New Zealand have continued to develop, with increasing numbers and a growing impact investment sector. The challenge for New Zealand's future is how to best support them.

SOCIAL ENTERPRISES IN PERU

Edison TABRA OCHOA*

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The concept of 'social enterprise' is unclear in Peru. Very often it is confused with the work of social or charitable organisations. In other cases, it is associated with part of the corporate social responsibility (CSR) activities that companies carry out in favour of their stakeholders. In the Peruvian market, CSR is often the subject of frequent practice in mining companies given the number of mineral resources on Peruvian territory. Despite this, companies have social reputation problems. Many of them have been associated with corruption scandals or environmental pollution. This situation undoubtedly means that the concept of 'social' is not identified with them but with the government or with social welfare organisations such as churches, foundations, NGOs, charity organisations and international organisations, among other entities.

This report on Peru answers questions about the understanding of social enterprise from an academic perspective but also includes a survey of 203 professionals, mainly lawyers, involved in the practice of corporate law. As will be seen at each point in the responses, each of the surveys comprises the opinion of two groups of people. The first group is made up of senior professionals who are characterised by working in the industrial and service sectors. They have several years of experience with postgraduate studies and their age is 28 years or older. The second group is made up of law graduates, or those about to graduate, with minimal work experience, although one aspect to highlight is that they belong to the millennial and centennial generations.

The discoveries obtained in each of the questions are uneven. In some cases, they confirm the theoretical information on the concept of 'social enterprise', while in others they present different information that is extremely important to evaluate. In other words, the perception of the senior group of respondents is different from that of the juniors, which shows the generational gaps with respect to the idea of 'social'. With this data, we hope to contribute to the debate and to the formulation of proposals that will enrich the knowledge of 'social' entrepreneurial work in Peru.

1. PERUVIAN BUSINESS LEGAL FRAMEWORK

1.1. ECONOMIC CONSTITUTIONAL MODEL

At present, the Peruvian state is governed under the economic model of a social market economy that establishes clear market rules for the correct use of such freedom and, in this way, protects the most vulnerable among economic agents, i.e. consumers. Both the Political Constitution and the Framework Law for the Growth of Private Investment[1] promote free private initiative with respect

[1] Decreto Legislativo No. 757, Ley Marco para el Crecimiento de la Inversión Privada (13.11.1991) https://spij.minjus.gob.pe/spij-ext-web/#/detallenorma/H752515.

for free competition and access to economic activity. Likewise, this regime aims to achieve minimum social welfare through a balance between free private initiative and social progress.

The Political Constitution of Peru (1993) provides a series of general principles with which the economic regime must comply.[2] The first of these principles establishes the freedom of private initiative, which is guaranteed through the economic regime. Second, freedom of labour and freedom of enterprise, commerce and industry are safeguarded. It is important to mention that the exercise of these freedoms must not be detrimental to morality, health and public safety. Thirdly, economic pluralism is established, through which the state allows the coexistence of different forms of property and companies. In other words, access to specific economic activities and the adoption of corporate forms may not be directly or indirectly limited. Fourth, free competition is mentioned and it implies that the state facilitates and oversees fair competition. It fights against limits to free competition and against the abuse of dominant and monopolistic positions. Fifth, the freedom to contract is protected; that is to say, the parties involved in a contractual transaction may agree or coordinate in accordance with the regulations in force. In addition, contracts may provide for conflict resolution mechanisms through arbitration or recourse to the courts. Sixth, national and foreign investment must be treated under the same conditions. Finally, there is consumer protection. This economic model ensures the health and safety of citizens and guarantees the right to information to avoid abuse.

In turn, the Framework Law for the Growth of Private Investment (1991) promotes free initiative. It establishes the right of any natural or legal person to exercise the economic activity of their choice, which includes the production or commercialisation of goods or the provision of services, respecting the provisions of the Constitution, laws and international treaties signed by Peru.

1.2. BUSINESS MODELS IN PERU

Currently, there is no agreed definition of 'company' in Peruvian law. However, for the purposes of this research, the definition of Hansmann and Kraakman[3] is mainly highlighted, which conceptualises the company as a nexus of contracts that is constituted to carry out a certain coordinated activity.[4] From this, it

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2 Constitución Política del Perú (29.12.1993) https://spij.minjus.gob.pe/spij-ext-web/#/detallenorma/H682678, Articles 58–65.

3 H. Hansmann and R. Kraakman, 'El rol esencial del derecho en las organizaciones' (2003) 46 *Themis Revista de Derecho* 15.

4 Ibid.

follows that the company is the set of individual contracts whose common part is to carry out a certain economic activity. Likewise, for the particular Peruvian case, one of the most commonly used theories is the company as an economic organisation.

In Peru, in accordance with the constitutional freedoms of enterprise, any person is free to choose the business model most convenient to that person's interests and economic needs. Sole proprietorships that do not have the protection of limited liability ('natural' persons), and the individual limited liability company or private limited company (PLC) are used to promote individual initiatives, while commercial companies (SA, SAC, SAA, SRL and SACS) are used for group initiatives. The most important are the joint stock company,[5] the private closed corporation or closely held anonymous company,[6] the limited liability company (LLC),[7] and the publicly held corporation.[8] For a better understanding, we will proceed to detail the main characteristics of these types of companies.

The individual limited liability enterprise or *empresa individual de responsabilidad limitada* (EIRL) is regulated under Decree Law No. 21621.[9] It can only be incorporated by a natural person (owner), and it is constituted by means of a public deed of incorporation and its registration in the Corporate Public Registry. It also has limited liability and has as administrative bodies the owner (supreme decision-making body) and the management (administration and representation). It has an indefinite duration and in the event that it must be dissolved, it may do so at the will of the owner, on the conclusion of its corporate purpose or if it is totally unable to carry it out, or in the case of losses that reduce the equity by more than 50% in two consecutive years, bankruptcy of the company, death of the owner, judicial resolution or other causes indicated in the law (1976). Likewise, for these types of companies, merger operations are presumed to be grounds for dissolution.

On the other hand, the joint stock company or *sociedad anónima* (SA) is a type of commercial company that requires the concurrence of a minimum of two or more shareholders for its incorporation. Its capital is represented by the contributions of the partners and is represented in shares. These shares are freely transferable unless restricted in its bylaws. The liability of the partners is limited to the amount of their contributions. Its governance is made up of the general

5 Known in Spanish as *sociedad anónima*.
6 Known in Spanish as *sociedad anónima cerrada*.
7 Known in Spanish as *sociedad comercial de responsabilidad limitada*.
8 Known in Spanish as *sociedad anónima abierta*.
9 Decreto Legislativo No. 21621, Ley de la Empresa Individual de Responsabilidad Limitada (14.09.1976) https://spij.minjus.gob.pe/spij-ext-web/#/detallenorma/H716120.

shareholders' meeting, the board of directors and the general management (CEO).

The private closed corporation or *sociedad anónima cerrada* (SAC) is a type of commercial company but more closely held than a joint stock company. It may have a minimum of two and a maximum of 20 shareholders. The shares of this company cannot be registered in the Public Registry of the Stock Market of the Peruvian Securities and Exchange Superintendence (SMV). In addition, it has limited liability. The internal structure consists of the general shareholders' meeting, the general management (CEO), and an optional board of directors. It also has a legal reserve, but the free transfer of shares is limited by the preferential acquisition right of the shareholders to acquire the company's shares before a third party.

The publicly held corporation or *sociedad anónima abierta* (SAA) is a company that has more than 750 shareholders. In addition, its shares must be registered on the Public Registry of the Stock Market (RPMV); therefore, this type of company is supervised by its superintendence. It has limited liability and is governed by the following corporate bodies: the general shareholders' meeting, the board of directors and the general management (CEO). Like the other companies, it must have a legal reserve and free transfer of shares is permitted.

Smaller limited liability companies or *sociedades comercial de responsabilidad limitada* (SRLs) must be formed by a minimum of two and a maximum of 20 partners. In addition, the capital must be divided into equal, cumulative and indivisible stakes. Regarding the liability that the partners must face, it is limited. In addition, its internal organisation is directed by the organs of the general meeting of partners and the management. Unlike other commercial companies, the SRL does not have the obligation to constitute a legal reserve, although it may do so voluntarily, and the transfer of shares is subject to a preferential acquisition right.

At the end of 2019 in Peru, a new type of company was created: the simplified closed corporation or *sociedad por acciones cerrada simplificada* (SACS).[10]

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[10] By means of the Legislative Decree No. 1409: Decreto Legislativo que promociona la formalización y dinamización de micro, pequeña y mediana empresa mediante el régimen societario alternativo denominado Sociedad por Acciones Cerrada Simplificada (11.09.2018) https://busquedas.elperuano.pe/normaslegales/decreto-legislativo-que-promociona-la-formalizacion-y-dinami-decreto-legislativo-n-1409–1690482-2/. Also, its additional regulation approved by Supreme Decree No. 312-2019-EF: Reglamento del Decreto Legislativo 1409, Decreto Legislativo que promociona la formalización y dinamización de micro, pequeña y mediana empresa mediante el régimen societario alternativo denominado Sociedad por Acciones Cerrada Simplificada (30.09.2019) https://busquedas.elperuano.pe/normaslegales/aprueban-el-reglamento-del-decreto-legislativo-n-1409-decr-decreto-supremo-n-312-2019-ef-1812452-3/.

This type of company came into operation in 2021 and seeks to promote the productive and entrepreneurial development of micro, small and medium-sized enterprises. Companies taking this form incorporate by means of a private document and digitally register using the Digital Intermediation System of the National Superintendence of Public Registries of Peru (SUNARP). Unlike other companies, the shares of an SACS can only be held by natural persons, who are provided the right of preferential subscription of shares.[11]

An additional mention has to be made of cooperatives. Peruvian law regulates their constitution and performance in the market.[12] They are organisations with legal personality that bring together many persons (associates) to carry out profit-making activities. Local rules prescribe that they are constituted by capital given by their associates and generate economic benefits for themselves and residually the society. In contrast to conventional companies, cooperatives' benefits are shared by associates taking into consideration their work in the cooperative. Associates may be natural persons or legal entities. In addition, the organisation involves a general associates' assembly, an administration council and a supervisory board.

2. THE CONCEPT OF 'SOCIAL ENTERPRISE' IN PERU

2.1. NOTION OF SOCIAL ENTERPRISE

In Peru, the term 'social enterprise' may be related to certain CSR issues. CSR is understood as 'the ethical form of management that implies the inclusion of the expectations of all groups related to the company, in order to achieve sustainable development'.[13]

The practice of CSR can be implemented in all sizes of companies; however, in Peru it is the large companies that have implemented CSR practices to a greater extent, given that they have sufficient resources to do so. In this sense, the perception is that 'social enterprises' will be those with the greatest economic capacity to finance and implement activities linked to their social mission. Their social initiatives are paid for mainly from their own income (equity) and, exceptionally, from donations and/or subsidies to finance social projects in favour of the population.

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[11] In the rest of the cases, it is complemented by rules set in the Peruvian Companies Act.

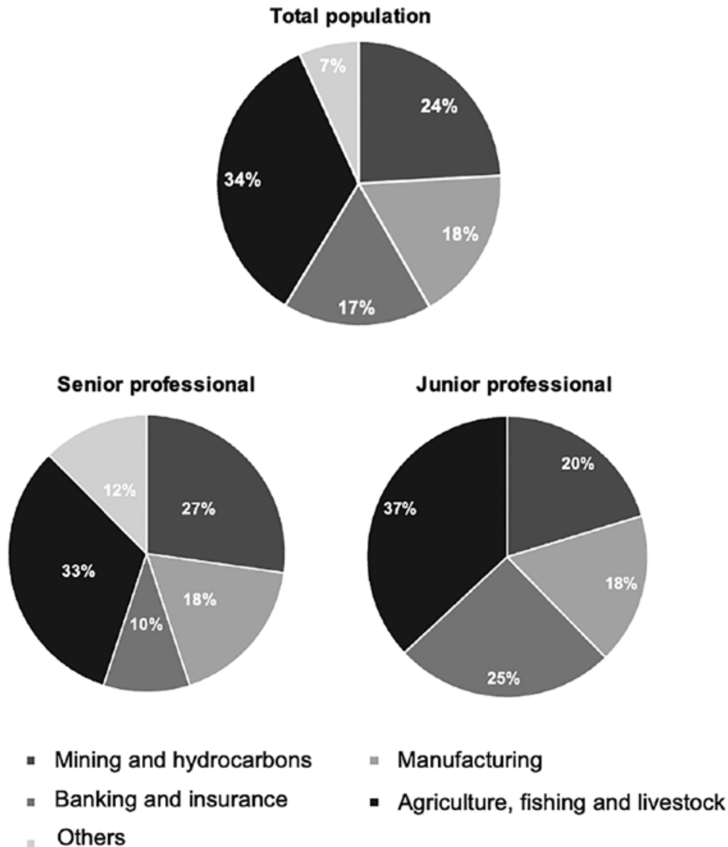
[12] Supreme Decree No. 074-90-TR (Single Ordered Text of the General Cooperatives Law) (14.12.1990) https://www.produce.gob.pe/images/produce/cooperativas/Normatividad/DS-074-90-TR.pdf.

[13] G. Canessa and E. García, *El ABC de la Responsabilidad Social Empresarial en el Perú y en el Mundo,* Siklos S.R. Ldta. 2005, p. 16.

2.1.1. *Industries with the Highest Number of 'Social'-Type Companies*

In order to ascertain Peruvians' perceptions, the survey asked the following question: in which industries are there a greater number of 'social' companies? The answers are presented in Figure 1.

Figure 1. According to you, in which industries are there a greater number of 'social'-type companies?



Source: Produced by the rapporteur.

Figure 1 shows that senior professionals perceived that the industries with the highest number of 'social' companies were those related to agriculture, fishing and livestock (33%), mining and hydrocarbons (27%), manufacturing (18%), 'others' (12%), and banking and insurance (10%). Similarly, it can be seen that junior professionals believe that there is a greater presence of 'social' companies in the agriculture, fishing and livestock industry (37%). This was followed by banking and insurance (25%), mining and hydrocarbons (20%), and manufacturing (18%). From this, it is evident that the perception

between both populations did not vary significantly due to the fact that the tendency is maintained, mainly, towards the agriculture, fishing and livestock industry.

With respect to the total population, 34% perceived that there is a greater number of 'social' companies in the agriculture, fishing and livestock industry. This was followed by 24% in mining and hydrocarbons, 18% in manufacturing, 17% in banking and insurance, and 7% in 'others'. It is worth mentioning that the presence of the answer 'other' by senior professionals demonstrates their knowledge of other industries in which 'social' enterprises are developed, such as the energy industries or the education sector, unlike junior professionals, who did not present other alternatives.

2.1.2. Financing Alternatives for 'Social' Enterprises

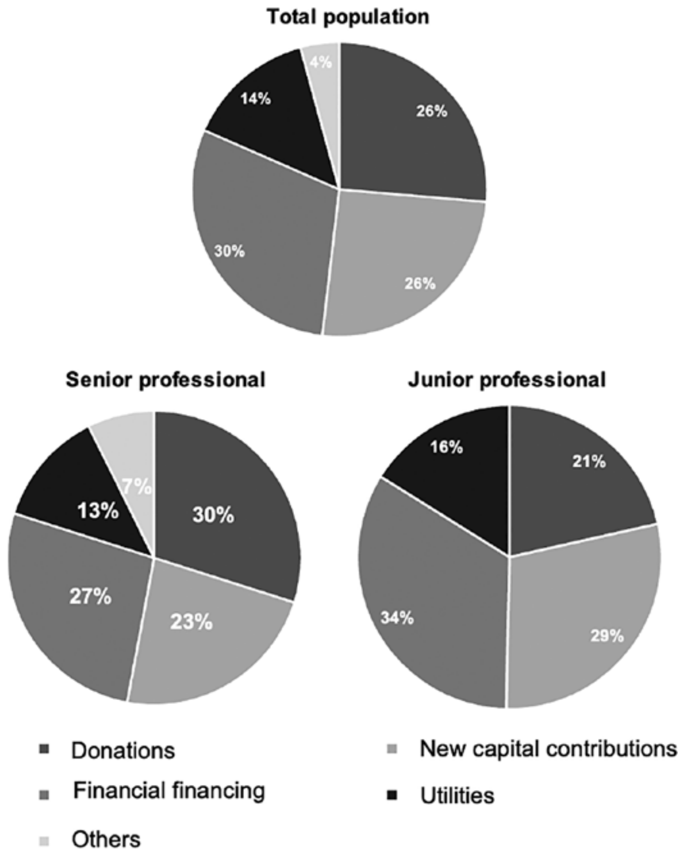
In order to obtain Peruvians' perception on the issue of financing, the following question was asked: what are the financing alternatives available to a 'social' company? The responses are shown in Figure 2.

Figure 2 shows that senior professionals perceived that the financing alternatives used by social enterprises were donations (30%), financial funding by banks (27%), new capital contributions (23%), profits (13%) and 'other' (7%). In 'other', various alternatives were included, some of which were crowdfunding, prizes and tax deductions. With regard to the responses of the junior professionals, they perceived social enterprises were financed by banks (34%), new capital contributions (29%), donations (21%) and profits (16%).

With regard to the details, it can be seen that senior professionals continue to believe that the 'social' type of enterprise is financed mainly by donations, while juniors are more aware that the 'social' type of enterprise can attract bank financing. In relation to the perception of the total population, it is evident that the financing alternatives used by social enterprises were financed by banks (30%), new capital contributions (26%), donations (26%), profits (14%) and 'others' (4%). In general, the responses were proportional, but there was a slightly greater inclination towards the financial funding by banks.

In summary, from the perception of the surveyed public, we can conclude that social enterprises are concentrated in the agriculture, fishing and livestock, mining and hydrocarbon sectors. There is also the belief that social enterprises are those of large economic size, given that the industrial groups chosen are among those most well established in the Peruvian economy. On the other hand, the general population's perception of the financing of social enterprises is confusing in that it shows that a quarter of respondents consider that the main source of financing for social enterprises comes from donations.

Figure 2. According to you, what are the financing alternatives available to a social enterprise?



Source: Produced by the rapporteur.

2.2. FORMS OF ORGANISATION OF SOCIAL ENTERPRISES

As described in section 1.2, Peruvian legislation offers a wide variety of business forms for the organisation of a company. However, no legislation offers a legal form aimed specifically at the segment of companies that wish to call themselves 'social.' They must instead opt for one of the existing types of companies available for all types of endeavour.[14]

In November 2020, the Peruvian Government enacted Law No. 31072 entitled the BIC Law (Benefit and Common Interest Corporation Act).[15]

[14] See section 1.2 on business models in Peru.

[15] Ley No. 31072, Ley de la Sociedad de beneficio e interés Colectivo (Sociedad BIC) (02.11.2020) https://busquedas.elperuano.pe/normaslegales/ley-de-la-sociedad-de-beneficio-e-interes-

This law permits entrepreneurs and potential investors to constitute a conventional company committed to environmental and social issues.[16] For companies to be considered BIC companies, they must generate a 'positive impact, integrating into their economic activity the achievement of the chosen purpose of social and environmental benefit'. This commitment should be included in the bylaws of the company at the point in the legal process of the constitution at the notary and the corporate registry, although the adoption of the Sociedad BIC label does not require the approval of the State Ministry of Production. Once adopted, the phrase *beneficio e interés colectivo* or simply 'BIC' is added to the business name. Existing enterprises can access the BIC certification as well, by modifying their bylaws accordingly.

An entity adopting the Sociedad BIC label will have disclosure obligations (discussed below), as well as relevant fiduciary duties requiring firm management integrated with or responsible to environment or social concerns. The breach of these duties can be considered a legal infringement against consumer or fair competition. In such cases, the National Institute for the Defence of Competition and Protection of Intellectual Property (Indecopi) can impose administrative sanctions (penalty fees).

In summary, the Sociedad BIC is not a new legal type of company but a voluntary certification that entrepreneurs or investors may apply on the legal constitution of the enterprise or in the process of modifying the bylaws.[17] Its main role is to identify and provide public recognition for companies that create positive environmental and social impacts. For it to do so, the Sociedad BIC must enjoy a good reputation in the market, which will arise only if the companies holding the Sociedad BIC label play with a social role in favour of a good environment and social wealth.

For the purposes of this study, it is important to differentiate the concept of non-profit organisations from for-profit organisations in Peruvian legislation (including for-profit organisations adopting the Sociedad BIC label). Non-profit organisations are those whose contributors do not have as a priority the generation of economic profitability, but rather safeguarding the welfare of the environment and human beings.

colectivo-socieda-ley-n-31072–1905747-1/. This law is commonly known as the BIC Law. In 2020 the BIC Law was complemented by Decreto Supremo (Supreme Decree) No. 004-2021-PRODUCE, Que aprueba el Reglamento de la Ley No. 31072, Ley de la Sociedad de Beneficio e Interés Colectivo (Sociedad BIC) (2021) https://busquedas.elperuano.pe/normaslegales/decreto-supremo-que-aprueba-el-reglamento-de-la-ley-n-31072-decreto-supremo-n-004-2021-produce-1929774-4/.

[16] In other words, entrepreneurs and potential investors may select whichever model of companies described in the Peruvian Companies Act (1998) and comply with extra legal requirements to get the classification of 'Sociedad BIC'.

[17] Article 4 of the BIC Law delimitates the companies regulated under Peruvian Companies Act (1998) are eligible for obtaining the certification of 'Sociedad BIC'.

According to the Peruvian Civil Code,[18] there are two main types of non-profit organisations: associations and foundations. According to Article 80 of the Peruvian Civil Code, the association is defined as 'a stable organisation of natural or juridical persons, or both, that through a common activity pursues a non-profit purpose'. Rule 99 of the law defines a foundation as 'a non-profit organisation established by means of the allocation of one or more assets for the realisation of religious, welfare, cultural or other objectives of social interest' (1984). Furthermore, Article 86 of the Peruvian Civil Code establishes that the general assembly is the supreme administration body of associations. It is in charge of approving legal dissolution and distribution of residual assets. In addition, reductions or increases in capital are within the competence of the assembly.

The case of foundations is similar to associations. They are regulated by the Peruvian Civil Code and can be created by natural or legal persons (Rules 100 and 101). Their founders are in charge of the administration and may dispose of the property as long as such disposals coincide with the social mission of the foundation. In addition, associations and foundations with a social mission are exempted from income tax, including on income generated through their business activities, and are eligible as beneficiaries of tax-advantaged donations. Their benefactors may discount the cost of donations in their own annual income tax bill.

For-profit institutions (companies) are regulated mainly[19] by the Law on the Individual Limited Liability Company (Decree Law No. 21621) and by the Business Corporation Act (Law No. 26887).[20] The purpose of this type of company is to generate income in order to increase the value of the contributions made by the investors. In fact, these two laws indicate that not only will the profits be assumed by the investors, but also the losses, depending on the type of company that has been selected.

Peruvian corporate law does not mention the purpose of business. Some ideas are described in Rule 177 of the Local Companies Act (1998), which mentions that directors are responsible to the company, the shareholders and the rest of stakeholders if their performance is in violation of corporate law or the bylaws, and was fraudulent, abusive of their duties or significantly negligent. But the rule does not resolve the question of corporate purpose and corporate governance

[18] Código Civil (24.07.1984) https://spij.minjus.gob.pe/spij-ext-web/#/detallenorma/H682684.

[19] As of the time of writing this report, there is a Preliminary Draft of the General Company Law prepared by the Working Group appointed by the Ministry of Justice and Human Rights of Peru. The official version of this draft is available in full at: https://cdn.www.gob.pe/uploads/document/file/1914635/Anteproyecto%20de%20la%20Ley%20General%20de%20Sociedades.pdf.pdf?v=1622134812.

[20] Ley No. 26887, Ley General de Sociedades (1998) https://spij.minjus.gob.pe/spij-ext-web/#/detallenorma/H777285.

and social responsibility research discusses both positions. The first position postulates that the purpose of a company is to contribute to investor wealth as the owner of economic capital. Capital makes possible the prosperity of society. In contrast, the stakeholder position proposes consideration of the interests of employees, creditors, managers, etc. The stakeholder position predominates in Peru because most corporate documents consider that good governance in companies is fundamental to an incentive climate of respect among shareholders and the rest of the investors.[21]

Thus, in Peru, the notion of 'social enterprise' can be associated with either non-profit or for-profit organisations (companies) as long as they practice social responsibility. In the case of non-profit organisations, foundations or associations undertake charitable activities to combat poverty. However, people usually tend to associate these charitable activities with normal practices of a social enterprise. In the case of companies, the social perception focuses on the term 'social' as a vital component of their CSR policy. It is an essential element of getting them to remain in the market as long as possible (sustainability).[22]

Additionally, most local enterprises may use non-profit organisations (associations or foundations) as an instrument of their CSR practices via funding. According to Peruvian civil law, a non-profit organisation may receive donations of money or assets to carry out their charitable mission. In some cases, these donations are eligible for deduction from the annual income tax bill.

In order to understand the idea that Peruvians have about the concept of the 'social' type of company, the question was asked: 'According to you, the concept of a 'social' type of company best fits the idea of: …' The results are shown in Figure 3.

Figure 3 shows that senior professionals considered that the 'social' type of enterprise fits in the alternative of both with 58%, 25% in a non-profit organisation, 16% in a for-profit organisation and 1% in neither. Regarding the junior professionals, 51% responded that they fit in both, 25% in for-profit organisations and 24% in non-profit organisations. Based on the above, the tendency among the senior and junior population was inclined towards the 'both' option, i.e. they perceived that the concept of 'social'-type enterprise fits both a non-profit and a for-profit organisation. Overall, the total population perceived that the 'social'-type enterprise fits best in both with 55%. Then, 25% considered it a non-profit organisation, 20% a for-profit organisation, i.e. a purely business organisation, and 0.49% none. From this, it can be seen that the tendency towards the option of 'both' was preserved.

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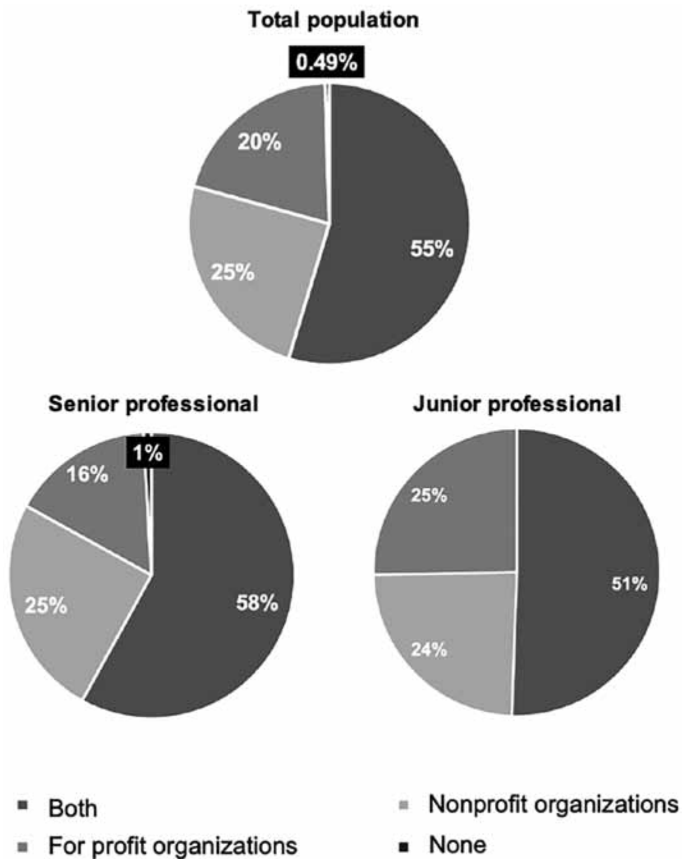
21 The Peruvian Securities and Exchange Commission, *The Good Corporate Governance Code for Peruvian Companies* (2013).

22 A sort of balance between the fulfilment of the social mission and financial sustainability, see A. Vives, *¿Pueden las empresas certificadas como responsables cotizar en bolsa?* (2017) http://cumpetere.blogspot.com/2017/09/pueden-las-empresas-certificadas-como.html.

Figure 3. According to you, the concept of a 'social' type of enterprise best fits the idea of:



Source: Produced by the rapporteur.

In summary, Peruvian regulations do not establish specific types of companies for the incorporation of 'social enterprises' and, therefore, the conventional types of companies offered by commercial legislation should be chosen. For its part, the survey shows that the notion of 'social enterprise' is associated with both companies and non-profit organisations. This means that in the Peruvian market there is a majority acceptance that social work continues to be a part of non-profit organisations, although it is now accepted that it can be carried out by companies.

2.3. CYCLE OF OPERATION OF SOCIAL ENTERPRISES

The procedures for incorporating a 'social' company do not differ from the case of a conventional company. In this sense, founders must comply with the provisions of the Civil Code and the registry law to form a non-profit organisation; founders of for-profit companies must comply with the provisions of the General Company Law and the registry law, as well as the legislation for the EIRL and the SACS. The same procedure will be followed in the event of dissolution. It should also be noted that both laws do not require a permit for the incorporation of a social company.

To qualify as a Sociedad BIC, however, additional requirements apply. Although a Sociedad BIC is not a new type of company, but rather a certification open to various types of firms, those seeking this qualification must present a strategic plan that guarantees the fulfilment of their social mission. They must also produce and present an annual management report prepared by independent third parties. Both documents must be approved within 60 days by the Ministry of Production of Peru. If the Sociedad BIC does not submit the management report and its results, it is in breach of its obligations, for which Indecopi may sanction it for infringement of the rules of free competition and consumer protection. Such sanctions will determine the company's entitlement to certification as a Sociedad BIC. The investors in a Sociedad BIC also have the right to initiate actions against it in the event of non-compliance with its social mission.

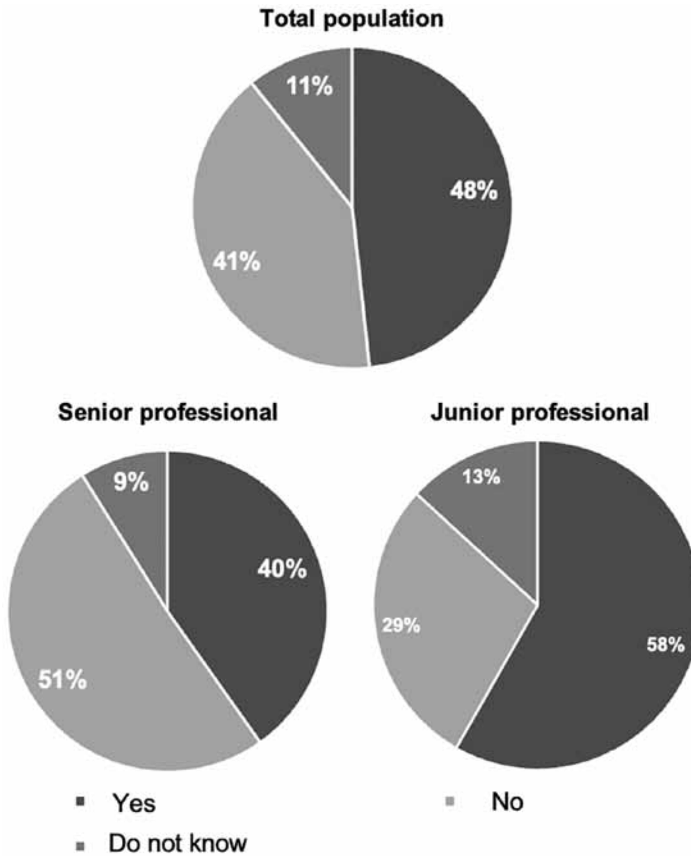
2.3.1. The Constitution of the 'Social' Type of Company

In order to understand the perception of Peruvians, the survey asked the following question: for the incorporation of a 'social' company, is the approval of any government entity required? The results are shown in Figure 4.

In Figure 4, it can be seen that 51% of the senior professionals surveyed considered that the 'social' type of enterprise does not require the approval of any government entity, while 40% said 'yes' and 9% 'don't know'. Among the junior professionals, 58% said 'yes', 29% 'no' and 13% 'don't know'. There is thus a clear change in the trend towards the answer 'yes' on the part of the juniors.

The joint survey shows that of the total number of respondents, 48% considered that an entity is needed, 41% said 'no' and 11% 'don't know'. Similarly, the trend of 'yes' from the juniors remained the same for the total population. However, it is worth noting that there is greater knowledge on the part of seniors when they say that approval from a government entity is not required.

Figure 4. According to you, for the incorporation of a 'social' company, is the approval of any governmental entity required?



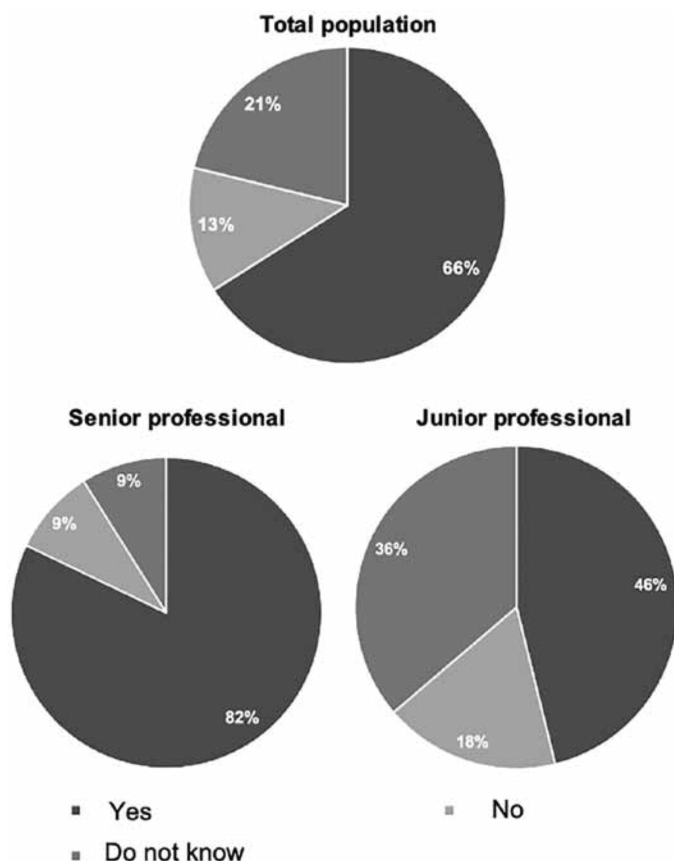
Source: Produced by the rapporteur.

2.3.2. The Change from a Conventional to a 'Social' Type of Company

In order to ascertain Peruvians' perceptions, the survey asked the question: could a conventional company change to a 'social' company? The answers are presented in Figure 5.

Figure 5 shows that 82% of senior professionals said 'yes', 9% 'no' and 9% 'don't know'. Among juniors, 46% said 'yes', 36% 'don't know' and 18% 'no'. In relation to the above, it can be seen that senior professionals had a strong inclination in one direction while juniors presented more balanced answers.

Figure 5. According to you, could a conventional company change to a 'social' type?



Source: Produced by the rapporteur.

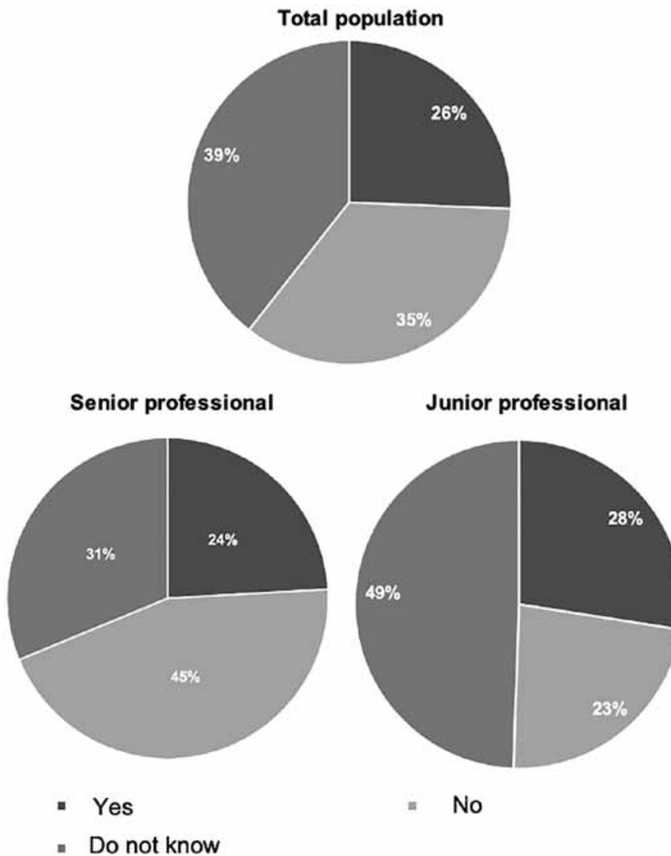
With respect to the total population, 66% considered that a conventional company could become a 'social' company, 21% said that they do not know and only 13% that it could not. It is important to highlight that the trend towards yes was maintained for the total population.

2.3.3. *On the Supervision of the 'Social' Type of Company*

With the objective of gathering the perception of Peruvians, the survey asked the question: is there any public/private entity dedicated to the supervision of the 'social' type of company? Figure 6 shows the responses.

Figure 6 shows that the responses of the senior professionals were 45% 'no', 31% 'don't know' and 24% 'yes'. On the part of the junior professionals, the answers were 49% 'don't know', 28% 'yes' and 23% 'no'. With respect to the affirmative

Figure 6. According to you, is there any public/private entity dedicated to the supervision of the 'social' type of enterprise?



Source: Produced by the rapporteur.

answers, it is worth mentioning that for the seniors, the public institutions that are dedicated to the supervision of the 'social' type of company were the National Superintendence of Customs and Tax Administration (Sunat), the Ministry of Energy and Mines, and Indecopi; and for junior professionals, it was mainly Sunat and the Superintendency of Banking, Insurance and Pension Fund Administrators (SBS). In general, it was found that 39% of the total population considered that they did not know of a public/private entity dedicated to the supervision of the 'social' type of enterprise, 35% perceived that such an entity did not exist and only 26% perceived that it did. For the total population, the entities that stood out were Sunat and SBS.

Peruvian law permits companies regulated under the Companies Act (1998) take on social commitments through CSR or to adopt the Sociedad BIC

certification; however, the perceptions of Peruvian lawyers are different. In the survey sample, 48% consider that these types of companies require approval from public institutions. Likewise, the Peruvian legal framework does not impose legal impediments for conventional companies to change their corporate purpose or align it with social goals. However, the survey found that 34% of respondents consider that conventional companies cannot change their corporate purpose to a social one or do not know whether this is permissible. Moreover, at present, there are no public entities dedicated exclusively to overseeing the work of companies dedicated to the 'social' sphere, apart from those that exercise oversight in the environmental and labour spheres. Nor do private actors engage in such supervision. However, 39% of respondents considered that there are indeed public/private entities that supervise social enterprises.

The survey suggests that a portion of respondents believe that the incorporation of social enterprises, and their change to this type, require state approval. It also suggests that there is a perception that the operation of 'social' enterprises requires the existence of legislation on the part of the Peruvian state. Or perhaps there is confusion that oversight in areas such as labour or social matters encompasses the 'social' part. This perception influences the adoption of initiatives to create companies that highlight their social work without neglecting their economic activities.

3. STATE/PRIVATE CERTIFICATIONS AND METRICS FOR SOCIAL ENTERPRISES

As mentioned above, in Peru the notion of 'social enterprise' tends to be associated with the practice of CSR as a way of promoting sustainable development. In this way, for a typical Peruvian business to be considered as a social enterprise, it must comply with a group of 'social' practices. In this sense, first, companies that practise social responsibility not only have to safeguard the existence of financial information, but they have to report non-financial information to their investors and the rest of their stakeholders. Second, the operations, transactions and contracts produced by the activity of the business must include real evidence of consideration of ESG factors. Third, decision-making must involve the evaluation of additional factors, such as labour rights.

Currently, the Peruvian government does not evaluate and grant social certifications to local companies or qualify them as such. In 2016, there was an important public certification initiative which was promoted by Peruvian Ministry of Labour staff. It was called '*Certificación de empresas socialmente responsables*' and consisted of a certification system to validate real private CSR programmes. Regrettably, this public service never was put into action.[23]

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[23] For further references see: https://www.trabajo.gob.pe/PERU_RESPONSABLE/registro_certificacion.html.

More recently, the legal regime of Sociedades BIC has been implemented to assign a label to those companies that generate a positive effect on the environment or on social affairs. Sociedades BIC may be considered a sort of public certification, but since the promulgation of the relevant Act in 2020, few companies have adopted this certification. According to the Local Corporate Registry, there are just 10 enterprises that have adopted the label of 'BIC' or 'Sociedad BIC'.[24] There are many possible causes for the low uptake. First, the state has provided limited information about this status. It has rarely been the subject of social media reports, and it has not been introduced by the state to entrepreneurs, potential investors, think tanks, academia or business organisations. Second, the Peruvian Collective Benefit and Interest Company Act does not offer any potential incentives to companies or prospective companies that might adopt this status. They will not receive any benefit (tax or financial) beyond those available to conventional enterprises. Third, as will be demonstrated in survey results reported in more detail below, the perception among legal practitioners, entrepreneurs, CEOs, etc. is that the term 'social enterprise' is associated purely with social labour done by international organisations or NGOs.

There are in addition private certifications and designations issued by various organisations. These include the International Organization for Standardization (ISO), Social Accountability International (SAI), the Global Reporting Initiative (GRI), the OECD Guidelines for Multinational Enterprises, the Caux Round Table (CRT) Principles, and the Global Sullivan Principles. Inclusion in indexes such as the Domini 400 Social Index (DSI 400) or the Dow Jones Sustainability Index (DSJI) may also indicate a company's social or environmental bona fides. Companies may also opt to use the B Corp system or environmental, social and governance (ESG) criteria as decision-making tools.

In summary, Peruvian corporate law does not contemplate any obligatory rules for local businesses to obtain certification related to social criteria. In contrast, most private certifications relate to measuring whether a company is socially responsible (ESG). Even the Sociedad BIC, while providing a legal certification available to new or existing companies, is optional, little used and frequently confused with the practice of CSR. The optional nature of social enterprise (and CSR activity) in Peru makes its uptake largely dependent on the incentives (bonus or subsidies) adopting entities can receive from the state.

4. SUBSIDIES AND BENEFITS FOR SOCIAL ENTERPRISES

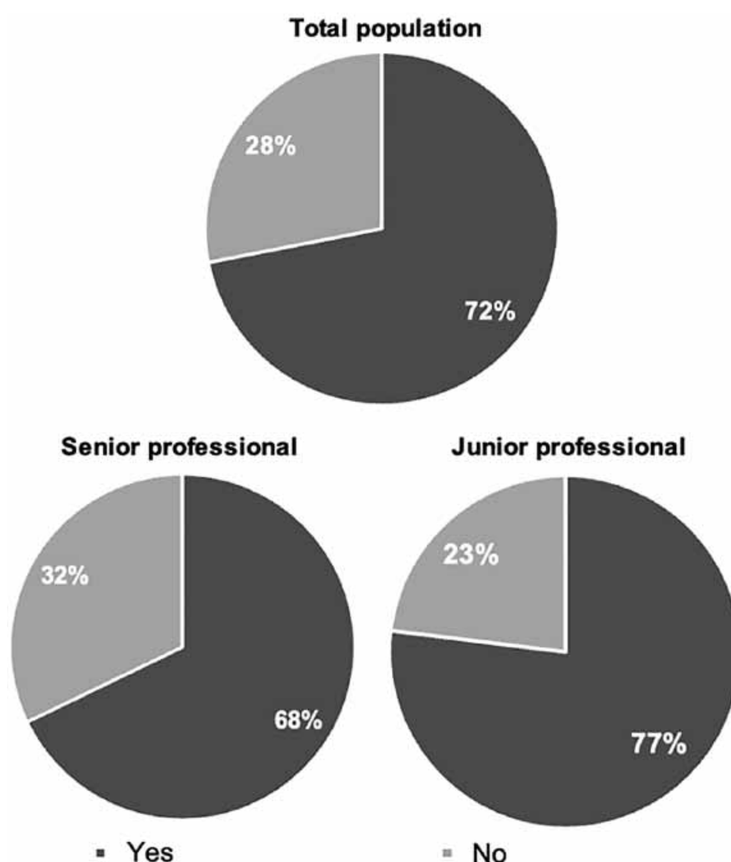
Peruvian law lacks incentives to encourage investors to consider financing a BIC business. Nor has the Peruvian government implemented direct subsidies and/or benefits for those companies that adopt the 'social' qualification or for

[24] The number of Sociedades BIC that actually exist in the market can be found at: https://www.sunarp.gob.pe/seccion/servicios/App/sociedades/consulta-sociedades-bic.asp.

their investors. However, there are certain tax benefits for those companies that carry out designated social activities. For example, the state may encourage employers to hire disabled people by offering an extra income tax deduction.[25] In addition, there is another income tax deduction in the case of local companies making donations in favour of private or public institutions.[26]

In order to obtain Peruvians' perception of the 'social' type of company, the following question was asked: do the 'social' type of companies that are registered with public entities enjoy tax, labour or other benefits? The answers are shown in Figure 7.

Figure 7. According to you, do 'social' enterprises that are registered with public entities enjoy tax, labour or other benefits?



Source: Produced by the rapporteur.

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25 See Article 47, Ley No. 2997, Ley General de la Persona con Discapacidad (General Law on Disabled Persons) (13.12.2012) https://spij.minjus.gob.pe/spij-ext-web/#/detallenorma/H1069864; Article 37, section z, Decreto Legislativo No. 774, Ley del Impuesto a la Renta (Income Tax Law) (30.12.1993) https://www.sunat.gob.pe/legislacion/renta/ley/capvi.pdf.

26 In accordance with Article 44, section d, Decreto Legislativo No. 774, Ley del Impuesto a la Renta (Income Tax Law) (30.12.1993) https://www.sunat.gob.pe/legislacion/renta/ley/capvi.pdf.

Figure 7 shows that 68% of senior professionals perceived that 'social' companies that are registered with public entities do enjoy tax, labour or other types of benefits, while 32% answered that they do not. Likewise, 77% of the junior professionals answered 'yes', while 23% said 'no'. In this regard, it can be seen that on both sides there was a clear trend toward 'yes'. Likewise, this trend was maintained in the total population, since 68% considered that 'social' companies do enjoy tax, labour or other benefits, while 32% did not.

In summary, Peruvian legislation does not contemplate direct benefits and subsidies for social enterprises other than the tax exemptions offered to all companies, in general, that carry out social initiatives aligned with their economic activity. The results of the survey, however, reflect several worrisome misperceptions. The first is that 'social' companies necessarily receive some kind of benefit, which may limit their existence in the market when investor interest should drive formation of social companies as well. In addition, this belief may generate the certainty that 'social' is related to subsidy or aid from the public or private sector, which is also inaccurate.

5. PRIVATE CAPITAL IN SOCIAL ENTERPRISES

Private capital of companies in Peru is supported by the Political Constitution of Peru (1993), which guarantees free enterprise, free private initiative, free competition and legal security, among other freedoms. In addition, the Framework Law for the Growth of Private Investment (Legislative Decree No. 757 of 1991) guarantees respect for private property and the free disposal of profits, among other freedoms. The security of private investments in companies does not vary when a firm has a 'social' orientation. For example, investors have the power to submit disputes related to their investment to national or international arbitration, as long as the dispute is of a private law or contractual nature, regardless of a firm's social commitments.

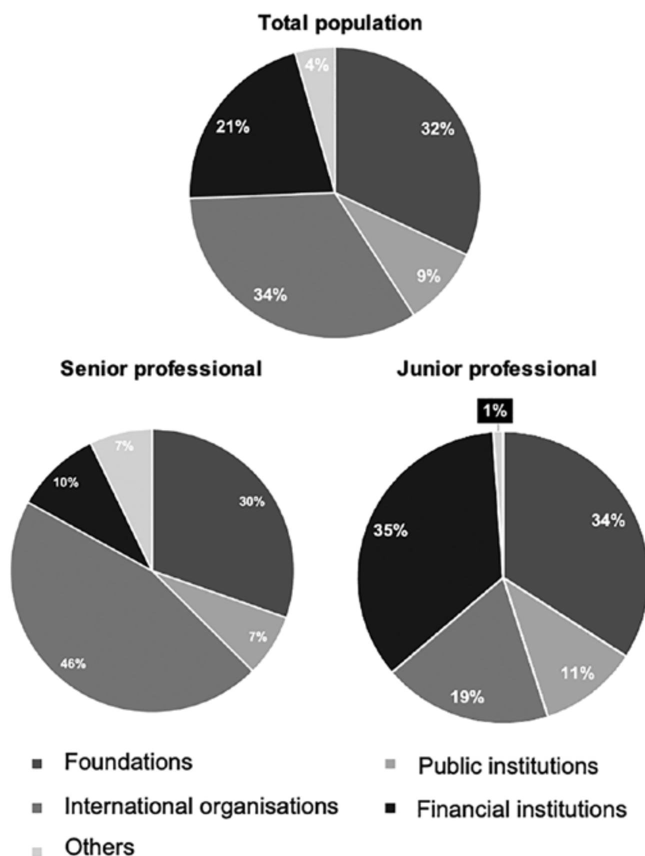
Both conventional and social enterprises are also free to issue stock to support their economic activities. Companies may list on the Lima Stock Exchange (Bolsa de Valores de Lima) to access public equity. The Peruvian Companies Act regulates many legal alternatives like contributions of shareholders (present or future), bond issues or estate sale of part of the company's assets.

Additionally, financing instruments like green bonds, social bonds and sustainable bonds that promote companies' transition to a low-carbon, climate-resilient economy and sustainable development are alternative means of raising capital. The purpose of these initiatives is to allow companies to access financing for expenditures falling within environmental and social categories. There is no

special legislation[27] regulating these vehicles, however. These bonds are issued according to the ordinary rules for debt financing provided by national statutes[28] and international soft law.[29]

The survey asked the question: what type of investors contribute to an enterprise with a 'social' connotation? The results are presented in Figure 8.

Figure 8. According to you, what type of investors contribute to a company with a 'social' connotation?



Source: Produced by the rapporteur.

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27 For public institutions there is a document named Peru Sustainable Bond Framework (R.M. 221-2021-EF/52).

28 Articles 304–343, Ley General de Sociedades (Companies Act) (09.12.1997) https://spijweb.minjus.gob.pe/wp-content/uploads/2021/05/LEY_26887.pdf; Articles 86–97, Ley del Mercado de Valores (Securities Exchange Act) (15.06.2002) https://www.smv.gob.pe/uploads/PeruLeyMercadoValores_002.pdf.

29 ICMA Green Bond Principles (2021), Social Bond Principles (2021), Sustainability Bond Guidelines (2021), and the United Nations Sustainable Development Goals (2015).

Figure 8 shows that the perception of senior professionals was that the types of investors that contribute to an enterprise with a 'social' connotation are international organisations (46%), foundations (30%), financial institutions (10%), public institutions (7%) and 'others' (7%). This last option included, for the most part, responses such as partners and private companies. It is important to note that 76% of senior professionals still consider that it is non-profit organisations that contribute to 'social' enterprises.

Unlike senior professionals, junior professionals considered for-profit financial institutions as the predominant source of capital for 'social' firms. Of this group, 35% indicated financial institutions were 'social' investors that contribute to an enterprise with a 'social' connotation, followed by foundations (34%), international organisations (19%), public institutions (11%) and 'others' (1%).

With respect to the total population, the types of investors contributing to an enterprise with a 'social' connotation were international organisations (34%), foundations (32%), financial institutions (21%), public institutions (9%) and 'others' (4%). Among the full survey group, it can be seen that the perception still persists that it is non-profit organisations that contribute to 'social' enterprises. This perception is worrisome because it demonstrates many Peruvian lawyers continue to associate social business with non-profit organisations funded by international organisations or foundations alone.

6. OTHER STAKEHOLDERS OF SOCIAL ENTERPRISES: INVESTORS, EMPLOYEES AND CUSTOMERS

Every Peruvian company, public or not, usually has permanent communication with a large number of its stakeholders. First, investors or shareholders who invest part of their money or goods in exchange for equity tend to get involved in management and decision-making too.[30] From this position, they may collaborate in the promotion of CSR practices in the company.[31] In the case of Sociedades BIC, investors have additional opportunities to ensure the

[30] G. Canessa and E. García, *El ABC de la Responsabilidad Social Empresarial en el Perú y en el Mundo,* Siklos S.R. Ldta. 2005, p. 41.

[31] Lastly in Peru, the movement of responsible investment is expanding among big investors (foreign or local). In this sense, they will be involved in promoting CSR management, best governance practices and sustainability reports, among others.

company's management and performance aligns with these adopted social and environmental principles.

In contrast, workers tend to have a more subordinate relationship with the company, receiving only financial compensation in return for their services to the company.[32] This group includes not only the company's employees, but also those who provide services for more than four hours a day through outsourcing or services.[33] Company management implements actions to benefit this group, such as respect for work–life balance, teamwork, volunteering, professional updating and compliance with labour rights, among others, as it chooses. Moreover, this stakeholder group has the obligation to comply with the policies, internal controls and corporate governance corresponding to the company's social mission.

Finally, customers are natural or legal persons who merely purchase the products or services provided by social enterprises in exchange for financial compensation. Social enterprises may implement actions that generate a positive impact on this stakeholder group, such as marketing with a social cause, responsible marketing or certification or standardisation of their activities, but they are not involved in governance.[34]

6.1. RELEVANCE OF THE 'SOCIAL' COMPANY WHEN ACQUIRING A PRODUCT OR SERVICE

In order to obtain Peruvians' perception of whether the 'social' connotation of a company influences their decision to purchase a product or service, the survey asked the question: when you purchase a product or service from a company, is it relevant that it has a 'social' connotation? The answers are shown in Figure 9.

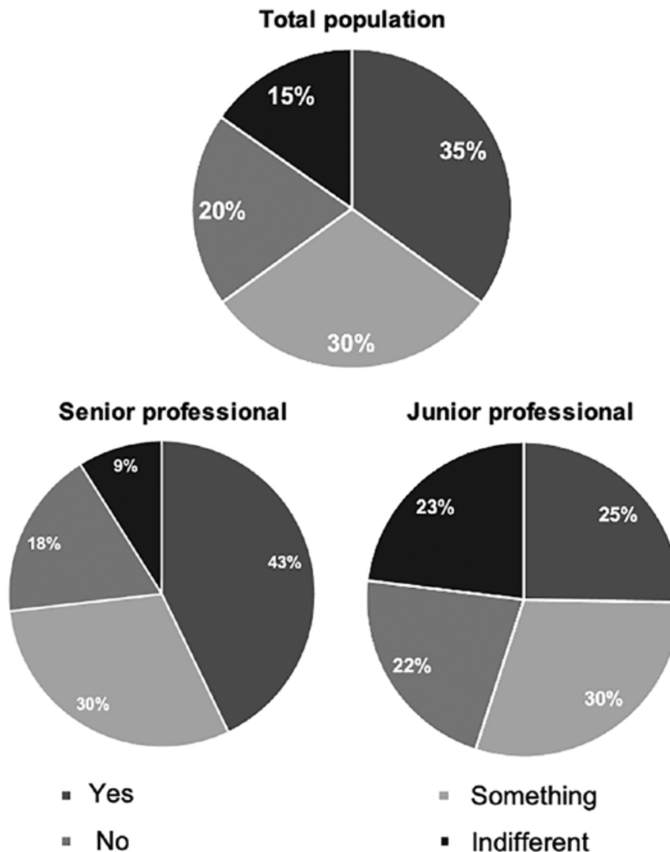
Figure 9 shows that the responses of senior professionals were 43% 'yes', 30% 'somewhat', 18% 'no' and 9% 'indifferent'. On the part of the junior professionals, the answers were 30% 'somewhat', 25% 'yes', 23% 'indifferent' and 22% 'no'. Notably, this suggests a greater concern for social issues on the part of seniors, while there is greater indifference on the part of young people. With respect to the total population, the responses were 35% 'yes', 30% 'somewhat', 20% 'no' and 15% 'indifferent'. In general, more than half of the respondents (65%) do take into consideration the social aspect of a company.

32 Article 4 of Decreto Legislativo No. 728, Ley de Productividad y Competitividad Laboral.

33 G. Canessa and E. García, *El ABC de la Responsabilidad Social Empresarial en el Perú y en el Mundo,* Siklos S.R. Ldta. 2005, p. 44.

34 Ibid., pp. 47–48.

Figure 9. According to you, when you purchase a product or service from a company, is it relevant that it has the connotation of 'social'?



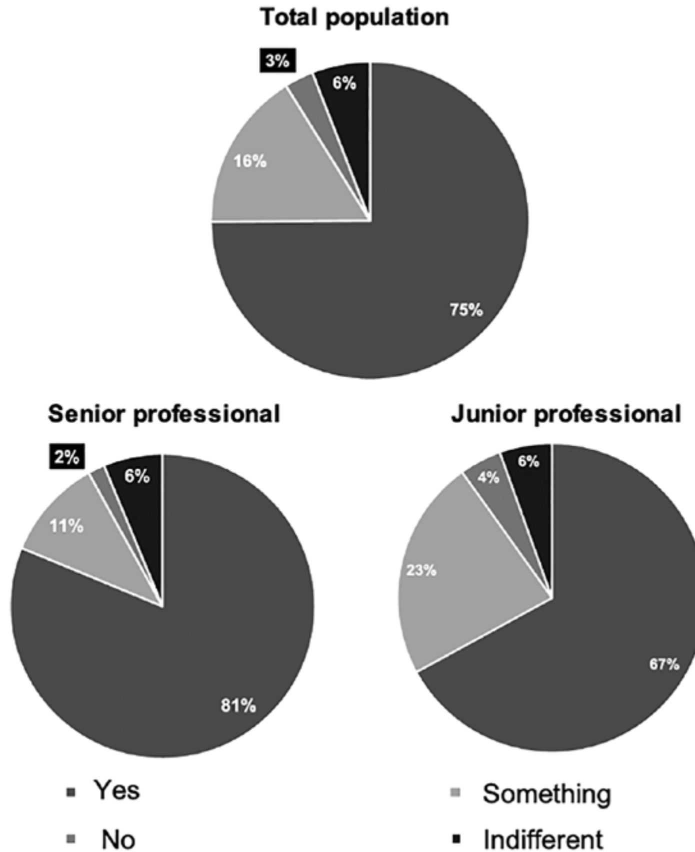
Source: Produced by the rapporteur.

6.2. INFLUENCE OF THE 'SOCIAL' TYPE OF COMPANY ON JOB PERFORMANCE

The survey asked the question: if you were a worker/employee of a company with a 'social' connotation, do you consider that its social mission would have a positive impact on your job performance? The answers are shown in Figure 10.

Figure 10 shows that the results for senior professionals were 81% 'yes', 11% 'somewhat', 6% 'indifferent' and 2% 'no'. In the case of the junior professionals, 67% answered 'yes', 23% 'somewhat', 6% 'indifferent' and 4% 'no'. As can be seen, there was a tendency for both parties to say 'yes', that is, that the social mission would have a positive impact on their work performance. Amongst the total population, 75% consider that the social mission of a company would have an

Figure 10. If you were a worker/employee of a company with a 'social' connotation, do you consider that its social mission would have a positive impact on your job performance?



Source: Produced by the rapporteur.

influence on their work performance, 16% somewhat, 6% are indifferent and 3% say that it would have no impact. In general, as in the previous question, it is notable that there is greater concern and appreciation for social issues on the part of seniors.

In the end, although the theory argues that CSR seeks to benefit a company's stakeholders (investors, employees and consumers), the data obtained shows that respondents, as potential consumers, do not value in their decisions the fact that companies carry out 'social' actions. The opposite happens when the surveyed public assumes the role of employee. In this case, most of them consider that their 'social' behaviour would influence their work performance. These results can be interpreted to suggest the idea of a 'social' company will be

better understood and more valued when stakeholders have a closer relationship with the organisation.

7. LAW PROPOSALS FOR SOCIAL ENTERPRISES

As of the date of this report, there are no new law proposals regarding social enterprise under consideration in Peru.

8. CONCLUSIONS

The notion of social enterprise in Peru is identified with social responsibility in general, and often with efforts of non-profit organisations supported by social aid funds or donations. There is also no special type of business dedicated to the promotion of social enterprise, and no special authorisation or permission from local authorities is required to engage in it.

Firms, however, may voluntarily opt to identify themselves using the Sociedad BIC label, which is a certification that involves extra legal requirements. Shareholders decide by themselves whether to include the denomination Sociedad BIC as part of their corporate name and to modify their bylaws and constitution accordingly. If so, these decisions will be certified by the notary and registered in the Corporate Registry. Peruvian corporate legislation has given competence to Indecopi to impose administrative sanctions (penalty fees) to oversee and to impose economic penalties on those Sociedades BIC which breach their promises with regard to the environment and society.

Peruvian legislation does not contemplate the provision of subsidies or direct benefits (tax or labour) for the category of 'social enterprises'. There are also no legal requirements for them to participate in the stock market other than those required for all those companies seeking to list. Local legislation on the promotion of private investments does not specifically regulate the security of investments in 'social' enterprises.

Misperceptions of the legal framework for social enterprise abound. For example, the study reported here suggests many consider that their potential investors would be limited to public institutions or international organisations. Whether the 'social' nature of a firm is important to Peruvians is also unclear. The study reported here suggests that potential employees are likely to consider that the connotation of 'social enterprise' would influence their job performance, but consumers are not likely to consider it when making purchasing decisions.

More detailed legal treatment of social enterprise is needed. To date, the Peruvian legislator has created the idea of the Sociedad BIC to promote management involvement in social and environmental issues. But this is not a new type of company, it only prioritises two social aspects, and it has little enforcement architecture and no associated benefits. Greater specificity would help ensure the conduct of associated companies is truly 'social' and proper to a 'social enterprise', and would give the concept greater influence.

SOCIAL ENTERPRISES IN POLAND

Szymon Byczko

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1. THE CONCEPT OF SOCIAL ENTERPRISE IN POLAND

Social enterprise (SE) does not have any definition in the Polish legal system.[1] None of the legislation uses this concept to describe an entity conducting business activity in support of a social mission. The case law of the Polish courts also does not use the concept of SE, but it is the subject of discussion. It is possible to find some typical characteristics of SE in many Polish constructions, but it has no legal meaning because of the lack of any binding regulation. Doctrinal statements also concern the comparison of the phenomenon of SE in Poland and other European Union countries.[2]

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[1] The legal situation was changed as of 30 October 2022 (which occurred after the principal drafting of this work) by the Social Economy Act. Some remarks on this very partial regulation are placed at the end of this report.

[2] For more details on SE as a socio-economic concept see J. Defourny and M. Nyssens (eds), *Social Enterprise in Central and Eastern Europe. Theory, Models and Practice*, New York/

Social enterprises in Poland operate mainly in areas typical for this type of venture in other countries.[3] These include agricultural production, processing and distribution of agricultural products, health care, cultural activities, education, and support for small businesses. Housing cooperatives and labour cooperatives also have quite a long history in the Polish legal system, and in the 1970s and 1980s enjoyed great popularity.

The literature states that in Poland there are about 1,100 entities that meet the characteristics of an SE provided by Ministry of Family, Labour and Social Policy.[4] These data are, of course, very approximate and difficult to verify because of the lack of a statutory definition of SE in Polish law. Research on this phenomenon was carried out as part of a wider project and can be considered relatively topical.[5] Even if there is no certification process for SE in Poland, it is recognised as a category in practice and there has even been a national competition for 'Social Enterprise of the Year' with 12 editions, organised by the Foundation for Social and Economic Initiatives in Warsaw.[6]

SEs have a relatively long and interesting history in Poland, including a connection with the struggle to regain independence during the partitions (1795–1918).[7] SEs (according to today's understanding of this phenomenon) were created as self-help organisations in all three partitions, pursuing the goals of economic self-help, self-education and maintaining a distinctive national identity. These organisations were associated with the circles of Polish entrepreneurs, the intelligentsia, and often with the support of the Catholic Church. During this period, one important SE that was created, and which exists (at least formally) to this day, is the cooperative PSS Społem. Established in 1868, this cooperative operates a chain of grocery stores. The general idea was to simplify the delivery chain, support producers, reduce prices and give some special benefits for clients, who are co-owners of the cooperative. It was especially important for poor peasants, giving them a chance to sell their products and obtain other types of support (cheaper loans, education, etc.).

London 2021; B. Doherty, H. Haugh and F. Lyon, 'Social Enterprises as Hybrid Organizations: A Review and Research Agenda' (2014) 16 *International Journal of Management Reviews* 417.

3 R. Richter, 'Rural social enterprises as embedded intermediaries: The innovative power of connecting rural communities with supra-regional networks' (2019) *Journal of Rural Studies* 179.

4 It is not based on any legal definition of SE, see A. Cieplewska-Kowalik and M. Starnawska, 'Social Enterprise in Poland: Institutional and Historical Context' in J. Defourny and M. Nyssens (eds), *Social Enterprise in Central and Eastern Europe. Theory, Models and Practice*, New York/London 2021, p. 148.

5 Ibid.

6 https://konkurs-es.pl.

7 See M. Biernacka, *Oświata a społeczno-kulturowe przemiany tradycyjnej społeczności wiejskiej od końca XIX wieku do odzyskania niepodległości* [Education and Socio-cultural Transformations of the Traditional Rural Community from the End of the Nineteenth Century to Regaining Independence], Etnografia Polska series, vol. XXVI z. 2, pp. 153–54.

However, in the period after 1945 there was a state seizure of self-help organisations. These organisations usually remained in their original legal form (mainly cooperatives) but were subjected to strict state supervision and their self-governance became a fiction. In the period from 1945 to 1989, it was also not possible for non-governmental organisations to operate in Poland.

After 1989, the possibility of unfettered operation of non-governmental organisations, including those engaged in SE, was restored. Those that were subjected to statisation during the communist period usually regained their independence, although it was a slow process. Today, PSS Społem exists as a classic cooperative, falling into the SE category. The example of this oldest Polish cooperative illustrates the changing fate of SE in Poland over the last 200 years.

Nowadays the most significant and recognisable SE in Poland seems to be the Wielka Orkiestra Świątecznej Pomocy (Great Orchestra of Christmas Charity) Foundation. It operates in the area of health care support and although it is based mainly on public generosity, it also conducts economic activity. The history of the Foundation dates back to 1991; since then it has collected over PLN 1.5 billion (US$350,000), mainly for the purchase of medical equipment. The Great Orchestra of Christmas Charity involves its members in many activities; for example, it offers support for medical training, which is repaid through work for the Foundation. From the wider perspective it might be seen as something more than simple charity, closer to the SE model. It is undoubtedly the best-recognised charity in Poland, although from the SE point of view it is unusual because economic activity is of secondary importance in it.

The biggest controversy in the SE sector in Poland is aroused by organisations built in cooperation with or on the initiative of various units of the Catholic Church. A very controversial example is the Lux Veritatis Foundation,[8] founded by an extremely traditionalist and intensely political faction of the Polish Church, gathered around Radio Maryja. The Foundation runs a nationwide television channel, Television Trwam, and conducts economic activities related to the exploitation of geothermal deposits. It is generously supported by state funds. The main controversies surrounding this SE relate to the ambiguities surrounding its funds (the way they are spent is secret, contrary to court decisions ordering disclosure) and its ideological involvement in the fight against 'gender ideology' (as its creators describe it). For the latter purpose, the Foundation spent US$83 million in the years 2009–2018.[9]

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[8] More about problems with the Lux Veritatis Foundation and its totally unclear, out-of-control commercial activities can be found at: https://siecobywatelska.pl/sprawa-lux-veritatis-miara-zawlaszczenia-panstwa-i-braku-praworzadnosci/.

[9] N. Datta, 'Tip of the Iceberg. Religious Extremist Founders against Human Rights for Sexuality and Reproductive Health in Europe 2009–2021', European Parliamentary Forum for Sexual & Reproductive Rights, Brussels 2021, p. 12.

There is no detailed research on the sources of SE funding in Poland. One can infer that those mainly engaged in running a business draw funds largely from this activity, while those focused on charitable activities receive funds from public generosity. But there is no data available to confirm this intuition.

Sometimes organisations working in the SE sector form complex structures using multiple entities to provide different sources of financing. For example, the Gajusz Foundation from Łódź does not run a business itself and receives generous support from the public. The Gajusz Foundation, however, is related to the 'PoMoc Foundation (both have the same founders), which carries out its business activity in the field of medical care. Funds from the PoMoc Foundation are transferred to support the Gajusz Foundation – as donations. This is a typical model for combining the competencies and capabilities of two entities to achieve an optimal structure for achieving an SE's objectives.

2. LEGAL FORMS OF SOCIAL ENTERPRISE IN POLAND

There is no specialised, separate legal form for the SE in the Polish legal system. Instead, organisations engaged in SE in Poland typically organise as cooperatives, although an SE may also utilise the foundation, association or even limited liability company forms. The concept of a 'public benefit organisation' (PBO), described in the Act on Public Benefit Organisations and Volunteering,[10] is also relevant. According to this Act, any legal person may qualify for PBO status, but its activity must remain non-profit and for the public benefit. It is not recognised by law as commercial activity and any economic activity conducted by a PBO must be incidental only. PBO status does function as a label for legal persons conducting non-profit or public benefit activity, which aligns with the concept of SE, but its commercial limitations distinguish it from the SE concept. In essence, this designation primarily enables non-profit organisations to conduct additional economic activities in support of their main goal. This would not be in line with a concept of SE that considers economic activity to be an entity's main goal, while also pursuing social goals.

Differences between SE and typical forms of economic activity in Poland must be made on the basis of doctrinal criteria, due to the lack of a statutory framework for such entities in the Polish legal system. Therefore, the entity examined must be assessed in the light of the criteria given as typical of the SE in the literature. As mentioned above, an SE may take different forms in the

[10] Act of 24 April 2003 on public benefit activities and volunteering, Dz. U. 2020/1057.

sense of legal personality. A typical company, cooperative or foundation must therefore be tested on the basis of the following criteria:[11]

- the private nature of the organisation (in terms of ownership and decision-making structure);
- the way the profit is distributed, which corresponds to the assumptions according to which the SE carries on its economic activity, but the distribution of profit takes account not only of the needs of investors but also of the social objectives pursued by the entity;
- the purpose of the activity must correspond to socially useful needs, have a positive impact on the environment (social, cultural, natural, etc.) of the entity itself; and
- the rules for the management of the entity must correspond to the SE's scheme, including the participation of employees, customers or beneficiaries of such an entity.

All the legal forms indicated above allow these characteristics of the SE to be assumed. The regulations of Polish law are flexible in this respect and allow founders to build an entity that carries out its business activity in a manner corresponding to the SE structure. Therefore, SEs can operate using the legal form of cooperatives, foundations, associations or limited liability companies.

2.1. COOPERATIVES

As indicated above, cooperatives have a long tradition in Polish law, dating back to the period before the reconstruction of the state in 1918. The legal requirements for cooperatives are quite complicated, as they can be found spread across several legislative acts separately regulating individual types of cooperatives.

The basic legal act regulating the purpose, structure and principles of operation of cooperatives is the Cooperative Law.[12] The basic principles for this type of legal person make it suitable for an SE to carry on its business in Poland. Cooperatives are created for the purpose of conducting economic activity, but the law clearly provides that this activity is carried out: 'in the interest of its members'.[13] This is a different construction than in the case of, for example,

[11] K.E. Sørensen and M. Neville, 'Social Enterprises: How Should Company Law Balance Flexibility and Credibility?' (2014) 15 *European Business Organization Law Review* 277.

[12] Act of 16 September 1982 on Cooperatives, Dz. U. 2021/648.

[13] A. Zbiegień-Turzańska, 'Organy spółdzielni' [Cooperative governance] in K. Pietrzykowski and A. Zbiegień-Turzańska (eds), *System Prawa Prywatnego*, vol. 21 Prawo spółdzielcze, Warsaw 2020, p. 296.

companies, where business activity is carried out in the interest of this legal person, and not its founders or shareholders.[14]

The close connection between the cooperative and its members is also apparent from the legal treatment of the cooperative's assets. According to the Cooperative Law, this property is 'owned by the members of the cooperative'. This means, of course, 'ownership' only in the economic and not legal sense, but this wording of the provision indicates that the cooperative's assets are to be used for cooperative members, and not only for the simple maximisation of the profit of a legal person.[15] This is particularly important in the case of, for example, housing cooperatives, which will be discussed later.

Cooperative law also provides for participation of cooperative members in the management of a cooperative, regardless of the value of contributions they have made to it. The principle of cooperative democracy is reflected in the rule that the highest body of the cooperative is the assembly of cooperatives, in which each member of the cooperative has one vote. Again, this principle differs radically from the rules of company governance, where the decision-making power of a shareholder depends on his or her investment in the capital stock of the company.

The Act also allows cooperatives to engage in non-economic activities to meet the needs of cooperative members, including cultural, educational and entertainment activities.

The Cooperative Law lists certain types of cooperatives, which are regulated in ways specific to the type of activity or the purpose for which they are established.

2.1.1. Agricultural Cooperatives

Agricultural cooperatives are organised to build a farm, which will then be run by the members themselves. As a rule, persons forming a cooperative contribute their agricultural land to it in order to obtain a large, efficient economic venture. However, the Act allows membership in such a cooperative of persons who do not own real estate, if it is justified by their qualifications useful to the cooperative. This type of cooperative is not very popular, probably due to their association with a period of forced collectivisation and an attempt to liquidate individual farms in the 1950s. As a result of this process, many people were forced to give up their own economic activities, and the forcibly created cooperatives were a symbol of inefficiency and waste. Today, however, there are several efficient and well-functioning cooperatives of this kind.

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14 On the company's interest, see S. Sołtysiński, 'Interes spółki. Wspólnicy i Interesariusze' [Interest of the company. Partners and Stakeholders] in S. Sołtysiński and P. Moskwa (eds), *System Prawa Prywatnego*, vol. 17A Spółki kapitałowe, Warsaw 2015, p. 37.

15 M. Wrzołek-Romańczuk, 'Pojęcie spółdzielni' [The concept of cooperatives] in K. Pietrzykowski and A. Zbiegień-Turzańska (eds),*System Prawa Prywatnego*, vol. 21Prawo spółdzielcze, Warsaw 2020, p. 38.

2.1.2. *Work Cooperatives*

Work cooperatives aim to organise jobs for the members of the cooperative and to organise it efficiently. This form of cooperative is not very popular, but a variation of work cooperatives called *disabled workers cooperatives* is particularly relevant to SE. The main goal of these cooperatives is to provide an environment enabling rehabilitation and elimination of exclusion for people with disabilities. In this type of cooperative, the profit and profitability of economic activity are secondary to the needs of the disabled persons themselves.

The Act also provides for the possibility of creating *cooperatives for the work of folk and artistic handicrafts*. These cooperatives aim at bringing together people engaged in artistic activities, as well as to cultivate traditional art forms, regional customs and national minorities.

2.1.3. *Housing Cooperatives*

Housing cooperatives are regulated by a separate Act.[16] They are formed to meet the housing needs of the members of the cooperative and limit their activities to the construction, operation and maintenance of residential houses, including the accompanying necessary infrastructure. The heyday of housing cooperatives was in the 1970–1990s, when huge districts of apartment blocks were built by cooperatives. It should be noted, however, that in those days they were cooperatives in name only, and the principles of their management and especially the allocation of housing to the members of cooperatives strayed far from the principles of cooperative democracy. At that time, members of housing cooperatives held both rights to participation in the cooperative and special, limited rights to apartments therein. For example, the apartments could be sold only to other members of the cooperative. This complicated system no longer applies, and members of housing cooperatives became regular owners of their apartments.

After 1989, large housing cooperatives gradually split up, and many of them disappeared because the members of the cooperative considered co-ownership of residential buildings to be a more effective form of management than a housing cooperative. Currently, housing cooperatives are most often created as a legal form for the creation of housing estates of independent residential houses. Still, the old, powerful housing cooperatives manage a huge number of apartments in Poland, but often their efficiency is low and in such large organisations it is difficult to maintain the principles of cooperative democracy.

[16] Act of 15 December 2000 on Housing Cooperatives, Dz. U. 2021/1208.

2.1.4. *Social Cooperatives*

Social cooperatives are the latest type of cooperatives defined by a specialised Polish law.[17] The purpose of a social cooperative is to run a business. However, the purpose of its activity is not so much to make a profit, but instead to socially reintegrate the members and employees of the cooperative or facilitate their employment. A social cooperative may be established only by persons who are beneficiaries of its activity, for example unemployed people, disabled people, or people requiring support in gaining independence in social or professional life. Other persons may be members of the cooperative only to a limited extent.

These cooperatives are therefore geared towards socially useful activities aimed at helping their members or employees. The Act provides rigid rules for the distribution of the profit of a social cooperative, which should be allocated in a significant part to the implementation of the objectives referred to above. The Act also allows social cooperatives to be supported by public funds. The catalogue of tasks for which a social cooperative can be established is quite narrow, and partly intersects with the objectives of disabled workers cooperatives mentioned above.

The multiplicity of legal regulations comes from very different stages of Poland's development and their lack of coordination discourages the establishment of cooperatives. However, this legal form can be successfully used to create an SE. It has a private law character, runs a business, and can be aimed at satisfying the needs of people beyond just its members. The principle of cooperative democracy also fits into the concept of the SE, providing an important role for the members of the cooperative in its management. There is nothing to prevent the statutes of the cooperative from laying down rules for the distribution of profit which will serve the attainment of socially useful objectives envisaged as a task financed by the economic activity of the cooperative.

2.2. FOUNDATIONS

The legal regulation of foundations in Polish law is very weak.[18] The Act on Foundations regulates only basic issues, including the objectives of foundations, which should be socially or economically useful. Polish law does not provide for any minimum contribution necessary for the establishment of a foundation, which makes it possible to create a foundation without initial assets. A controversial issue is whether a foundation can act in the interest of the people who founded it, which in practice is quite common. Sparse legal regulation

[17] Act of 27 April 2006 on Social Cooperatives, Dz. U. 2020/2085.

[18] Act of 6 April 1984 on Foundations, Dz. U. 2020/2167.

allows for any shaping of the rules for the distribution of profit, and tax law regulations provide for exemption from taxation of the part that is transferred for statutory purposes.

Polish law allows foundations to conduct business activity, which enables them to be used for creating an SE. Moreover, the Act on Foundations does not limit the size of the commercial activity carried out; it is possible for this activity to become the main subject of the foundation's activities.[19] Undoubtedly, it can then act for the benefit of the beneficiaries of the foundation, pursuing a socially useful goal. However, it is unlikely to be possible to create a foundation acting in the interest of the people who created it, for example providing some non-financial benefits for themselves like health care or education. This is because the law does not provide for the distribution of profit among the founders; it is only possible to use other services on the part of the foundation, for example health or educational services. Even in the event of the liquidation of the foundation, its assets do not return to the founders, but are transferred to a social purpose that is consistent with the purpose of the foundation.

Due to the very modest regulation, any provisions regarding the participation of beneficiaries in the management of the foundation must be provided for in the statutes. The Act does not prevent these persons, for example, from deciding on the day-to-day operation of the foundation, the allocation of its funds, etc.

Foundations are subject to only limited control by public authorities. Foundations submit current reports on their activities and are subject to random control by local government bodies.

2.3. ASSOCIATIONS

The Act on Associations regulates two types of associations:[20] *stowarzyszenia zwykłe* ('ordinary associations') and *stowarzyszenia rejestrowe* ('registered associations'). Ordinary associations cannot have legal personality and may not carry on an economic activity, which excludes them from the list of entities suitable for an SE. In contrast, registered associations are legal persons, and the Act allows them to conduct business activity. An association (ordinary or registered) may be formed for any legal purpose. The association acts in the interest of its members, but it is prohibited from activities meet the needs of other people as well. An example of a registered association is the Polskie Towarzystwo Turystyczno-Krajoznawcze (PTTK, Polish Tourist and Sightseeing Society), which deals with tourist guidance, maintenance of tourist routes and

[19] P. Mikołajczak, 'Becoming Business-Like: the Determinants of NGO's Marketization Turning Into Social Enterprises in Poland' (2019) 10(3) *Oeconomia Copernicana* 538.

[20] Act of 7 April 1989 on Associations, Dz. U. 2020/2261.

hostels, and other activities in the interest of its own members and other people who use tourism infrastructure. In addition, various benefits of participating in the association are provided for the members of the PTTK, such as discounts for touristic equipment, special prices for guidance, etc.

If an association conducts economic activity, it is barred from distributing the profit from this activity among the members of the association. The law provides for the management of the association based on the principles of democracy and direct participation of members.

The above-mentioned features allow the association to be used to create an SE to a certain extent only. In particular, the impossibility of distributing the profit generated among the members of the association limits the possibility of acting on their behalf and excludes 'attracting investors'.

Associations, like foundations, are subject only to limited and random control by local government bodies.

2.4. LIMITED LIABILITY COMPANIES

The provisions of the Polish Commercial Companies Code[21] provide for the possibility of establishing a limited liability company for purposes other than conducting business activity. The purpose of the company may be indicated freely, as long as it is in accordance with the law. It can be a socially useful purpose, and a company can even be created for non-profit, charitable or similar purposes.[22] It is therefore possible to set up a company that will pursue non-economic or mixed purposes, combining economic activity with other, socially useful ones. The regulations concerning this type of company mostly establish default rules only, which gives the possibility of a very flexible use of the legal form described here.

The Commercial Companies Code allows individual adopting firms to enable the participation of persons outside the company in governance, for example in the selection of its bodies. This may apply to both the election of members of the executive bodies (management board) and supervisory bodies (supervisory board). Generally members of both are elected by shareholders. However, it is possible to create special rights for employees, clients, beneficiaries, etc. of a company to elect some members of any board. It is also possible to create a special position within the board for such a 'special' member, for example giving him or her a decisive vote in some cases.[23]

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21 Act of 15 September 2000, Companies Code, Dz. U. 2020/1526.

22 S. Sołtysiński, 'Cel spółki' [Purpose of the company] in S. Sołtysiński and P. Moskwa (eds), *System Prawa Prywatnego*, vol. 17A Spółki kapitałowe, Warsaw 2015, p. 30.

23 Similar constructions are known in the Polish legal system. See the Privatization Act of 1990: 'The company's employees elect one-third of the members of the supervisory board.'

The Commercial Companies Code also does not prevent the modification of the rules for the distribution of profit.[24] An individual company may adopt rules that provide for the obligatory transfer of part of its profit to social, charitable purposes, indicated in the company's statute.

The flexibility of Polish company regulation allows for very precise adaptation of such a company to the needs of a specific project. Importantly, the freedom here is greater than in the case of cooperatives because the provisions of cooperative law are mostly mandatory. However, changes to the default structures of the company made through the articles of association can be amended, a process in which only shareholders may vote. Therefore, shareholders with an appropriate majority of votes will always be able to change the structure of the company, depriving it of the features suitable for SE. In addition, the tax law does not provide for any benefits related to the non-commercial (or mixed) purpose of a company's operations. Therefore, even that part of the profit that will be transferred to socially useful purposes will be fully taxable.

One serious advantage of a limited liability company compared to other legal forms is its ability to attract investors. Cooperatives do not provide attractive investment opportunities, as they do not provide specific benefits for people who have made large contributions. Members of a cooperative are treated equally, regardless of the amount of capital involvement. Foundations and associations are even more unattractive in terms of investment, as distribution of the benefits among their members is not allowed. A limited liability company allows for the combination of investment goals with socially useful goals. As a shareholder, an investor remains interested in maximising profit, because he or she has a stake in it. Shareholders also have the opportunity to sell their shares at a profit in the event of the company's economic success. The legal forms discussed earlier do not provide such possibilities, and thus will struggle to attract equity capital.

2.5. GENERAL ASPECTS OF LEGAL FORMS FOR SOCIAL ENTERPRISE

Although the idea of SE does not map perfectly onto any of the existing legal forms available under Polish law, the permissible purposes and activities of a cooperative, foundation, association or limited liability company can all accommodate SE. All may indicate a social objective and can also conduct business activity as the basis for generating profit intended for the implementation of those social objectives. But other elements of some forms will be more easily adapted to SE than others.

[24] A. Herbet, 'Prawa wspólników' [Shareholder's rights] in S. Sołtysiński and P. Moskwa (eds), *System Prawa Prywatnego*, vol. 17A Spółki kapitałowe, Warsaw 2015, pp. 428–29.

The distribution of profit between participants, which might be crucial for potential investors, is possible only in the case of a limited liability company. In the case of foundations and associations, it is not possible to transfer profit to participants. It is only possible to provide them with other benefits, for example benefits in services, training, care, etc. In the case of cooperatives, the situation is complex because the law does not preclude the distribution of profit among the members of the cooperative, but in practice they typically benefit from participating in the cooperative in another way: by providing them with a job, housing, services, etc.

Each form will allow at least a portion of profits to be allocated to the social purposes indicated in the founding act of the entity. Depending on the nature of the entity, however, it may not be possible to so dedicate all profits. For example, cooperative law provides that the entity acts in the interest of its members, so it would be unacceptable to allocate the profit entirely to 'external' purposes.

The ability of beneficiaries, employees and other persons to participate in management also varies by legal form. The law on cooperatives provides for participation in management only for the members of the cooperative themselves. However, they are covered by the principle of cooperative democracy, which should guarantee them a significant and real impact on management. The situation is similar in associations. In other entities, the participation of beneficiaries, employees and other persons in management or co-management is also possible, but depends on the will of the founders and/or shareholders. The appropriate formation of the articles of association or the statutes of the foundation may provide for a wide range of participation of these persons in management or control.

The transfer of participation is possible only in the case of a company. Other entities provide only for the possibility of resigning from membership and accepting a new member. In the case of a foundation, due to the nature of this entity, this issue is outdated; one can only transfer the rights of the founder to another person.

Transformations, such as divisions and mergers, are also possible only between homogeneous categories of entities. It is not possible to transform a foundation into a company or cooperative, for example.

It would be useful to create a specialised entity for SE that combines the features of a cooperative and a company, perhaps by modifying, simplifying and deformalising cooperative law. Compared to the legal forms presented above, such an entity should have the following characteristics. Flexibility of design is paramount, allowing adaptation to the needs of a specific type of activity, including the freedom to choose the subject of activity of a non-commercial or mixed nature. Freedom in determining the rules for the allocation of profit is also important, both to allow distribution among participants and to permit allocating profit in whole or in part for other purposes.

Freedom to change the participants, like the rules in a limited liability company, is also very important. In some activities (health care, education) the group of interested persons may fluctuate, necessitating changes to those participating in SE governance. For example, there is no sense in participation in a housing cooperative by someone who already sold his or her apartment. It would also be advisable to solve the problem of transformations of such an entity, allowing for division and merger in particular circumstances. An initially chosen legal form may became obsolete in light of new or expanded activities or may not attractive for the potential investors that are necessary to scale. For example, a small foundation might develop over time into a large business, but under current Polish law there is no legal way to transform such a foundation into a company or cooperative. Any transformation is possible only within company law.

3. LIFECYCLE

All of the legal entities described follow a similar lifecycle according to general rules of Polish private law. Beginning a legal entity is the decision of the founder, who will engage in the act of founding and build out the principles for how the entity will function. In the case of foundations and associations, this process is divided into two stages: the decision to establish a legal entity and creating its statute. In the case of cooperatives and companies, it is a homogeneous act, in the form of an agreement or statutes. A limited liability company gains the ability to function independently as soon as the contract is drawn up as a 'company in the organisation' (*spółka w organizacji*).

No preliminary approval from the public authority is required for the establishment of any of these legal forms; each is created at the moment of entry into the Polish Court Register.[25] An application for entry into the Court Register is subject only to formal assessment. The register will contain current substantive and financial statements as well as information on changes made to the founding acts. The register is public and accessible to anyone, including online.

The only requirements for persons who are members of the governance bodies of these legal forms is that they be natural persons with full capacity for legal acts. For entities that obtain the status of a PBO, however, persons holding positions in governance must not have an economic relationship with the entity outside the employment relationship. It is also forbidden for a PBO to grant loans, donations or leases of property, or to engage in transactions with persons sitting on its bodies. Members of executive bodies may not sit simultaneously on supervisory bodies and may not be related to those persons who do.

[25] Polish Court Register Act of 20 September 1997, Dz. U. 2021/112.

The decision to terminate the functioning of a legal entity is left to its ownership body except for situations provided for by law (e.g. in the event of bankruptcy). Such a decision cannot be influenced by the employees or beneficiaries of such an entity. After the decision to terminate comes the liquidation stage, which is aimed at terminating the entity's activity, disposing of its property and satisfying any claims against it. The existence of a legal person ends at the moment of deletion from the Polish Court Register. In the case of cooperatives and companies, the assets after liquidation are normally divided among the participants of these legal persons. In the case of foundations and associations, assets must be allocated to a social purpose that coincides with their purpose.

4. CERTIFICATION OF SOCIAL ENTERPRISES

There is no certification process for SEs under Polish law. As noted above, entities can be certified as public benefit organisations after verification of the required features by the Polish Court Register. During their operations, PBOs must report on their activities to the Committee for Public Benefit, a public authority. This committee supervises PBOs and may request that an entity should be removed from the PBO register. This decision is ultimately made by the registry court.

Of course, some Polish SEs are certified by foreign institutions like B Lab, but private certification in Poland has no real meaning.

5. BENEFITS OF SOCIAL ENTERPRISE STATUS

Polish law does not provide any benefits specifically for SEs or their investors, as the SE is not a separate category within tax or other law. An SE may benefit indirectly result from regulations concerning certain of the legal forms they utilise. For example, the statutory activity of a foundation is exempt from taxation. However, benefits like these are driven solely by foundation regulations; the status of an organisation as an SE has no bearing on them.

In the case of PBOs, profits spent on statutory activities are exempt from income tax.[26] There are also some special legal rules targeting donors, but these are not very significant. Donors may earmark 1.5% of their income tax for PBOs,[27] which creates some flexibility in how tax money is spent, but does not provide donors with personal financial benefits.

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[26] Act of 15 February 1992 on Corporate Income Tax, Dz. U. 2022/2587.

[27] Act of 24 April 2003 on public benefit activities and volunteering, Dz. U. 2020/1057.

The lack of tax or investment benefits or preferences greatly limits the scope of investment in SE in Poland. Depending on the nature of a particular SE, investors or persons otherwise supporting such organisations act for either purely altruistic reasons, as donors, or act as investors expecting mainly profit maximisation. The impossibility of linking purely commercial activities, which are attractive to investors, with public benefit activities greatly limits the attractiveness of the SE in Poland. Although the Cooperative Law contemplates the possibility of cooperatives conducting other activities, for example cultural activities, this is not widely utilised. If such non-commercial activity is carried out, it is typically no different from the activity undertaken by purely commercial entities. On the other hand, entities focused mainly on activities supporting others (e.g. charity) do not attract investors because they cannot offer them a share in the profits.

6. POSSIBLE CHANGES IN LEGAL REGULATIONS

For the time being, Polish law only foresees the possibility of non-profit organisations conducting business activity, but it does not deal with the opposite idea: socialisation of economic activity. Any changes should begin with the examination and inclusion of the SE phenomenon itself in separate regulation. In doing so, it will be important to distinguish SEs from PBOs, as dealing with entities intended to conduct economic activity in support of social objectives. In defining SE under Polish law, the carrying on of economic activity should be the starting point. Elaborating the definition further would require careful consideration, taking advantage of foreign experience, but also the long-standing SE traditions in Poland.

The next step should be to analyse the existing legal situation with regard to the entities typical of the activities of an SE. Work should focus on simplification and clarification of the legal regulation of cooperatives, to make this form more attractive to investors. Changes in the structure of a limited liability company are also possible, especially when it comes to conducting its non-strictly economic activity. For example, a company acting as an SE should ensure some form of participation of beneficiaries or employees on supervisory board. Of course, it is possible to create such a provision in the articles of association, but they might be changed anytime by shareholders. Solutions provided by the European Company[28] (perhaps a simplified version) might be a useful model for such a solution.

After establishing certain fundamental principles regarding SE, Poland should consider providing benefits to these entities under its tax law. It should

[28] Act of 4 March 2005 on European Company, Dz. U. 2022/259.

also address profit distribution, investments and facilitation of the transfer of funds between entities in this further stage of work.

Before concluding, it is necessary to mention Act of 5 September 2022 on Social Economy.[29] It came into force at the end of 2022 (30 October 2022), some time after this report was prepared. This Act mentions SE, but it seems that the meaning of SE in the Act is rather different from the understanding applied here. The Social Economy Act describes SE as a special status available to other forms of organisations: PBOs, social cooperatives, foundations and some others, like legal persons created by Catholic Church and other legally recognised Churches in Poland. To qualify, their activities are limited to only two goals: social reintegration and social services. Although other jurisdictions offer special SE certifications for firms taking a variety of legal forms, SE status being available to a company, any kind of cooperative, a foundation, etc. is a novel concept in Poland. Notably, too, this status contemplates a commendably broad freedom of activity: permissible activities for SEs are not described or limited by the state but only by the needs of the community and the imagination of their creators. Thus far, however, review of the list of SEs created on the basis of the Act[30] demonstrates a fairly narrow field of operations. This list includes only NGOs, social cooperatives and foundations, and they do not really connect business with social targets in a single entity.

[29] Act of 5 August 2022 on Social Economy, Dz. U. 2022/1812.
[30] http://www.bazaps.ekonomiaspoleczna.gov.pl.

SOCIAL ENTERPRISES IN ROMANIA

Lucian Bercea

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1. INTRODUCTION: ECONOMIC SOLIDARITY IN ROMANIA

After the decades of economic development at the beginning of the 20th century, during the communist regime, between 1947 and 1989, Romania experienced a planned economy, in which companies were nationalised. Private initiative

was dramatically limited and profit maximisation was not the main goal of the economic activity of the state enterprises.[1]

Since 1990, Romania has had a market economy, based on free initiative and competition (principles established by the 1991 Constitution), in which the state must ensure inter alia: the freedom of trade and the protection of fair competition; the implementation of a favourable framework for the enhancement of the factors of production; the protection of national interests in economic activity; financial and foreign exchange activities; the exploitation of natural resources in the national interest; the protection of the environment; the maintenance of the ecological balance; the creation of conditions necessary for the improvement of the quality of life; and the implementation of regional development policies in accordance with the objectives of the European Union.[2] Free access to economic activity, free initiative and their exercise in accordance with the law are constitutionally guaranteed.[3] The state has the obligation to take measures for economic development and social protection to ensure a decent standard of living for its citizens.[4]

Economic solidarity is not explicitly stated as part of the legal framework applicable to economic agents in general.[5] In contrast to the substantial

1 After the Second World War, Romania fell under the influence of the Soviet Union, like other Central and Eastern European countries, and the Romanian economy underwent a radical reform. The vast majority of private enterprises were nationalised, and the state enterprise became the main economic agent, the vehicle of the socialist planned economy. A series of regulations (e.g. Act no. 11/1971 on the organisation and management of socialist state enterprises; Act no. 5/1978 on the organisation and management of socialist state enterprises and their operation on the basis of workers' self-direction and economic-financial self-management; Act no. 6/1988 on the legal status of socialist enterprises based on the principles of workers' self-management and economic-financial self-management, etc.) gradually increased the strict economic planning of the state and the influence of the centralised political decision-making on the activity of state enterprises. From 1947 to 1989, private economic initiative was considerably limited. These premises justify the reluctance of the Romanian transition (post-1990) legislator to create institutions and mechanisms that could be blamed, on the one hand, for reproducing a 'solidarist' model and, on the other hand, for perpetuating the expectations of a certain part of the Romanian population to be assisted by the state.

2 Art. 135 Romanian Constitution. The Romanian Constitution does not explicitly protect the consumer against the illicit commercial practices of economic organisations (L. Bercea, 'Fundamentele constituționale ale protecției consumatorului', *Pandectele Române* no. 12/2011, pp. 34–51).

3 Art. 45 Romanian Constitution.

4 Art. 47 Romanian Constitution.

5 Conceptually, the new Romanian Civil Code establishes a necessary connection between the patrimony of the legal person and the fulfilment of a purpose in accordance with the general interest: every legal person must have an autonomous organisation and its own patrimony, assigned to the fulfilment of a lawful and moral purpose, in accordance with the general interest (Art. 187 Romanian Civil Code). This condition should not necessarily be understood as imposing the pursuit of a general interest, but as preventing the particular aim pursued from contravening public order (R. Rizoiu in M. Nicolae, V. Bîcu, G.-A. Ilie and R. Rizoiu, *Drept civil. Persoanele*, Universul Juridic, Bucharest 2016, p. 282).

intervention of the state in the economy during the communist regime, in the post-1990 period there has been a certain reluctance to impose any limitations on the profit-oriented purpose of private economic activity. The fiduciary obligations of the directors of commercial companies to pursue the interests of the shareholders and to maximise profits (under the protection of the business judgment rule)[6] represent a real barrier to achieving goals other than the welfare of the business owners and the maximisation of the value of the investors' holdings.[7] The protection of minority shareholders in business corporations does not prevail over the social interest either.[8] In addition, the protection of corporate creditors does not exceed the limits of the company's assets except in cases of an abuse of legal personality (piercing the corporate veil), since the creditors generally share the risk of the business's failure along with the shareholders.[9]

However, particularly in the last two decades, economic organisations and legal mechanisms have been regulated that can be integrated into the spirit of the economic solidarity, as a recent trend in European legal systems. However, these developments have a rather marginal effect on the strong shareholder primacy norm governing for-profit entities. This analysis will focus on reviewing the social enterprise under Romanian law.[10]

2. CONCEPT AND PRINCIPLES

2.1. CONCEPT

The concept of the social economy – including the social enterprise sector, but also other concepts such as the non-profit sector and the volunteering sector – enjoys a medium degree of recognition in the Romanian legal system. However,

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6 L. Bercea, 'Business Judgment Rule and the Romanian Legal Culture', *Romanian Journal of Comparative Law* no. 1/2011, pp. 80–94.

7 Act no. 31/1990 on companies imposes on the directors the obligation to carry out their mandate with diligence, prudence, and loyalty towards the company.

8 Act no. 31/1990 on companies provides that the rights of shareholders must be exercised in good faith, respecting the rights and legitimate interests of the company and of other shareholders. Mechanisms for the protection of minority shareholders include actions for the annulment of decisions of the general meeting of shareholders, liability actions against directors, actions for the appointment of management experts to review the operations of directors, or certain mechanisms for the withdrawal from the company.

9 Act no. 31/1990 on companies requires the partners who, as a rule, are liable for the company's obligations in a limited way to be liable in an unlimited way if they abuse the limited liability and the separate legal personality of the company.

10 For a general overview on the economic solidarity under Romanian law, L. Bercea, *Économie solidaire en Roumanie, La solidarité, Journées Françaises*, Travaux de l'Association Henri Capitant, vol. LXIX/2019, Bruylant/LB2V, Paris 2021, pp. 345–56.

in practice, the social economy represents a small-scale, emerging sector, in which less than 2% of the active population is employed.[11]

The main instrument that creates a general framework for social enterprises is Act no. 219/2015 on the social economy, which establishes measures aimed at promoting and supporting the social economy. The concept of the social economy includes a set of private economic and social activities, which serve the general interest, the interests of a community or personal non-patrimonial interests, through the increase of social inclusion or the supply of products, services and/or works. The social economy is based on private, voluntary and solidary initiative, with a high degree of autonomy and responsibility, as well as on the limited distribution of profit or surplus to the partners or members.

Act no. 219/2015 on the social economy recognises two types of entities specific to this framework: social enterprises and insertion social enterprises. The former are given this status if they pursue the objectives of the social economy; the latter are characterised by the pursuit of the socio-professional integration of disadvantaged people. Insertion social enterprises can be qualified, along with the protected work units, as WISE-type enterprises; the main difference is that protected work units may be both private and public units.[12] Moreover, Act no. 219/2015 provides a general set of regulations for the existing agents[13] that had acted before as de facto social enterprises under specific legal regimes.

2.2. PRINCIPLES

Act no. 219/2015 on the social economy outlines the principles, the objectives and the activities of general interest that are supposed to lead to these objectives. Taking these objectives and principles as a starting point, the regulation establishes the criteria required to acquire the status of social enterprise or insertion social enterprise, the mechanisms for financing and supporting these enterprises, as well as the public institutional framework for certifying, monitoring and supporting them.

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[11] European Economic and Social Committee, *Recent developments in the social economy in the European Union*, 2017, https://www.eesc.europa.eu/sites/default/files/files/qe-04-17-876-ro-n.pdf. The 1.7% level of employment in the social economy sectors is relatively low compared to the EU average (6.3%).

[12] Protected work units are regulated under Act no. 448/2006 on the protection and promotion of the rights of persons with disabilities.

[13] M. Lambu and C. Petrescu, *Social enterprises and their ecosystem in Europe. Updated country report: Romania*, European Commission, Publications Office of the European Union, Luxembourg 2019, p. 20.

According to this regulation, the social economy is based on the following principles:

1. the priority given to the individual and to social objectives over the increase of profit;
2. collective solidarity and responsibility;
3. the alignment of the interests of associate members with the general interest or the interests of a community;
4. the democratic control of the members over the activities carried out;
5. the voluntary and free form of association in the specific organisational forms related to the social economy;
6. the separate legal personality, management autonomy and independence from public authorities;
7. the allocation of the greater part of the profit/surplus to the achievement of objectives serving the general interest, those of a community or the non-patrimonial personal interest of the members; and
8. a transparent and responsible decision-making process in the interests of the community it serves.

The social economy pursues as objectives the consolidation of economic and social cohesion, the occupation of the labour force, and the development of social services. It contributes to the development of local communities, social inclusion, the transition to the circular economy and social innovation, creates jobs, and involves people from vulnerable groups in social and/or economic activities, facilitating their access to community resources and services.

The achievement of these objectives is carried out through certain activities of general interest:

- the production of goods, provision of services and/or the execution of works that contribute to the welfare of the community or its members;
- the promotion of activities that can generate or secure jobs;
- the development of vocational training programmes for persons belonging to vulnerable social groups; or
- the development of social services to increase the capacity of integration into the labour market of persons belonging to vulnerable groups.

There are no specific economic activities that must be carried out by enterprises in order to achieve social enterprise status, but it is necessary to pursue the general or community interest or a personal not-for-profit interest, along with social inclusion. Any activity from the economic, cultural-artistic, social, educational or scientific field, along with health, sport, housing, environmental protection and preservation of traditions, the ultimate goal of which is the fulfilment of the objectives of the social economy mentioned above, is seen as an activity

of general interest. From this perspective, not-for-profit non-governmental organisations (associations and foundations) appear to be the most dynamic and the oldest actors in the field of social enterprises.[14] However, they play a marginal role at the scale of the Romanian economy.

3. GENERAL LEGAL STATUS

3.1. CATEGORIES

The categories of economic agents expressly qualified by law as entities that may qualify for social enterprise status are:

- cooperative partnerships of the first degree;[15]
- credit cooperative partnerships;[16]
- associations and foundations;[17]
- mutual aid funds for employees;[18]
- mutual aid funds for retirees;[19]
- agricultural companies;[20]
- agricultural cooperative partnership;[21] and
- all other categories of legal entities that cumulatively comply with the concept and principles of the social economy.

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14 E.g. Caritas Alba Iulia is a not-for-profit charity and public utility organisation, active since 1990, which provides the following services: early education development for youth; activities for disadvantaged children and young people and for people with disabilities; family home centres; health care and social assistance at home, and development of mobility competence; consultation programmes for people with addictions; long-term care for the elderly in day and residential centres; programmes for integration of Roma people; accredited and non-formal vocational training and study houses; volunteering; rural development and agricultural practice; rural community support; emergency programmes; and active participation in the development of social policies. As an instrument for financial self-support, Caritas Alba Iulia developed a chain of 10 stores, CariShop (M. Lambu and C. Petrescu, *Social enterprises and their ecosystem in Europe. Updated country report: Romania*, European Commission, Publications Office of the European Union, Luxembourg 2019, p. 25). With regard to the mutual aids for retirees, also qualified under Romanian law as social enterprises, Omenia Retirees' Mutual Aid Association Bucharest (http://www.carp-omenia.ro/) was founded in 1952 for mutual assistance among its members and currently has around 54,000 members (ibid., p. 31).

15 Act no. 1/2005 on the organisation and functioning of cooperatives.

16 Government Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy.

17 Government Ordinance no. 26/2000 on associations and foundations.

18 Act no. 122/1996 on the legal status of mutual aid funds for employees and their unions.

19 Act no. 540/2002 on the legal status of mutual aid funds for retirees.

20 Act no. 36/1991 on agricultural companies and other forms of partnership in agriculture.

21 Act no. 566/2004 on agricultural cooperatives.

As the last category includes all other legal entities, irrespective of their legal status and economic activity, if their founding documents comply with the concept and principles of the social economy, the list is not exhaustive. Therefore, any other legal entity (e.g. a company governed by Act no. 31/1990 on companies) may also qualify for social enterprise status. Nevertheless, the incidence of this category in practice is low.

The most recent statistics show that, from the total amount of 2,485 social enterprises in Romania, 2,440 of entities were active at the end of 2021; a total of 1,841 social enterprises obtained certification as such in 2021.[22] Most of them are either limited liability companies (LLCs, established based on the Act no. 31/1990 on companies) or non-governmental organisations (associations and foundations).

3.2. CERTIFICATION

Under Romanian law, economic agents may obtain two specific types of status under the framework of the social economy: social enterprises and insertion social enterprises.

The status of social enterprise is attested by a public certificate of social enterprise confirming the social purpose of the enterprise and the fact that it follows the principles of the social economy. The certificate is issued to an entity that meets the following criteria:

1. it acts with a social purpose and/or in the general interest of the community;
2. it allocates at least 70% of the profit or surplus obtained to the social purpose and to the statutory reserve;
3. it undertakes to transfer the assets remaining after its liquidation to one or more social enterprises; and
4. it applies the principle of social equity to its employees ensuring fair wage levels between its employees, which cannot exceed the ratio of 1:8.

The social purpose of the economic activity, the observance of the social economy principles and the criteria mentioned above must be expressly stipulated in the founding documents of the entity. The public certificate of social enterprise is issued by the departmental employment authority for five years, with the possibility of extension.

The insertion social enterprise meets these requirements for social enterprise status if at least 30% of the personnel employed or cooperating members belong

22 https://alaturidevoi.ro/wp-content/uploads/2022/01/Registrul-unic-de-eviden%C8%9B%C4%83-a-%C3%AEntreprinderilor-sociale-decembrie-2021.pdf.

to the vulnerable group (individuals or families at risk of losing their capacity to satisfy their daily living needs) or the cumulative working time of these employees represents at least 30% of the total working time of all employees. The aim of this type of enterprise is to combat exclusion, discrimination and unemployment through the socio-professional integration of disadvantaged persons.[23] The status of social integration enterprises is attested by the granting of the *social mark*, a public certificate that recognises this status, valid for three years, which includes a specific element of visual identity that is applied to the products, works or documents that certify the provision of a service.

3.3. REGULATORY OVERSIGHT

Social enterprises are subject to regulatory oversight of their compliance with the legal criteria that authorised the issuance of the social enterprise certificate and the social mark. This oversight of social enterprises and insertion social enterprises is carried out by the monitoring bodies within the employment authority and territorial agencies of the National Agency for Payments and Social Inspection where the social enterprises or insertion social enterprises are located, or where they carry out their activity or operate their secondary offices.

In order to ensure the necessary, accurate and complete information on the situation and evolution of the social economy at national level, the (Single) Register of Social Enterprises was established. The register stores: identification data on the social enterprises and insertion social enterprises; data regarding the number of employees/members of these entities; data regarding the number of employees/members from the vulnerable groups; data regarding the total number of volunteers; data on certification; and infringements and sanctions applied in relation to the status of social enterprise or insertion social enterprise. The data stored in the Register is publicly available.

In order to provide the Register with the relevant information, the social enterprise has the following reporting duties:

1. to communicate to the employment agency any changes to the founding documents or bylaws, within 15 days from the change;
2. to communicate to the employment agency the annual activity reports, within three months from the end of the calendar year; and
3. to communicate to the employment agency, in brief, the annual social report on the activity carried out and the annual financial statements, within three

[23] Insertion social enterprises are required to provide support measures for employees belonging to the vulnerable group to ensure their professional and social integration: information, counselling, access to forms of vocational training, job adaptation to the person's capacities, accessibility of the workplace to the person's needs, etc.

months from the end of the calendar year or from the end of the financial year specific to each category of legal persons.

The annual activity report of the social enterprise[24] contains relevant data on the entire activity carried out during the reporting period (e.g. facilities and support measures from which the enterprise benefits, suspension of the activity, duration and causes that led to the suspension). The annual activity report will also include an annual social report,[25] presenting information about the company's social objectives and detailing: the objectives achieved, the objectives not achieved, and the objectives not planned but achieved; the field of social intervention (e.g. social services or education); the resources used in the activity carried out and the social needs identified; and the social changes generated by this activity. The annual report will also contain a financial report aiming to illustrate the reinvestment of 90% of the profit or surplus obtained by the social enterprise. These reports can be accessed upon request by any interested person at the headquarters of the employment authority where the social enterprise was certified.

3.4. EXIT

The public certificate of social enterprise can be withdrawn by the employment agencies if there is a violation of one or more of the certification criteria or upon expiration of the term fixed for the suspension of the social enterprise's activity.[26] The withdrawal of the social mark may be ordered for the same reasons, with an additional one being the prior withdrawal of the public certificate of social enterprise (as the social mark can be obtained only by an entity that is certified as a social enterprise). As for the cancellation of the social mark, this is ordered upon the expiration of the certificate's validity. In addition, the social enterprise may waive this status by notifying the employment authority. The loss of the status of social enterprise does not lead to a compulsory dissolution of the enterprise as a legal person; it causes the return of the legal entity to its regular

[24] Government Decision no. 585/2016 for the approval of the Methodological Norms for the application of the provisions of Act no. 219/2015 on the social economy, Annex no. 5[A].

[25] Government Decision no. 585/2016 for the approval of the Methodological Norms for the application of the provisions of Act no. 219/2015 on the social economy, Annex no. 5[B].

[26] The suspension of the certificate ordered at the express request of the social enterprise shall cease on the date requested by it, but not later than 12 months from the communication of the suspension of the certificate. The suspension of the certificate ceases if, within 30 calendar days from its communication, the social enterprises prove the removal of the causes that were the basis for taking this measure according to the provisions of these norms and prove the payment of the established fines. On the contrary, the employment agency can withdraw the certificate at the expiration of the mentioned terms.

status and the termination of the specific rights and duties corresponding to the social enterprise status.

4. SPECIAL LEGAL REGIMES

4.1. CLASSIFICATION

The social economy sector is not limited to the categories of economic agents expressly defined by law as entities that may qualify for social enterprise status. Other entities may conform to the objectives of the social economy without claiming social enterprise status; moreover, there are several legal mechanisms (other than creating legal entities) dedicated to the social economy and accessible to all forms of economic organisations. A possible classification of these entities and mechanisms that meet the requirements of the social economy includes:

1. entities that have a specific legal regime relating to the principles of the social economy and that include, but are not limited to, those expressly qualified as social enterprises by Act no. 219/2015 on the social economy:
   a. cooperative partnerships, governed by the general regime[27] or by special regimes (e.g. credit cooperatives organisations,[28] agricultural cooperatives);[29]
   b. mutual partnerships, which do not have a general regime; special regimes are established for mutual insurance companies;[30]
   c. associations and foundations, as not-for-profit legal entities,[31] which may perform certain economic activities; and
   d. family enterprises and entities without legal personality which may perform economic activities;[32]
2. special forms of economic agents governed by general company law (e.g. commercial companies regulated by Act no. 31/1990 on companies) that do not have a specific legal regime related to the principles of the social economy, but meet certain objectives of economic solidarity: the debutant limited liability company (D-LLC/SRL-D), which promotes entrepreneurial integration into the economic environment and job creation;[33] and

[27] Act no. 1/2005 on the organisation and functioning of cooperatives.
[28] Government Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy.
[29] Act no. 566/2004 on agricultural cooperatives.
[30] Act no. 71/2019 on mutual insurance companies.
[31] Government Ordinance no. 26/2000 on associations and foundations.
[32] Government Emergency Ordinance no. 44/2008 on economic activities performed by authorised natural persons, individual enterprises, and family enterprises.
[33] Government Emergency Ordinance no. 6/2011 for the stimulation of implementation and development of micro-enterprises by start-up entrepreneurs.

3. functional mechanisms dedicated to the social economy and accessible to all forms of economic organisations, in particular fiscal ones:
   a. employment of disabled persons;[34] and
   b. the benefit of a special tax regime for economic activities that, directly or indirectly, generate social benefits.[35]

4.2. COOPERATIVE LEGAL ENTITIES

Cooperative legal entities[36] are obliged to carry out their economic activities exclusively via their cooperative members unless the bylaws provide otherwise. The cooperative legal entity is a private economic organisation defined as an autonomous association of natural or legal persons, constituted based on free association for the purpose of promoting the economic, social and cultural interests of the cooperative members, the organisation being jointly owned and democratically controlled by its members, according to cooperative principles.[37]

Cooperative legal entities of the first degree have natural persons as cooperative members, while cooperative legal entities of the second degree may have legal persons as cooperative members. Cooperative legal entities may form regional and national associations or unions, which may establish commercial companies regulated by Act no. 31/1990 on companies, which, in turn, may participate as members in cooperative legal entities of the second degree. Between the cooperative legal entity and the cooperative members, three types of legal relationships may be established:

1. financial relationships – the obligation to make a contribution to the initial capital of the entity;
2. employment relationships – based on an individual employment contract; and
3. cooperative business relationships – deliveries of products and provision of services performed for the benefit of the cooperative member on behalf of the cooperative legal entity as an independent economic operator.

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34 Act no. 448/2006 regarding the protection and promotion of disabled person's rights.

35 Fiscal Code.

36 Act no. 1/2005 on the organisation and functioning of cooperatives.

37 The types of regulation of cooperative organisations, depending on their object of activity, are master cooperatives, consumer cooperatives, development cooperatives, agricultural cooperatives, housing cooperatives, fishing cooperatives, transport cooperatives, forestry cooperatives, and other forms.

The legal regime of cooperative legal entities is close to the regime of commercial companies.[38] However, there are specific features regarding the participation in the share capital and the rights and obligations of cooperative members, the assets and administration of cooperative companies, and the reorganisation and liquidation of cooperative legal entities. The maximum ownership of the share capital is 20% and the minimum number of cooperative members is five.[39]

The decisions of the general assembly are taken according to the rule of 'one member, one vote'. The cooperative members have limited liability. The cooperative members have the special right to benefit from facilities and services offered by the cooperative legal entity and the special obligation to respect the principles and values of the cooperative movement. They are guaranteed a right of pre-emption and a preferential right under equal conditions for the acquisition of real estate sold by the cooperative legal entity. The directors can only be appointed from among the cooperative members; the executive director is not part of the cooperative legal entity and is appointed via a competition.

The assets of the cooperative legal entity consist of: (i) the divisible part (the amount of the shares issued in exchange for the contribution to the share capital and the dividends); and (ii) the indivisible part (accumulated during the activity of the entity, which cannot be distributed among or acquired by the cooperative members). A legal reserve of 20% of the capital is established, through annual deductions of 5% of gross profit. Cooperative bonds can be issued to the limit of 33% of the registered capital. It is forbidden to transform or reorganise the cooperative legal entity into a commercial company or individual enterprise. When the cooperative legal entity is liquidated, the divisible part of its assets will be distributed to the members and the net assets of the indivisible part to another cooperative entity.

4.3. CREDIT COOPERATIVES

Credit cooperative entities[40] include credit cooperatives and central credit cooperatives. Credit cooperatives are credit institutions constituted as autonomous associations of natural persons aimed at meeting their common economic, social and cultural needs and aspirations. Their activity is based, first

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38 The system of commercial companies is regulated by Act no. 31/1990 on companies. This system is supplemented by the provisions of the Civil Code on company contracts (Arts 1881–1954 Romanian Civil Code) and on the legal person (Arts 187–251 Romanian Civil Code). For a comprehensive analysis of Romanian company law, L. Bercea, 'Introduction (Romania)' in A. Vicari and A. Schall (eds), *Company Laws of the EU. A Handbook*, C.H. Beck/Nomos/Hart, Munich/Baden-Baden/Oxford 2020, and the subsequent chapters.

39 The minimum age is 16 years.

40 Government Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy.

and foremost, on the principle of mutual aid of the cooperating members. Each cooperative member has the right to one vote, regardless of the number of shares held. The activity in a cooperative network is carried out primarily in the interest of the cooperative members,[41] or the credit cooperative affiliated to the central credit cooperative. Credit cooperatives have specific operational territories, and the operational territories of the credit cooperatives affiliated with the same central credit cooperative cannot overlap. Central credit cooperatives are credit institutions established by the association of credit cooperatives, for the purpose of managing their common interests.

4.4. EMPLOYEE MUTUAL AID FUNDS

Employee mutual aid funds[42] are not-for-profit associations, based on the free consent of the employees, which mutually support each other financially. The members of an employee mutual aid association can only be natural persons who are employees. Employee mutual aid funds carry out their activity exclusively through their members. The object of activity of mutual aid funds of employees consists of granting loans to their members. The interest on the loans is paid into the social fund of the members, after deduction of statutory expenses.

4.5. MUTUAL AID FUNDS FOR RETIREES

Mutual aid funds for retirees[43] are civic organisations, private legal entities with a non-patrimonial, non-governmental, non-political, charitable purpose, providing mutual aid and social assistance. Mutual aid funds of retirees can be founded based on the right to free association of retirees, social assistance recipients and members of their families who are dependent on them. The income obtained by retirees' mutual aid funds can be used for loans, grants,

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[41] Another category of financial institutions that are supposed to improve access to finance for disadvantaged people are non-banking financial institutions (Act no. 93/2009 on non-banking financial institutions). These institutions can perform inter alia activities of granting consumer credits and micro-credits, granting credits to members of non-profit associations organised based on the free consent of employees/retirees, to help their members with financial loans, in the legal form of mutual aid funds. Nevertheless, in practice, many of these institutions combine easier access to financing for clients with very onerous financial conditions, often abusing their vulnerabilities (R. Rizoiu and M. Gherghe, 'Câte nuanțe de gri are creditul? Despre tehnici de creditare la limita legii și dincolo de ea', *Revista Română de Drept Privat* no. 1/2019, pp. 288–323).

[42] Act no. 122/1996 on the legal regime of mutual aid funds for employees and their organisations.

[43] Act no. 540/2002 on the legal regime of mutual aid funds for retirees.

cultural, artistic, tourist and leisure activities, investments, and subsidies for basic food products sold by the members of the funds through their own stores.

4.6. AGRICULTURAL COOPERATIVES

An agricultural cooperative[44] is a private legal person, an autonomous association of natural or legal persons, constituted based on free association, with the aim of promoting the interests of cooperative members, according to cooperative principles, in order to implement agricultural policies designed to stimulate the association of agricultural producers. Agricultural cooperatives carry out economic, technical and social activities in the private interest of their members, who must be active farmers.[45]

The legal regime of the agricultural cooperative is similar to that of other cooperative legal entities. Agricultural cooperatives of the first degree are constituted by natural persons, authorised natural persons, individual enterprises and/or family enterprises. Second-degree agricultural cooperatives can be constituted by legal persons in addition to natural persons, in order to integrate, horizontally and vertically, the economic activity of the latter. The agricultural cooperatives of the third degree are constituted by agricultural cooperatives of the second degree that develop common investments, observing the cooperative principles.

The value of the members' production must be at least 50% of the total production sold by each member, in relation to the group or groups of products within the agricultural cooperative. The production intended for sale corresponding to the land and the number of animals belonging to the individual members of the agricultural cooperative shall be evaluated in accordance with the agreement between the members and the agricultural cooperative. The agricultural cooperative may not carry out the collection, sale and processing of the primary production for non-members if this exceeds 30% of its turnover.

State and European budget funds, transitional national aids and compensatory rural development measures applicable to agricultural land by agricultural cooperatives may be distributed to cooperative members without being taxed. The services provided by the cooperative entity for the benefit of the cooperative

[44] Act no. 566/2004 on agricultural cooperatives.

[45] Cooperatives comprise legal entities classified by areas and branches of activity: services, acquisitions and sales, and processing of agricultural products; manufacturing and small-scale industry in agriculture; exploitation and management of agricultural, forestry, fisheries and livestock land; mutual assistance and agricultural insurance; and entities that can carry out their respective activities in common and that can organise the integration of primary production resulting from joint processing or marketing, as well as the joint use of tools and buildings belonging to the cooperatives.

members will not be considered as acts of sale, with corresponding taxation effects. The counter-value of the economic activities carried out based on the cooperative relations will be returned to the cooperative member and will be subject to income tax.

The derogatory tax regime of the Tax Code applicable to agricultural cooperatives includes: exemption from profit tax during the first five years of production; exemption of the members from income tax in the case of legal entities with the status of micro-enterprises (as defined by the Fiscal Code with reference to the number of employees and the annual turnover/gross revenue of the enterprise) and from income tax in the case of natural persons for the production valued by/to the agricultural cooperative; exemption of the cooperative members from tax on the real estate used for the production valued by/to the agricultural cooperative; and exemption of the cooperative members from tax on the lease in the case of land leased by the cooperative.

4.7. NOT-FOR-PROFIT ORGANISATIONS: ASSOCIATIONS AND FOUNDATIONS

Associations and foundations[46] are private legal entities without a for-profit purpose, formed by natural and legal persons who pursue activities of general interest, in the interest of certain communities or in their own personal not-for-profit interest.

An association is constituted by three or more persons who jointly and without the right of restitution put their material contribution, their knowledge or their contribution in labour towards carrying out activities of general interest, in the interest of certain communities or in their own personal non-patrimonial interest. A foundation is set up by one or more persons who, based on a legal act *inter vivos* or *mortis causa*, establishes a patrimony that is permanently and irrevocably assigned to the accomplishment of a goal of general interest or in the interest of certain communities.

The recognition of public utility status[47] entitles the association or foundation to benefit from the use of public property free of charge. Associations and

[46] Government Ordinance no. 26/2000 on associations and foundations.

[47] An association or foundation can be granted by the Romanian Government with the status of public utility if the following conditions are cumulatively met: (i) its activity is carried out in the general interest or in the interest of certain communities; (ii) it has been operating for at least three years and has achieved part of the established objectives, proving an uninterrupted activity through significant actions; (iii) it presents an activity report detailing the performance of a previous significant activity, through the development of programmes or projects specific to its purpose, accompanied by the annual financial statements and the income and expenditure budgets for the last three years prior to the date of submission of the application for the recognition of the status of public utility; (iv) it has assets, logistics, members and staff, corresponding to the fulfilment of the proposed purpose; (v) the value of

foundations may carry out economic activities subject to restrictions depending on whether those activities are related to their purposes. Direct economic activities, when the association's or foundation's activities are incidental and closely related to its main purpose, are permitted. Indirect economic activities, however, in which the association or foundation operates one or more unrelated commercial companies are only allowed if the dividends obtained (if not invested) are used to accomplish the purpose of the association or foundation. In addition, if the association or foundation is dissolved, the net assets (regardless of their source) cannot be transferred to natural persons after the liquidation. The assets may be transferred only to legal persons under private or public law with the same or a similar purpose.

4.8. DEBUTANT LIMITED LIABILITY COMPANIES

The debutant limited liability company[48] (D-LLC/SRL-D) is implemented by a beginner entrepreneur as sole shareholder, or by no more than five beginner entrepreneurs as partner shareholders.[49] It is classified as a micro-enterprise.[50] The requirements for a debutant limited liability company to obtain the special advantages as a micro-enterprise (turnover below €500,000) are as follows: (i) to hire at least to employees on a full-time and indefinite basis; and (ii) to reinvest annually at least 50% of the profit made in the previous fiscal year. The micro-enterprise generally benefits from certain incentives:

1. the granting by the state of a non-refundable financial grant of at least 50%, but not exceeding €10,000, of the value of the project related to the business plan;
2. guarantees granted by the National Credit Guarantee Fund for Small and Medium-sized Enterprises, for credits contracted of no more than 80% of the amount of the loan, up to a limit of €80,000;

the patrimonial assets for each of the previous three years is at least equal to the value of the initial patrimony; (vi) it proves the existence of collaboration agreements and partnerships with public institutions or associations or foundations from the country and abroad; and (vii) it proves the achievement of significant results in terms of the proposed goal or presents letters of recommendation from competent authorities in the country or abroad, recommending the continuation of the activity.

[48] Government Emergency Ordinance no. 6/2011 for the stimulation of the implementation and development of micro-enterprises by start-up entrepreneurs.

[49] At the end of 2019, almost 50,000 limited liability companies (LLC-D) were registered in Romania: https://www.onrc.ro/index.php/ro/statistici.

[50] Regulated by Act no. 346/2004 on stimulating the implementation and development of small and medium enterprises. In 2017, in Romania, 99.7% of companies were SMEs, which achieved 60% of GDP and employed 60% of the labour force.

3. exemption from payment of social insurance for the income of up to four employees, within the limit of the average gross salary of the previous year; and
4. exemption from payment of fees for registration in the Trade Register.[51]

5. ORGANISATION AND RELATED MECHANISMS

5.1. DECISION-MAKING PROCESS

The decision-making process within a social enterprise depends on the legal status of the entity certified as a social enterprise. For instance, cooperatives are democratically run by their members and observe the 'one member, one vote' principle. Mutual aid fund associations for retirees are required to adopt a decision-making process that allows for a well-balanced representation of stakeholders. Both associations and foundations are governed by their members engaged in the decision-making process.[52] However, in most cases there are no specific rules related to the decision-making process incurred by the social enterprise status. As for insertion social enterprises, regardless of their legal form and regime, they should involve members in the governance process.

5.2. FUNDING AND SUPPORT MECHANISMS

Insertion social enterprises can be financed from national or international public or private sources[53] and can benefit from support measures such as state aid.[54] Insertion social enterprises that employ young people at risk of social

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[51] The last two facilities have been virtually wiped out by subsequent legislation that removes these costs from all companies (in the case of fees for registration in the commercial register) or shifts the expenses to employees (in the case of social insurance contributions).

[52] M. Lambu and C. Petrescu, *Social enterprises and their ecosystem in Europe. Updated country report: Romania*, European Commission, Publications Office of the European Union, Luxembourg 2019, p. 37.

[53] E.g. the Start ONG 2022 programme launched by Kaufland Romania and implemented by the Act for Tomorrow Association had a total budget of €500,000 for projects that have a positive impact in education, health, environment and culture. In addition, the winners benefit from training sessions and useful tools, in the areas essential for carrying out their activity, such as attracting financial resources, social media and PR, project management, graphic design, etc. Another financing campaign is Soluții pentru Comunitate launched by Synevo Romania LLC and Medicover Association, focusing on projects that aim to improve the quality of people's lives in the areas of education, health and environment.

[54] E.g. Order of the Ministry of European Funds no. 772/2018 regarding the approval of the de minimis aid scheme 'Support for the establishment of social enterprises', related to the Operational Programme Human Capital 2014–2020, priority axis 4: 'Social inclusion and combating poverty', specific objective 4.16: 'Consolidation of capacity social economy

marginalisation benefit from certain economic facilities. In public acquisition procedures, the contracting authority has the right to impose special provisions aimed at achieving social outcomes. Moreover, public authorities have the power to reserve contracts for insertion social enterprises or for social enterprises, for the latter exclusively regarding social, health and cultural services; the maximum duration of the contract is three years.[55]

Insertion social enterprises can benefit from certain facilities from the local public authorities: the allocation of buildings or land from the public domain; support in the promotion of the products, services and works in the community and the identification of potential markets; support in the promotion of tourism and related activities, and in the promotion of the local historical and cultural patrimony; and other facilities and tax exemptions. Social enterprises and insertion social enterprises can benefit annually from programmes designed to stimulate the implementation and development of micro-enterprises in the social economy. In order to obtain these facilities, insertion social enterprises submit to the authorities of the local public administration an application, accompanied by a supporting memorandum which emphasises the necessity and usefulness of the required facility.

On the other hand, while municipal and regional public authorities have limited power to support social enterprise development with local funding, a significant amount of funding is provided by European Union funding programmes[56] (e.g. the LEADER programme or the Operational Programme Human Capital POCU 2014–2020,[57] with an 85% European Union contribution and 15% national contribution).

Besides external funding sources, there are other income sources specific to each form of organisation: membership fees, partnership projects, donations and grants (associations and foundations), membership fees and interest on the members' loans (mutual aid funds and cooperatives), and dividends and income from economic activities (social enterprises governed by general company

enterprises to function in a self-sustainable manner'. This scheme was applied in the less developed regions of Romania and consisted of granting non-refundable financial aid based on subsidy contracts, of a maximum of €100,000 for a minimum of five jobs newly created by the social enterprise. Eligible expenses include taxes for the establishment of the enterprise, salary expenses, expenses for the acquisition of assets and the rental of premises for the conduct of the economic activity. The total amount of state aid is estimated at over €200 million (co-funded by the European Union (85%) and the national budget (15%)) and is granted in compliance with the relevant European Union legislation for state aids.

[55] Act no. 98/2016 regarding public acquisitions and Act no. 99/2016 regarding sectorial acquisitions.

[56] M. Lambu and C. Petrescu, *Social enterprises and their ecosystem in Europe. Updated country report: Romania*, European Commission, Publications Office of the European Union, Luxembourg 2019, p. 65.

[57] https://ec.europa.eu/regional_policy/ro/atlas/programmes/2014–2020/romania/2014ro05m9op001.

law). Another important form of financing for associations and foundations is crowdfunding.[58] With regard to bank financing, generally associations have limited access to bank loans, as these entities are seen as high-risk clients, given the lack of patrimonial guarantees; however, social enterprises can benefit from the short- and medium-term loans offered by credit cooperatives.[59]

5.3. SPECIAL TAX REGIMES

Act no. 219/2015 on the social economy does not provide special fiscal benefits for social enterprises. However, the Romanian Fiscal Code establishes tax regimes that indirectly promote social economy objectives in the framework of profit tax, income tax and value-added tax. These regimes are applicable to all enterprises, irrespective of their qualification as a social enterprise.

With regard to the income tax, the Fiscal Code establishes the tax rates for micro-enterprises and particular conditions for the deductibility of social expenses:

1. in the calculation of income tax, certain social expenses, even if not directly related to the economic activity, benefit from a limited deductibility, within the upper limits of 5%, applied to the value of the expenses on salaries (aids, gift vouchers, operating expenses, etc.);
2. income tax for micro-enterprises, which replaces profit tax (for a turnover of up to €500,000) benefits from a quota of 1% if the company has one or more employees, and 3% in the absence of employees.

The Fiscal Code provides certain exemptions from the payment of income tax and certain categories of non-taxable income:

1. exemptions from the payment of income tax, granted for individuals with severe disabilities or with acute disabilities, and individuals who perform economic activities considered strategic in Romania (e.g. creation of computer programs, research, development and innovation activities, activities in the construction sector); and

[58] E.g. Startarium (https://startarium.ro/) is a popular crowdfunding platform coordinated by the Ropot Association. According to the rules of this platform, the projects will be financed only if the amount requested through the campaign has been obtained in full, otherwise the amounts obtained will be returned to the supporters. The CrestemIdei (https://crestemidei.org/) crowdfunding platform, coordinated by the Civitas Foundation for Cluj Civil Society, operates on a similar basis.

[59] M. Lambu and C. Petrescu, *Social enterprises and their ecosystem in Europe. Updated country report: Romania*, European Commission, Publications Office of the European Union, Luxembourg 2019, p. 77.

2. non-taxable income, including: compensation for temporary incapacity to work; compensation for children; income earned from the recovery of waste that is subject to national programmes; income received as sponsorship; income of a social nature received on behalf of employers (grants, gift vouchers, food allowances, transfer expenses, compensation for moving to a location other than the place of residence during the first year of activity after completion of studies); benefits in the form of the right to a stock options plan (acquisition by employees at a preferential price of shares issued by employers); and income obtained from agricultural activities necessary for subsistence.

The Fiscal Code also provides reduced rates of VAT[60] and exemptions for operations of general interest:

1. a reduced rate of 9% for medical products and for food products for human and animal consumption;
2. a reduced rate of 5% for the supply of houses as part of social policy (houses for the elderly persons and retirees; recovery and rehabilitation facilities for disabled minors; houses with a maximum floor space of 120 m^2 at a maximum price of RON 600,000 (about €120,000), purchased by natural persons; houses provided by city councils with subsidised rent for vulnerable individuals or families); and
3. tax exemption for operations of general interest: health, education, provision of services or supply of goods closely related to social assistance or protection, carried out by public institutions or by other entities recognised as having a social nature.

6. CONCLUSION

The organisations and mechanisms of the social economy – including the social enterprise sector and other areas such as the non-profit sector and the volunteering sector – enjoy a reasonable degree of legal recognition in Romania. However, in practice, the social economy represents a small-scale, emerging sector. This status could improve under the influence of the European ecosystem of sustainable development.

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[60] Compared to the general level of 19%.

SOCIAL ENTERPRISES IN SINGAPORE

Alan K. Koh and Samantha S. Tang*

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1. INTRODUCTION

Social enterprises and novel business entities such as benefit corporations are all the rage in recent corporate law discourse.[1] Despite having no formal regime for social enterprises, Singapore has a long and storied history of notionally private enterprises acting for social and public purposes. This report introduces Singapore's legal regime on social enterprises and proceeds as follows. Section 2 offers an overview of Singapore's social enterprise landscape, identifies the legal forms used by social enterprises and their respective regulators, and briefly explains the private capital and fundraising ecosystem. The next three sections explain key features of the three dominant legal forms used by social enterprises, namely *companies* (section 3), *cooperatives* (section 4), and *charities* (section 5). Section 6 concludes.

2. SOCIAL ENTERPRISES IN SINGAPORE

2.1. LEGAL LANDSCAPE

Unlike some other jurisdictions, Singapore does not have a business form specifically designed for social enterprises. There are no restrictions under Singapore law governing which businesses may identify themselves as 'social enterprises'.

A recent study on social enterprises conducted by the British Council with the Singapore Centre for Social Enterprise (raiSE) defined a social enterprise as 'a business entity set up with clear social goals and where there is clear management intent as well as resources allocated to fulfil its social objectives …

[1] See e.g. D.B. Reiser and S.A. Dean, *Social Enterprise Law: Trust, Public Benefit and Capital Markets*, Oxford University Press, Oxford 2017; B. Means and J.W. Yockey (eds), *The Cambridge Handbook of Social Enterprise Law*, Cambridge University Press, Cambridge 2018; E. Lim, *Social Enterprises in Asia: A New Legal Form*, Cambridge University Press, Cambridge 2023.

[where] at least 20 per cent of resources have to be committed [by the entity] for reinvestment towards social impact.'[2]

Based on this definition, raiSE estimated that in 2020 the total number of organisations operating in Singapore that qualified as social enterprises ranged from 2,660 to 12,717, with the lower estimate of 2,660 being the more prudent estimate.[3] This estimate was, in turn, based on an estimate of the prevalence of social enterprises among three main types of organisations: (i) micro, small and medium enterprises (MSMEs); (ii) non-governmental organisations (NGOs); and (iii) cooperatives.[4]

Among MSMEs, raiSE estimated that the total number of social enterprises ranged from 1,087 (0.4% of total MSMEs) to 11,144 (1.4% of total MSMEs). Another 2020 survey by raiSE of 150 entities that qualified as social enterprises per raiSE's own criteria found that 72% chose to incorporate as a private limited company. Other business forms used by social enterprises included the limited liability partnership (9%), sole proprietorship (7%), and the company limited by guarantee (5%).[5] In light of these findings, it is clear that the *private limited company* is one of the dominant business forms used by social enterprises. We discuss the key features of the private limited company in section 3 below, as well as the *company limited by guarantee* (CLG) given that this corporate form has specific features that make it attractive for non-profit organisations.

Based on prior research on social enterprises in Singapore, raiSE took the position that all 85 cooperatives registered in Singapore as of 2019 qualified as social enterprises.[6] The essential features of *cooperatives* are discussed in section 4 below. Among NGOs comprising charities and societies, raiSE estimated that 331 charities and 1,157 societies were social enterprises based on a prevalence rate of 14.5%.[7] Key aspects of *charity* regulation relevant to social enterprises are discussed in section 5 below.

2.2. REGULATION

There is neither a dedicated legal regime nor a public regulator for social enterprises as a whole in Singapore. Rather, raiSE, a company limited by guarantee incorporated in 2015, is arguably the central player in Singapore's

[2] British Council, 'The State of Social Enterprise in Singapore' (2021), p. 15, https://www.raise.sg/images/The-State-of-Social-Enterprise-2021_FINAL.pdf.
[3] Ibid., p. 19.
[4] Ibid., p. 18.
[5] Ibid., p. 29.
[6] Ibid., p. 18.
[7] Ibid.

social enterprise ecosystem.[8] raiSE holds itself out as 'a sector developer and membership body for aspiring social entrepreneurs, existing social enterprises and other individuals and organisations that are interested in contributing to the development of the Social Enterprise sector'.[9] raiSE was the product of a joint effort by three government bodies, namely the Ministry of Social and Family Development (MSD), the National Council of Social Service, and the Singapore Totalisator Board (Tote Board).[10] raiSE's funding situation is relatively opaque; while its annual financial statements show that part of its revenue is derived from membership fees and investment income, it is unclear if raiSE obtains any capital from governmental and/or private entities.[11] raiSE is not a regulatory body, and does not have any regulatory powers over social enterprises.

Social enterprises are therefore regulated according to the legal form adopted.

Table 1. Regulators for legal forms used by social enterprises

Legal Entity	Regulator	Legal Regime
Business entities (e.g. companies, sole proprietorships, partnerships)	Accounting and Corporate Regulatory Authority – a statutory board under the Ministry of Finance[12]	E.g. Companies Act 1967 Business Names Registration Act 2014
Cooperatives	Registry of Co-operative Societies – a government body under the MCCY[13]	Co-operative Societies Act 1979
Societies	Registry of Societies – a government body under the Ministry of Home Affairs[14]	Societies Act 1966
Charities	Commissioner for Charities – a government body under the MCCY[15]	Charities Act 1994

Source: Compiled by the rapporteurs.

Strictly speaking, a charity under Singapore law is not a distinct legal form as such, but rather a legal status that can be granted to a legal entity. When a legal entity – such as a business entity, a cooperative or a society – receives charity status, it becomes subject to additional regulation in its capacity as a charity in addition to any other regulation applicable to the underlying legal form.

8 raiSE Singapore, 'Membership Terms and Conditions' (2022) https://www.raise.sg/membership-terms-conditions.html.
9 raiSE Singapore, 'Singapore Centre for Social Enterprise' (2022) https://www.raise.sg/.
10 raiSE Singapore, 'About raiSE' (2022) https://www.raise.sg/about/about-menu/about-us.html.
11 raiSE Singapore, 'Financial Statement' (2020) https://www.raise.sg/images/resources/raiSE_AR1920_financialstatement_201001_OL.pdf.
12 Accounting and Corporate Regulatory Authority Act 2004, s. 3.
13 Ministry of Culture, Community and Youth (MCCY), 'We champion the co-operative spirit' (2022) https://www.mccy.gov.sg/sector/co-ops.
14 Societies Act 1966, s. 3.
15 Charities Act 1994, s. 3.

2.3. PRIVATE CAPITAL AND FUNDRAISING

As a critical player in Singapore's social enterprise ecosystem, raiSE has been instrumental in offering and facilitating fundraising by social enterprises. raiSE administers the VentureForGood (VFG) grant. As of early 2022, the VFG grant offers up to S$300,000 (approximately US$220,000) to 'all new and existing locally based social enterprises that are registered/intend to register under the [Companies Act 1967] or [Co-operative Societies Act 1979]'.[16] Applicants must demonstrate that the business has 'a compelling social objective', 'a viable business proposition', and 'a committed team'. raiSE states that the VFG grant is 'supported by the MSD', suggesting that the grant relies in part or entirely on government money. raiSE also connects social enterprises with private venture capital funds through initiatives such as the Sustainable Impact Accelerator.[17]

Beyond raiSE, fund providers for social enterprises comprise both government and private entities. Examples of government or government-linked entities funding social enterprises include the Tote Board (a statutory board),[18] DBS Bank (a government-linked company),[19] and ABC Impact (a private equity fund whose investors comprise government-linked companies).[20] Examples of private entities include the Impact Investment Exchange and Garden Impact Investments.[21]

For completeness, Singapore does not have any securities regulation, investment restrictions or ownership restrictions specifically directed at social enterprises as such. Similarly, the Singapore Exchange does not have any listing requirements that explicitly contemplate social enterprises.

3. COMPANIES

Companies are a popular organisational form for social enterprises in Singapore. This section focuses on private limited companies given the prevalence of this business form among social enterprises, and summarises key characteristics with specific reference to features that are critical for social enterprises. Features of the company limited by guarantee (CLG) legal form are briefly discussed given their relevance to non-profit entities.

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16 raiSE Singapore, 'raiSE VentureForGood (VFG) Grant' (2022) https://www.raise.sg/ventureforgood.html.

17 Quest Ventures, 'Sustainable Impact Accelerator' (2022) https://www.questventures.com/businesses/accelerate/sustainable-impact-accelerator/.

18 British Council (n. 2), p. 24.

19 Ibid., p. 27.

20 abcIMPACT, 'About Who We Are' (2023) https://www.abcimpact.com.sg/about-us/.

21 British Council (n. 2), pp. 26–27.

3.1. KEY FEATURES

Singapore's Companies Act 1967 (2020 Revised Edition) (CA) regulates 'corporations' – a term of art comprising Singapore-incorporated companies and foreign companies.[22]

3.1.1. *Types of Companies*

The types of companies that may be incorporated under the CA are:[23] (i) unlimited companies, which places no limits on the liability of members for the company's debts;[24] and (ii) companies in which a member's liability is limited.[25] Companies limited by shares may be either private (not exceeding 50 members) or public (no limits on number of members).[26] Shares are generally freely transferable, save for private companies where there are restrictions on shares provided for in the company constitution, which is the basic governing document.[27]

Social enterprises may often take the form of a private company limited by shares, but the CLG, which is a 'public' company under the CA,[28] is also a viable option. In a CLG, a member's liability is limited by the corporate constitution to the sum that they have agreed to undertake.[29] CLGs are rarely used by for-profit enterprises due to the absence of starting capital and paid-up capital, which require the CLG to rely on external sources for funding.[30] Further, profit distribution to members is hindered by the fact that members do not hold shares, and profit distributions to other persons are impossible, given that company resolutions and constitutional provisions purporting to grant any person other than a member 'any right to participate in the divisible profits of the company … [are] void'.[31] CLGs therefore tend to be non-profit enterprises that

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22 CA, s. 4(1) (defining 'corporation' as 'any body corporate formed or incorporated or existing in Singapore or outside Singapore and includes any foreign company').

23 CA, s. 7(2).

24 CA, s. 4(1) (defining 'unlimited company').

25 CA, s. 4(1) (defining 'company limited by guarantee' and 'company limited by shares').

26 CA, s. 18(1)(b).

27 The modern Anglo-Commonwealth 'constitution' is the equivalent of the memorandum and articles of association, charter and bylaws, operating agreement, *teikan*, *zhangcheng*, *Satzung*, and like instruments in other jurisdictions. CA, s. 18(1)(a); see also Companies (Model Constitutions) Regulations 2015, First Schedule (Model Constitution for a Private Company Limited by Shares), reg. 26.

28 J. Lee, V. Yeo and N. Fernandez, *Guide to Company Law in Singapore*, Wolters Kluwer, Singapore 2022, p. 13.

29 CA, s. 4(1).

30 Singapore Legal Advice, 'Setting Up a Company Limited by Guarantee in Singapore' (31 October 2019) https://singaporelegaladvice.com/law-articles/set-up-company-limited-by-guarantee-singapore/.

31 CA, s. 38(1).

do not require a profit distribution mechanism.[32] Prominent examples of non-profit CLGs include the Esplanade, a performing arts centre in Singapore.[33]

3.1.2. Objects Clauses

A company may provide for an objects clause in its corporate constitution delimiting the activities that the company may engage in. While objects clauses are no longer compulsory for any company incorporated on or after 1 April 2004,[34] a company under current law at its option may adopt an objects clause in its constitution with a special resolution[35] requiring 75% approval from members present and voting.[36]

Any act, transaction and contract that is beyond the stated objects is deemed *ultra vires* but not necessarily void or unenforceable.[37] Thus, objects clauses may be relevant for social enterprises using the corporate form, but are ultimately of limited utility. A social enterprise may adopt an objects clause as a public statement of its socially beneficial and/or non-profit purpose(s).[38] However, the objects clause would not directly constrain the company from engaging in acts or transactions with third parties beyond the ambit of the objects clause (i.e. *ultra vires* acts) given that an *ultra vires* transaction is not automatically void *ab initio*. While the presence of an objects clause would allow members to seek court intervention to restrain or set aside corporate acts that are *ultra vires*, members would nonetheless face several obvious difficulties.[39] As a practical matter, to enforce the objects clause, a member would need to stay sufficiently informed about the company's activities and act quickly while an *ultra vires* transaction is still in motion.[40] In addition, since any third-party interests harmed by restraining an uncompleted *ultra vires* transaction would likely be addressed by the court as part of its intervention anyway,[41] it would be difficult

32 C. Tan, 'BT Explains: Company limited by guarantee' (7 May 2021) https://www.businesstimes.com.sg/companies-markets/bt-explains-company-limited-by-guarantee.

33 Ibid.

34 Compare Companies Act (Chapter 50, 1994 Revised Edition), s. 22(1)(b) (repealed from 1 April 2004 by Companies (Amendment) Act 2014 (Act 5 of 2004), s. 8) with CA, s. 23(1A) (first introduced by Companies (Amendment) Act 2004 (Act 5 of 2004), s. 9).

35 CA, s. 26(1).

36 CA, s. 184.

37 CA, s. 23(1A). On the modern effects of *ultra vires*, H. Tjio, P. Koh and P.W. Lee, *Corporate Law*, Academy Publishing, Singapore 2015, §§07.050–07.055.

38 R.T. Langford, 'Purpose-Based Governance: A New Paradigm' (2020) 43 *UNSW Law Journal* 954, 966, 970 (discussing the applicability of objects clauses in Australia in the context of corporate purpose).

39 Whether there is sufficient incentive on the part of members to attempt enforcement is an issue beyond the scope of this report.

40 Members cannot seek court intervention under the CA in respect of a completed *ultra vires* transaction.

41 CA, s. 25(3).

for the company to escape all economic detriment arising from a member's zealous enforcement of an objects clause.

3.1.3. Management Powers and Directors' Duties

The CA grants directors broad management powers over the company's affairs. As Singapore is a common law jurisdiction, the law on directors' duties[42] to the company has been primarily developed by the courts via case law,[43] and supplemented by statutory duties in the form of specific CA provisions. Directors generally owe duties only to the company; except when the company is on the brink of or already in a state of insolvency,[44] only in exceptional circumstances might directors owe duties to specific individual members or non-member stakeholders or to them as a class.[45] Private enforcement of director duties is rare in Singapore and generally limited to closely held private companies.[46] As of the writing of this report in 2023, no director of a listed company has been ever found personally liable in a civil action for breach of their duties.[47]

The two directors' duties most likely relevant for social enterprises are: (i) the duty to act for proper purposes; and (ii) the duty to act bona fide in the company's interests. The duty to act for proper purposes requires directors to exercise their powers for the purposes that they are conferred. Singapore jurisprudence on this duty remains underdeveloped.[48] In theory, this duty could potentially be used to compel directors to exercise their powers in accordance with corporate

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42 On directors' duties in companies generally (albeit primarily in the for-profit context), see S.S. Tang, 'National Report on Singapore' in R. Mariano Manóvil (ed.), *Groups of Companies: A Comparative Law Overview*, Springer, Singapore 2020, pp. 515–24 and (for a more in-depth if dated account), Tjio et al. (n. 37), ch. 9.

43 These duties include: (i) the duty to act bona fide in the company's best interests; (ii) the no-conflict rule (i.e. the duty to avoid a conflict of interests); (iii) the no-profit rule (i.e. the duty not to make a secret profit); (iv) the duty to act for proper purposes; and (v) the duty to act with care, skill and diligence to the company in the execution of their duties. Breaches of such duties may result in civil liability in the form of equitable remedies and/or monetary compensation where applicable. P. Koh, *Company Law*, 3rd ed., LexisNexis, Singapore 2017, §§5.23, 5.70.

44 *Traxiar Drilling Partners II Pte Ltd (in liquidation) v. Dvergsten, Dag Oivind* [2018] SGHC 14, [2019] 4 SLR 443, [83]–[84].

45 See e.g. Tjio et al. (n. 37), §§09.005–09.010; L. Talbot, 'Trying to Save the World with Company Law? Some Problems' (2016) 36 *Legal Studies* 513, 523; *Brunninghausen v. Glavanics* [1999] NSWCA 199, [40]–[41].

46 See S.S. Tang, 'The Anatomy of Singapore's Statutory Derivative Action: Why Do Shareholders Sue – or Not?' (2020) 20 *Journal of Corporate Law Studies* 327.

47 On the one recent prominent but failed attempt, see *Tiong Sze Yin Serene v. HC Surgical Specialists Ltd* [2020] SGHC 201, [2021] 3 SLR 1269; A.K. Koh, D.W. Puchniak and C.H. Tan, 'Company Law' (2020) 21 *Singapore Academy of Law Annual Review of Singapore Cases* 224, 243–48.

48 See further J. Lee, 'Making a Case for the Duty to Act for Proper Purposes' [2014] *Singapore Journal of Legal Studies* 79.

purpose(s) – but the prospects of doing so are more theoretical than real given the absence of any Singapore case law on this point.[49]

The duty to act bona fide in the company's interests requires a director to (i) act bona fide; and (ii) act in the best interests of the company. In determining whether a director has acted bona fide, the test is 'whether an intelligent and honest man in the position of a director of the company concerned could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company'.[50] Singapore has an 'informal' business judgment rule,[51] in that the courts will be slow to review the merits of business judgements that were honestly or reasonably made by the directors.[52] The company's best interests are determined based on the company's commercial interests as a separate legal entity. Where the company is solvent, the shareholders' interests are paramount.[53] Directors may consider the interests of non-investor stakeholders such as employees and creditors,[54] but are not compelled to do so. The CA offers some recognition of employee interests in the form of section 159, which states:

> The matters to which the directors of a company are entitled to have regard in exercising their powers include –
>
> (a) the interests of the company's employees generally, as well as the interests of its members …

However, there is nothing in statute or case law that compels the directors to consider, much less act in accordance with, other non-investor stakeholder interests. Directors who breach the duty to act bona fide in the company's interests may be civilly liable for monetary compensation for losses suffered by the company.[55]

Section 157(1) of the CA specifies that '[a] director must at all times act honestly … in the discharge of the duties of his or her office', which mirrors the duty to act bona fide in the company's best interests.[56] Breaches of section 157(1) may result in criminal liability, ranging from fine (not exceeding S$5,000

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49 See R.T. Langford, 'Purpose-Based Governance: A New Paradigm' (2020) 43 *UNSW Law Journal* 954, 966 (discussing the limited applicability of a director's fiduciary duties to act in good faith in the company's interest and proper purpose to corporate purpose generally).

50 *Goh Chan Peng v. Beyonics Technology Ltd* [2017] SGCA 40, [2017] 2 SLR 592, [36].

51 H. Tjio, 'The Rationalisation of Directors Duties in Singapore' (2005) 17 *Singapore Academy of Law Journal* 52, 64.

52 *Vita Health Laboratories Pte Ltd v. Pang Seng Meng* [2004] SGHC 158, [2004] 4 SLR(R) 162, [16]; *ECRC Land Pte Ltd (in liquidation) v. Ho Wing On Christopher* [2003] SGHC 298, [2004] 1 SLR(R) 105, [49].

53 *Raffles Town Club Pte Ltd v. Lim Eng Hock Peter* [2012] SGCA 62, [2013] 1 SLR 374, [27]–[29].

54 On creditors' interests near or in insolvency, see n. 44 above.

55 Koh (n. 43), §5.85.

56 Ibid., §5.14.

(approximately US$3,800) or imprisonment (not exceeding 12 months) upon conviction, in addition to civil liability.[57]

For completeness, shareholders do not owe any fiduciary duties to the company.[58]

3.1.4. Members' Rights

Voting rights available to members holding shares ('shareholders') depend on the type of shares held. The default rule for companies limited by shares is 'one share, one vote',[59] but it is up to the constitution to regulate the voting rights of class shares or preference shares.[60] Voting rights in a CLG are not regulated directly by the CA but are instead left completely to the company's constitution; it is possible for members to have no voting rights if there are constitutional provisions to that effect.[61] Under the relevant Model Constitution, each CLG member generally has a single vote.[62] The shareholders (or members) collectively exercise their voting power in the general meeting by voting on resolutions.

For social enterprises, it is important to note that it is difficult to amend the corporate constitution to include objects clauses incorporating social beneficial purposes because a special resolution is required. However, where such clauses are already adopted, they are difficult to remove. Important provisions in the corporate constitution may be 'entrenched' *ab initio* at time of incorporation or upon later introduction such that unanimous approval of the members would be required to alter or remove the provision.[63]

Information rights are relatively limited in Singapore. Apart from limited access to certain registers and company filings[64] and some financial information before annual general meetings,[65] members of Singapore-incorporated companies have no access to a stand-alone inspection rights regime enabling direct access to the company's records.[66]

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57 Civil liability for s. 157(1) of the CA is distinct and in addition to any remedies available to the company at common law: CA, ss. 157(3)(a) (director to disgorge any profits made and personally compensate company for any losses suffered), 157(4) (civil liability under statute is in addition to any other liability or duty for directors).

58 See E. Lim, *A Case for Shareholders' Fiduciary Duties in Common Law Asia*, Cambridge University Press, Cambridge 2019.

59 CA, s. 64(1).

60 CA, s. 180(2).

61 CA, s. 180(3).

62 Companies (Model Constitution) Regulations 2015, Second Schedule (Model Constitution for a Company Limited by Guarantee), reg. 20(2)–(3).

63 CA, s. 26A.

64 On registers, see generally Lee et al. (n. 28), pp. 182–99.

65 CA, s. 201(1), (9).

66 See generally D.W. Puchniak and S.S. Tang, 'Limited Shareholder Inspection Rights in Singapore: Worrying Legal Gap or Unnecessary for Rankings?' in R. Thomas, P. Giudici

As to litigation rights, aggrieved shareholders may avail themselves of shareholder remedies provided in the CA, as well as those developed by case law. We discuss the forms of shareholder litigation relevant for enforcing corporate purpose at section 3.5 below.

3.1.5. Stakeholder Participation

Non-investor stakeholders in Singapore generally do not have the right to participate in the internal governance of a solvent company. There is no co-determination regime in Singapore as a matter of company law. As discussed earlier, directors have the discretion to consider stakeholder interests in exercising their duties, but are not legally compelled to do so. It is possible for stakeholders, in their capacity as members of the public, to acquire limited information on the company's operations through the online portal administered by the Accounting and Corporate Regulatory Authority (ACRA). Where the company is insolvent, the creditors may take over the management of the company, subject to the relevant rules in Singapore's insolvency and restructuring regime.[67]

3.1.6. Entity and Owner Taxation

The standard corporate tax rate in Singapore is 17%.[68] There are presently no tax exemptions or incentives in respect of for-profit corporate social responsibility or environmental, social and governance (ESG) activities. There is no pass-through taxation for companies, but under Singapore's one-tier corporate tax system, dividends paid by Singapore-resident companies are not taxable.[69]

3.2. FORMATION

In practice, the entire incorporation process in Singapore can be completed by filing documents on ACRA's online portal. It is a relatively straightforward process comprising two steps, each of which generally takes just 15–30 minutes to complete.

Given that there are no specific legal requirements for establishing a social enterprise in Singapore, there are no additional government approvals or

and U. Varottil (eds), *Research Handbook on Shareholder Inspection Rights*, Elgar, Cheltenham 2023.

67 On judicial management (the main creditor-in-possession restructuring regime) see Lee et al. (n. 28), ch. 19. On receivership see ibid., pp. 295–305.

68 Income Tax Act 1947, s. 43(1)(a).

69 Income Tax Act 1947, s. 13(1)(za).

requirements for incorporating a company that is committed to operating in a socially beneficial way.

3.3. MAINTENANCE

ACRA regulates public accountants, corporate service providers and business entities (including sole proprietorships, partnerships and companies).[70] In this sense, ACRA's regulatory authority encompasses both non-profit and for-profit entities. Institutions of public character[71] that take the form of a business entity will therefore also be subject to ACRA's oversight.

The documents that a company is required to submit annually to ACRA are primarily administrative and financial in nature.[72] While non-compliance may result in criminal liability for the company and its officers,[73] ACRA does not mandate reporting of any specific information unique to or characteristic of social enterprises.

3.4. EXIT

A member in a private company limited by shares may withdraw from the company via share buyout orders under either the oppression remedy under the CA[74] or the just and equitable winding up regime under the Insolvency, Restructuring and Dissolution Act 2018 (IRDA).[75] A company may also be wound up under the IRDA via voluntary winding up[76] or by court order upon application by a member, creditor, director, or insolvency or restructuring

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70 The primary legislation is the Accounting and Corporate Regulatory Authority Act 2004.

71 See section 5 below.

72 CA, s. 197 and Companies (Filing of Documents) Regulations, reg. 36 (annual return); CA, ss. 201–204 (financial statements in compliance with the Singapore Financial Reporting Standards); s. 201(16) read with Twelfth Schedule (directors' statement); s. 207 (auditor's report, unless company is exempt).

73 CA, s. 197(6) (applying to the annual return).

74 On withdrawal from a comparative perspective, see A.K. Koh, *Shareholder Protection in Close Corporations: Theory, Operation and Application of Shareholder Withdrawal*, Cambridge University Press, Cambridge 2022; A.K. Koh, 'Shareholder Withdrawal in Close Corporations: An Anglo-German Comparative Analysis' (2022) 22 *Journal of Corporate Law Studies* 197. See also M. Chew, *Minority Shareholders' Rights and Remedies*, 3rd ed., LexisNexis, Singapore 2017, ch. 4.

75 See, in addition to the sources in n. 74 above, A.K. Koh and S.S. Tang, 'Towards a "Just and Equitable" Remedy for Companies' (2017) 133 *Law Quarterly Review* 372.

76 A voluntary winding up can be initiated by the company's members by a special resolution: IRDA, s. 160(1)(b).

practitioner.[77] Generally, where a for-profit company is liquidated, the proceeds will be first applied to the satisfaction of its debts and liabilities, with the shareholders receiving the remainder. However, the winding up of a CLG may proceed differently if the entity is a non-profit. Non-profit CLGs may have a constitutional provision to the following effect:

> If upon the winding up or dissolution of the company there remains, after the satisfaction of all its debts and liabilities, any moneys or property whatsoever, the same must not be paid to or distributed among the members of the company, but must be given or transferred to a charity or institution of a public character, as determined by the members of the company at or before the time of the dissolution having objects similar to those of the company, and which is registered under the Charities Act [1994].[78]

Any amendment or adoption of such a provision would usually require a special resolution passed by the members in a general meeting.[79]

It is unclear whether a comparable constitutional provision mandating non-distribution constraints would be consistently enforceable in a social enterprise with the form of a (for-profit) private company limited by shares. The possibility remains that court-ordered withdrawal via the oppression remedy, which operates as a forced distribution, could not be completely excluded in situations involving management misconduct or unfair treatment of the minority by the majority.

3.5. ENFORCEMENT OF SOCIAL MISSION

There are two types of shareholder litigation that may be relevant for social enterprises. First, members may apply to court to enforce the corporate constitution, or to challenge constitutional amendments.[80] While these mechanisms may appear to be useful in enforcing objects clauses, they are rarely, if ever, invoked in practice. Private enforcement of directors' duties is possible through the statutory derivative action – which may be relevant where a director breaches his or her duty to act bona fide in the company's best interests – but successful claims are rare.

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77 IRDA, s. 124(1). Both solvent and insolvent companies may be wound up this way; see the various grounds in IRDA, s. 125(1).

78 Companies (Model Constitution) Regulations 2015, Second Schedule (Model Constitution for a Company Limited by Guarantee), reg. 68(2).

79 CA, s. 26(1).

80 See Chew (n. 74), §§2.024–2.055. For a comparative view, see A.K. Koh and S.S. Tang, 'Direct and Derivative Shareholder Suits: Towards a Functional and Practical Taxonomy' in A. Afsharipour and M. Gelter (eds), *Comparative Corporate Governance*, Edward Elgar, Cheltenham 2021.

4. COOPERATIVES

Cooperatives ('coops' for short) are legal entities with a long history in both Anglo-Commonwealth and civil law jurisdictions. The coop movement can be traced back to the Rochdale Society of Equitable Pioneers, which was founded as a consumer coop in 1844 in Manchester, United Kingdom. In Singapore, 'cooperative societies' were first legally recognised in 1925 when Singapore was under British colonial rule,[81] and were historically the quintessential social enterprise in Singapore.[82] Currently, coops are organised under the Co-operative Societies Act 1979 (2020 Revised Edition) (CSA), and are regulated by this Act and associated subsidiary legislation.[83] The Cabinet Minister charged with responsibility for coops, the Minister for Culture, Community and Youth (MCCY Minister),[84] is empowered to make rules or exemptions,[85] delegate its functions to a Registrar of Co-operative Societies (Registrar),[86] and hear appeals against the decisions of the Registrar.[87] The CSA also vests the Registrar with powers over most coop regulation matters. As of 15 August 2022, there are 84 registered coops in Singapore.[88] The Singapore coop sector is of a considerable scale; according to the latest annual report released by the Registrar in September 2021, there were 1.475 million members in 87 coops, and the coops together held S$20.3 billion (approximately US$14.5 billion) in total assets as of 31 March 2021.[89]

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81 The first cooperatives legislation was the Co-operative Societies Ordinance 1924 (Ordinance 21 of 1924), which was enacted on 3 November 1924 and went into force on 1 January 1925. The first coop founded was the Singapore Government Servants' Co-operative Thrift and Loan Society (now Singapore Government Staff Credit Co-operative Society), registered on 7 October 1925: SNCF, 'Know our Co-ops Series: First Co-op in Singapore – SGS Co-op' (8 April 2020, archived 27 November 2020) https://web.archive.org/web/20201127112643/https://sncf.coop/media-hub/publications/108-2020-co-operator/april-2020/700-know-our-co-ops-first-co-op-in-singapore-sgs-co-op.

82 raiSE Singapore, 'The State of Social Enterprise in Singapore' (May 2017) https://www.raise.sg/images/resources/pdf-files/raiSE---State-of-Social-Enterprise-in-Singapore-2017-Report.pdf ('The first formal social enterprises in Singapore can be traced to the establishment of the Singapore Government Servants' Cooperative Thrift and Loan Society. Cooperatives were then seen as the main established form of social enterprises').

83 Including the CSR.

84 Constitution of the Republic of Singapore (Ministerial Responsibility) Notification 2020, Fourth Schedule.

85 CSA, ss. 95–97B.

86 CSA, s. 3(1).

87 CSA, ss. 9(7).

88 MCCY, 'Co-ops Sector' (15 August 2022) https://web.archive.org/web/20220815050340/https://www.mccy.gov.sg/sector/co-ops.

89 MCCY, 'Annual Report on the Co-operative Societies in Singapore for the Financial Year Ended 31 March 2021' (September 2021) https://www.mccy.gov.sg/about-us/news-and-resources/statistics/2019/jan/-/media/C9A5A571A2BB4EB89A2C908C389CC933.ashx.

Coops operate a number of socially critical businesses in Singapore, many of which fall under the umbrella of NTUC[90] Enterprise, which is also a coop.[91] Enterprises run by NTUC Enterprise-affiliated coops include one of Singapore's largest grocery retailers (NTUC Fairprice),[92] as well as food courts (NTUC Foodfare),[93] preschool (NTUC First Campus),[94] commercial real estate (Mercatus),[95] nursing homes (NTUC Health),[96] and (until 1 September 2022) insurance (NTUC Income).[97] These enterprises are expressly branded as 'social enterprises'.[98] Of these, NTUC Fairprice and NTUC Income made it onto both of the World Cooperative Monitor's 2019 rankings of the world's top 300 cooperative and mutual organisations.[99]

The exposition that follows in this section is, to the best of the rapporteurs' knowledge, the first published scholarly overview of the legal framework governing coops in Singapore.

4.1. KEY FEATURES

4.1.1. Overview

In general, coops 'are conceived by law as entities running an enterprise in the interest of their members as consumers, providers or workers of the cooperative

90 NTUC is itself an acronym for the National Trades Unions Congress, Singapore's national centre (confederation) of trade unions. This is roughly comparable to the USA's AFL-CIO and Japan's *Rengō*/*Zenrōren*/*Zenrōkyō*.

91 NTUC Enterprise, 'About Us' (2022) https://www.ntucenterprise.sg/aboutus/.

92 Fair Price Group, 'Our Group' (2022) https://www.fairpricegroup.com.sg/our-group/.

93 Foodfare, 'About Foodfare' (2022) https://www.foodfare.com.sg/.

94 NTUC First Campus, 'About Us' (2022) https://ntucfirstcampus.com/about-us/nfc-ethos.

95 https://www.mercatus.com.sg/.

96 NTUC Health, 'About Us' (2022) https://ntuchealth.sg/about-us.

97 Since 1 September 2022, NTUC Income has been operated by an unlisted public company limited by shares incorporated under the Singapore CA.

98 See NTUC Enterprise, 'About Us' (September 2021) https://web.archive.org/web/20220902121653/https://www.ntucenterprise.sg/aboutus/ ('NTUC Enterprise is the holding entity and single largest shareholder of the NTUC Enterprise group of social enterprises. NTUC Enterprise aims to create a greater social force to do good by harnessing the capabilities of its social enterprises to meet pressing social needs in areas like health and eldercare, childcare, daily essentials, cooked food and financial services. Serving over 2 million customers annually, NTUC Enterprise wants to enable and empower all in Singapore to live better and more meaningful lives'); NTUC, 'Who We Are' (September 2021) https://web.archive.org/web/20220902161353/https://www.ntuc.org.sg/wps/portal/up2/home/aboutntuc/whoweare/organisationdirectory (under the tab 'NTUC SOCIAL ENTERPRISES'); NTUC Enterprise, 'Annual Report 2021' (2022) https://web.archive.org/web/20220913081059/https://www.ntucenterprise.sg/wp-content/uploads/2022/05/NTUC-Enterprise-AR2021.pdf.

99 The two rankings are by turnover and by turnover divided by gross domestic product per capita: World Cooperative Monitor, 'Exploring the Cooperative Economy Report 2021' (November 2021), pp. 104, 156, https://monitor.coop/sites/default/files/2022-01/WCM_2021_0.pdf.

enterprise'.[100] Although coops are no longer the numerically dominant form of social enterprise in Singapore, all existing coops are automatically classified as social enterprises by raiSE.[101] A large number of coops, including the NTUC-affiliated coops mentioned above, brand themselves as social enterprises. Accordingly, it would be fair to say that the coop is the only specialised legal form of organisation in Singapore for social enterprises.

Coops are entities that are legally separate and distinct from companies of all types.[102] As bodies corporate, coops enjoy perpetual succession, and legal capacity to hold property, enter contracts, and to sue and be sued.[103] A coop can be founded either with the object of promoting its members' economic interests, or with the object of promoting the interests of the public or a section thereof while having regard to its members' economic interests.[104] Coops are therefore always *permitted* to pursue a social mission – insofar as that social mission is about something other than the members' economic interests as members – but are not necessarily strictly required to pursue one by law. Regardless of the individual coop's social mission, coops must contribute part of their surplus towards the furtherance of either the cooperative movement, the labour movement, or both; this will be discussed later below at section 4.1.5.

4.1.2. Membership

Membership in coops is restricted to either individuals (i.e. natural persons), coops or trade unions.[105] To qualify for membership, an individual must meet requirements as to minimum age,[106] Singapore citizenship or residency,[107] and other matters as prescribed in the coop's bylaws such as employment or profession.[108] In addition, membership in a 'credit society' (i.e. coop providing financial services)[109] (hereinafter 'credit coop') is restricted to 'individuals who belong to a field of membership consisting of a pre-existing common bond of

[100] A. Fici, 'An Introduction to Cooperative Law' in D. Cracogna, A. Fici and H. Henrÿ (eds), *International Handbook of Cooperative Law*, Springer, Singapore 2013, pp. 22–23. For an alternative, functional definition used for collection of statistics, see International Labour Office Department of Statistics, 'Guidelines concerning statistics of cooperatives' (ICLS/20/2018/Guidelines, adopted March 2019), §19 (establishing four criteria).

[101] British Council (n. 2), §18.

[102] CA, s. 4(1) (excluding Singapore-registered cooperative societies from the definition of 'corporation', which includes 'companies' registered under the CA and other comparable foreign-registered entities).

[103] CSA, s. 11(1).

[104] CSA, s. 4(1)(a)–(b).

[105] CSA, s. 39(1)–(3).

[106] CSA, s. 39(1)(a)(i) (12 years of age for a school coop, 16 for others).

[107] CSA, s. 39(1)(a)(ii).

[108] CSA, s. 39(1)(a)(iii).

[109] CSA, ss. 2(1), 16A–16BA.

association or community of interest among the members thereof'.[110] Coops are required to keep a register of members.[111]

Coops may but are not required to issue ordinary shares to members. All coop members enjoy limited liability, with liability limited to the nominal value of shares subscribed for ('limited by shares'), or the amount specified in the coop's 'bylaws' (which are the equivalent to the 'constitution' of a company) ('limited by guarantee').[112] Coop shares are not subject to seizure or sale by creditors of a member,[113] but may be transferred to another existing or an incoming member of the coop[114] and inherited upon the death of a natural person member.[115]

4.1.3. Decision-Making by Members

Coop decision-making is in principle centred on the general meeting, which wields 'supreme authority', and at which each member has the right to attend and vote.[116] Each natural person member has one vote regardless of the number of shares held, whereas the voting power of non-natural person members is fixed by the coop's bylaws.[117] Natural person members must exercise their vote in person, and proxies are not permitted.[118] However, as membership bodies of coops can be very large, the general meeting of all members may be replaced by a smaller body, the 'meeting of delegates', as of right in coops with more than 3,000 members, and by permission of the Registrar for coops with smaller memberships.[119] The meeting of delegates has the same powers as the general meeting of members under the CSA.[120] A meeting of delegates must comprise at least 20 members, and delegates are elected from amongst the members,[121] with each delegate representing a certain number of individual members each.[122] Although coops are often founded with the object of promoting the interests of a section of the public other than its members, there is nothing in coop legislation prescribing the formal participation in management or decision-making by stakeholders other than the members.

110 CSA, s. 39(4).
111 CSA, s. 18.
112 CSA, s. 46.
113 CSA, s. 25.
114 CSA, s. 44(2).
115 CSA, ss. 26, 45.
116 CSA, s. 50.
117 CSA, s. 42.
118 CSA, s. 42(1).
119 CSA, s. 51(1), (7).
120 CSA, s. 51(2).
121 CSA, s. 51(3)–(4). The method of election of delegates is to be specified in the coop's bylaws: CSA, s. 51(6).
122 CSA, s. 51(1).

A coop's bylaws, which govern internal affairs,[123] must include provisions on matters specified in the CSA.[124] The Registry of Co-operative Societies issues separate model bylaws for non-credit and credit coops on the Ministry of Culture, Community and Youth website.[125] Amendments to bylaws are possible via a three-quarters vote of the members at a general meeting or of the returned votes in a referendum of the members.[126] However, no bylaw amendment is valid unless and until the Registrar (i) is satisfied that the amendment is not inconsistent with the CSA and Co-operative Societies Rules 2009 (CSR) and (ii) duly registers the amendment.[127]

4.1.4. Management

Under the CSA, the 'committee of management' (by whatever name each coop chooses to call it) is 'responsible for the management of the affairs of the [coop]'.[128] While the one-tier committee of management is the standard governance structure,[129] the Registrar may, if it considers it 'necessary or desirable', require a two-tier structure comprising a board of trustees and a board of directors.[130] A committee of management must comprise five to 30 natural persons, none of whom need be coop members.[131]

Members of committee of management are subject to statutory duties of honesty and care ('reasonable diligence').[132] Officers of coops are subject to statutory duties not to make improper use of (i) their position as officers or (ii) information acquired through their position, whether for the benefit of themselves or any person, or to the coop's detriment.[133] Breach of these statutory duties may be subject to criminal prosecution, with a maximum fine of S$5,000 (approximately US$3,600) and up to 12 months' imprisonment.[134] In addition, the committee of management member or officer in breach may be liable to the coop for any profit made or damage caused.[135] Given that the statutory language of these duties in the coop context tracks that applicable to directors and officers

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[123] CSA, s. 16 (providing that the members are bound by the bylaws).
[124] CSA, s. 14(2) and The Schedule.
[125] MCCY, 'By-law amendments and dissolution of co-ops' (2021) https://www.mccy.gov.sg/sector/initiatives/by-law-amendments-restructuring-dissolution-of-co-ops.
[126] CSA, s. 15(3).
[127] CSA, s. 15(2), (5).
[128] CSA, s. 2(1); see CSA, s. 61(1)–(3) for a statement of the committee of management's functions.
[129] CSA, s. 4(2)(a).
[130] CSA, s. 4(2)(b).
[131] CSA, s. 59(1)(a).
[132] CSA, s. 63(1).
[133] CSA, s. 63(4).
[134] CSA, s. 63(5)(b).
[135] CSA, s. 63(5)(a).

of companies under the CA,[136] it may be assumed that they would be interpreted in a similar way. However, the extent to which fiduciary duties of directors and officers of companies in common law and equity would apply to cooperatives is unclear.[137] The CSR further prescribes specific duties for certain types of officers.[138]

4.1.5. Taxation and Distributions

While coop income is legally exempted from corporate income tax,[139] coops are required by law to contribute part of their surplus[140] to a state-operated, tax-exempt[141] Central Co-operative Fund (CCF) 'to be used to further co-operative education, training, research, audit and for the general development of the cooperative movement in Singapore'.[142] The bulk of CCF's expenditures go towards funding the Singapore National Co-operative Federation (SNCF), which is the coop industry body and the CCF Secretariat.[143] As compared with Singapore's flat corporate income tax of 17%,[144] the statutory contribution rate for coops is progressive and levied at 5% for the first S$500,000 (approximately US$360,000) of surplus, and 20% for further surplus.[145] The second-tier contribution (i.e. surplus levied at 20%) may be made to either CCF (by default) or the Singapore Labour Foundation (SLF) at the coop's election,[146] although it appears that the overwhelming majority of such contributions go to the SLF.[147] The SLF is a public entity ('statutory board') created by its own enabling legislation and its objects primarily concern the promotion of the welfare of unionised workers and their families and the development of the trade union movement

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136 See section 3.1 above.

137 The CSA statutory duties are in addition to and not in derogation of any other written law or doctrine otherwise applicable to *officers* of a 'society': CSA, s. 63(8). The Act defines 'society' as a coop registered under the Act: CSA, s. 2(1). Accordingly, the Act is silent on the extent to which *company* officers' duties apply to coop officers. The Act is also silent on the common law and equitable duties and liabilities of committee of management members who are not officers.

138 CSR, r. 14 (covering the chairman, secretary, treasurer, and chief executive officer).

139 Income Tax Act 1947, s. 13(1)(f).

140 'Surplus' is defined as 'the economic results of a [coop] as shown in the audited financial statements of that society after provisions have been made for depreciation and bad debts': CSA, s. 2(1).

141 Income Tax Act 1947, s. 13(1)(e), First Schedule.

142 CSA, s. 71(1).

143 MCCY (n. 89), p. 28.

144 Income Tax Act 1947, s. 43(1)(a).

145 CSA, s. 71(2)(b).

146 CSA, s. 71(2)(b), (3).

147 See MCCY (n. 89), p. 26. As coops were exempted from the mandatory first-tier contribution for that year (see below nn. 149–151 and accompanying text), the contribution figures should reflect the second-tier contributions only.

in Singapore.[148] From 2020 to 2021 the first 5% rate was lowered to zero for coops with financial years ending 31 December 2019 to 30 September 2020,[149] and from 31 December 2020 to 30 September 2020[150] as part of the Singapore government's support for coops during the COVID-19 pandemic.[151]

Coop surplus net of statutory contributions to CCF or both CCF and SLF is 'net surplus'.[152] A coop may distribute net surplus to officers as honoraria, and to members either as dividends, 'patronage refunds', bonus certificates or bonus shares,[153] albeit subject to partial distribution constraints. Generally, the maximum dividend payable on shares is capped at 10% per annum,[154] but credit coops failing to meet prudential requirements as set by the Registrar would be subject to more stringent caps on an individualised basis.[155] Dividends received from coops by members are subject to income tax.[156]

4.2. FORMATION

As compared to registration of a for-profit private company limited by shares, which is a relatively simple online process without substantive review of the proposed enterprise on the merits by the regulator,[157] the process of registering a coop requires the preparation of substantial paperwork and a four-step process[158] involving the Registrar. For the first step, a *pro-tem* committee of at least three persons must be established to (i) perform a 'feasibility study of the proposed coop',[159] (ii) prepare a viability statement comprising a business plan

[148] Singapore Labour Foundation Act 1977, s. 4.
[149] Co-operative Societies (Prescribed Rate of Contribution under Section 71(2)(a)) Rules 2020, r. 2.
[150] Co-operative Societies (Prescribed Rate of Contribution under Section 71(2)(a)) Rules 2021, r. 2.
[151] MCCY (n. 89), p. 20.
[152] CSA, s. 2(1).
[153] CSA, ss. 72(1), 73(1).
[154] CSA, s. 72(2)(b); CSR, r. 13.
[155] CSA, s. 72(2)(a).
[156] Inland Revenue Authority of Singapore, 'Dividends' (14 January 2022) https://www.iras.gov.sg/taxes/individual-income-tax/basics-of-individual-income-tax/what-is-taxable-what-is-not/dividends.
[157] Section 3.2 above.
[158] The following description is based on the official guidance provided on the Registry of Co-operative Societies website, with additional citations to legislation added by the rapporteurs as appropriate. For the official guidance see MCCY, 'How to set up a co-op' (25 January 2022) https://www.mccy.gov.sg/sector/initiatives/how-to-set-up-a-co-op. See also the guidance offered by the apex body for coops, the SNCF: SNCF, 'Form a co-op' (2022) https://www.sncf.coop/form-a-co-op.
[159] MCCY (n. 158). See CSA, s. 8(a).

and at least three years' worth of financial projections, (iii) 'consider the [coop's] objects and by-laws',[160] and (iv) draft the bylaws.

For the second step, the *pro-tem* committee submits the viability statement, draft bylaws, and a list of prospective members and their personal details to the Registrar. The website guidance sets out a process by which the Registrar gives substantive comments on the submitted documents.

For the third step, a preliminary meeting must be held by at least five persons qualified for membership in the proposed coop, and the draft bylaws as amended to reflect any changes required by the Registrar must be adopted at this preliminary meeting.

In the fourth and final step, an application form, a list of proposed members and personal information, a viability statement comprising the business plan and financial projections, the proposed bylaws, and preliminary meeting minutes signed by the proposed members would be submitted to the Registrar for approval.[161] The Registrar has discretion to deny registration notwithstanding the application having met all substantive legal requirements, and is vested with the statutory power to impose additional terms and conditions for registration as it thinks fit.[162]

4.3. MAINTENANCE

Although the MCCY Minister is designated as the regulator with responsibility over the CSA,[163] in practice its functions are performed by the office of the Registrar.

4.3.1. Registrar's Powers

The Registrar is expressly empowered by the CSA to conduct special audits on the governance, operations, financial condition and affairs generally of every coop.[164] The Registrar's enforcement powers are extensive, including the right to access 'any materials or information belonging or relating to the [coop]'.[165] There is no evidence that there has ever been a dispute in Singapore over a coop's social mission that has been raised for resolution by the Registrar.

160 MCCY (n. 158) ('The business plan should contain things like (but not limited to) business strategy, products and services, target customers, expected demand. Financial projections should include the balance sheet, income and expenditure and cash flow statements'). See CSA, s. 8(b).

161 MCCY (n. 158). Cf. CSA, ss. 7–8.

162 CSA, s. 9(4).

163 See n. 84.

164 CSA, s. 33A.

165 CSA, s. 77(1).

4.3.2. *Audit and Reporting of Coops*

All coops must be audited annually by a public accountant or a person authorised by the Registrar.[166] The audited financial statements, together with the audit report and an annual report, must be submitted by a coop to the Registrar within six months of the closing of the coop's financial year.[167] Financial statements must comply with the applicable accounting standards, the Singapore Financial Reporting Standards.[168]

4.3.3. *Assessment of Social Mission*

There is nothing in coop legislation specifically prescribing the details of how fidelity to their social mission (if applicable) is to be assessed. The use of the word 'cooperative' (or its equivalents in other languages) is regulated,[169] but otherwise the Registrar is vested with essentially unlimited power to regulate coops as it thinks fit. As of 2022, the Registrar's power to issue written directions and non-mandatory instruments appears to have been exercised almost exclusively in the context of credit coops. Written directions so far appear to concern risk management matters,[170] and a Code of Governance for Credit Co-operatives issued by the Registry of Co-operative Societies was last revised in 2016.[171]

4.4. EXIT

4.4.1. *Winding Up*

A coop may be voluntarily dissolved upon application by the coop[172] if (i) the members so approve with a three-quarters vote at an extraordinary general

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[166] CSA, s. 33.

[167] CSA, s. 34.

[168] CSA, s. 34(7); Accounting Standards Act 2007, s. 8; Accounting Standards Council Singapore, 'Financial Reporting Standards: Effective for annual reporting period beginning on 1 January 2022', https://www.asc.gov.sg/pronouncements/financial-reporting-standards/2022-volume.

[169] Non-coops are prohibited from using the word 'cooperative' or its equivalents without the Registrar's approval, except for businesses operating with the word as of 1 January 1980: CSA, s. 99(1).

[170] MCCY, 'Prudential requirements for credit co-ops' (14 October 2021) https://www.mccy.gov.sg/sector/initiatives/prudential-requirements-for-credit-co-ops.

[171] Registry of Co-operative Societies and SNCF, 'Code of Governance for Credit Co-operatives' (17 October 2016) https://www.mccy.gov.sg/-/media/MCCY-corp/Sectors/Code_of_Governance_for_Credit_Co-ops-_2016.pdf. Additional guidance documents for credit coops are released at MCCY, 'Sectors' (2022) https://www.mccy.gov.sg/sector/initiatives/resources-and-useful-links.

[172] Coops may also be dissolved after an inquiry held by the Registrar either on its own initiative or upon application by a creditor, or by the Registrar on its own initiative on enumerated legal grounds: CSA, s. 83(1)–(2).

meeting convened for the purpose, and (ii) the Registrar is of the opinion that the coop should be wound up and issues a winding up order accordingly.[173] The Registrar's order is essential for dissolution, but any member may appeal the winding up order within two months of the date of the order to the MCCY Minister, whose decision is final.[174] Based on the annual reports issued by the Registrar, only a few coops were deregistered in the years ending on 31 March of 2021 (one), 2020 (two) and 2019 (one),[175] although the precise grounds were not disclosed.

In a winding up, coop assets are subject to non-distribution constraints. They must be distributed in the following order: costs of liquidation; discharge of coop liabilities; refund of capital contribution to the members; payment of unpaid dividends or patronage refunds if any and subject to the cap in the CSR or the bylaws;[176] and either the Co-operative Societies Liquidation Account or a charitable purpose as selected by the members prior to winding up and approved by the Registrar.[177] The principal and interest in the Co-operative Societies Liquidation Account may be used at the direction of the MCCY Minister to further the coop movement or for charitable purposes.[178] In other words, surplus in liquidation is never distributed to the members.

4.4.2. Restructuring

While the CSA contains provisions governing the merger (amalgamation) of coops or the transfer of assets and liabilities from one coop to another,[179] there is nothing in this Act specifically providing for conversions of coops into other entities. The restructuring mechanisms available to companies and other corporate entities under the IRDA do not apply to coops. Realistically, the most legally certain, if complicated, way of entity conversion that is consistent with existing law would be to transfer the old coop's assets and liabilities to a new entity, issue shares or other membership interests in the new entity to the old coop's members, and dissolve the old coop. There are no legal restrictions on

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[173] CSA, s. 83(1).

[174] CSA, s. 83(3)–(4).

[175] MCCY (n. 89), p. 9; MCCY, 'Annual Report on the Co-operative Societies in Singapore for the Financial Year Ended 31 March 2020' (October 2020), p. 9, https://www.mccy.gov.sg/-/media/MCCY-corp/Sectors/RCS_Annual_Report_FYE_31Mar2020; MCCY, 'Annual Report on the Co-operative Societies in Singapore for the Financial Year Ended 31 March 2019' (October 2019), p. 8, https://www.mccy.gov.sg/sector/-/media/393D31AEB76F42F2ADD2EDC896AE2AA4.ashx.

[176] CSA, s. 88.

[177] CSA, s. 89(3)–(4).

[178] CSA, s. 89(5)–(6).

[179] CSA, ss. 74–75.

such a transfer of assets beyond the mandatory involvement of the Registrar in the process, and whose approval would be necessary.

4.5. ENFORCEMENT OF SOCIAL MISSION

Legal enforcement of rules or norms governing coops in Singapore is theoretically possible, but decided cases have been exceedingly rare, with the sole line of cases arising from a provision of the CSA that is no longer in force and hence no longer relevant.[180] Insofar as a dispute arises out of 'the constitution, election of officers or conduct of general meetings', the Registrar may resolve it on the merits or recommend parties to refer the dispute to arbitration that must be by a referee appointed by the Chief Justice of Singapore and who is not a government official.[181] A Registrar decision on the merits may also be challenged by an aggrieved party by referral to arbitration on the same terms.[182] A Registrar decision not subsequently challenged by arbitration may be enforced as a civil judgment of the District Court,[183] a lower court with limited original civil jurisdiction. Despite the existence of these provisions on the statute books, insofar as coops are concerned, it would be fair to say that the legal framework for enforcement of social mission by the members appears undeveloped.

5. CHARITIES AND INSTITUTIONS OF PUBLIC CHARACTER

5.1. CHARITIES

Charities are regulated by the Charities Act 1994, and by the Commissioner for Charities (the Commissioner). According to the Commissioner's website (Charity Portal), only three types of legal entities are eligible for registration as a charity in Singapore: companies limited by guarantee; societies registered with the Registry of Societies;[184] and charitable trusts.[185] The entity's governing

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180 *Singapore Government Officers' Co-operative Housing Society Ltd v. Achutha Menon* [1979] SGCA 5, [1979–1980] SLR(R) 98, reversing *Singapore Government Officers' Co-operative Housing Society Ltd v. Achutha Menon* [1978] SGHC 52, [1977–1978] SLR(R) 567.

181 CSA, s. 91(1)–(3).

182 CSA, s. 91(3).

183 CSA, s. 91(5).

184 These are regulated by the Societies Act 1966.

185 Charity Portal, 'Criteria for Registration as a Charity' (2022) https://www.charities.gov.sg/Pages/Charities-and-IPCs/Register-as-a-Charity/Criteria-for-Registration-as-Charity.aspx.

instruments must provide that it is operated for exclusively charitable purposes,[186] which fall within the following categories:[187]

1. relief of poverty;
2. advancement of education;
3. advancement of religion; or
4. other purposes beneficial to the community, which include commonly recognised ones such as:
    a. promotion of health;
    b. advancement of citizenship or community development;
    c. advancement of arts, heritage or science;
    d. advancement of environmental protection or improvement;
    e. relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantages;
    f. advancement of animal welfare; and
    g. advancement of sport, where the sport promotes health through physical skill and exertion.

The entity's purposes must also be wholly or substantially for the benefit of the community in Singapore.[188] Charities are required to have at least three governing board members, of which two must be permanent residents or Singapore citizens.[189] Charities are required to keep accounting records[190] and issue annual reports,[191] and are subject to annual audit and examination requirements.[192]

5.2. INSTITUTIONS OF PUBLIC CHARACTER

A registered charity may apply to be approved as an institution of public character (IPC). In addition to the tax benefits enjoyed by charities, IPCs may allow donors to enjoy tax exemptions of 2.5 times the qualifying donation amount.[193] The generous

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186 Charities (Registration of Charities) Requirements, reg. 3(1)(a).

187 Charity Portal, 'Criteria for Registration as a Charity' (2022) https://www.charities.gov.sg/Pages/Charities-and-IPCs/Register-as-a-Charity/Criteria-for-Registration-as-Charity.aspx; see also R. Leow, 'Four Misconceptions About Charity Law in Singapore' [2012] *Singapore Journal of Legal Studies* 37, 45–48.

188 Charities (Registration of Charities) Requirements, reg. 3(1)(c).

189 Charities (Registration of Charities) Requirements, reg. 3(1)(b).

190 Charities Act 1994, s. 11.

191 Annual reports must be made available for public inspection: Charities Act 1994, ss. 14–15.

192 Charities Act 1994, s. 13.

193 Income Tax Act, s. 14Z; Charities (Institutions of a Public Character) Regulations, reg. 9 (issuance of tax deductible receipts); Charity Portal, 'Commissioner of Charities' (2022) https://www.iras.gov.sg/taxes/other-taxes/charities/donations-tax-deductions.

tax exemptions available for donations to IPCs can be particularly attractive to donors, and are arguably the single most important benefit enjoyed by IPCs. IPCs are primarily regulated by the Commissioner and Sector Administrators. The Sector Administrators consist of government ministries and state-linked organisations that exercise oversight over entities whose charitable purposes relate to their regulatory responsibilities.[194]

Table 2. Sector administrators for IPCs

Sector Administrator	Charitable Purpose(s)
Ministry of Education	Advancement of education
Ministry of Health	Promotion of health
Ministry of Social and Family Development	Relief of poverty or those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantages
People's Association	Advancement of citizenship or community development
Sport Singapore	Advancement of sport

Source: Compiled by the rapporteurs.

A registered charity may only acquire IPC status when it satisfies the following requirements:[195]

- its governing instruments are approved by the Sector Administrator;
- its activities are exclusively beneficial to the community in Singapore as a whole and are not confined to sectional interests or groups of persons based on race, belief or religion;
- its activities meet its objectives under its governing instruments and the objectives of the Sector Administrator;
- its governing board is sufficiently independent;[196]
- at least half of its governing board members are Singapore citizens;
- its governing board members are accountable for the management of donations received;
- the appointment of its auditor is approved by the Sector Administrator; and
- the approval of the institution or fund as an institution of a public character is not contrary to the public interest.

194 Inland Revenue Authority of Singapore, 'Donations and Tax Deductions' (2022) https://www.charities.gov.sg/Pages/AboutUs/Commissioner-of-Charities.aspx.

195 Charities (Institutions of a Public Character) Regulations, reg. 3(1).

196 The independence requirements are provided in Charities (Institutions of a Public Character) Regulations, reg. 3(4)–(6).

Where IPC status is granted, it will be valid for a period not exceeding two years as provided by the Sector Administrator.[197] A charity may seek an extension of its IPC status by submitting the required documents to the Sector Administrator.[198] The Sector Administrator may also suspend or revoke a charity's IPC status where, inter alia, the charity has been mismanaged, no longer serves a 'purpose for the benefit of the community in Singapore', or where such actions are necessary or desirable in the public interest.[199]

6. CONCLUSION

Social enterprises have become a hot topic in contemporary corporate law scholarship. While Singapore lacks a specific legal framework for social enterprises, it nonetheless has an active ecosystem for social enterprises that is facilitated by key players such as raiSE.

Existing legal regimes for companies, cooperatives and charities offer a useful framework for social enterprises to structure their activities. However, the diverse legal forms available for social enterprises – as well as the absence of a single regulator – may result in a 'patchwork' of legal regimes difficult for social enterprises to navigate. Nevertheless, creating a separate and distinct regime tailored for social enterprises may not be useful in Singapore's context for at least two reasons. First, a new legal regime for social enterprises is likely to overlap with existing regulations, and result in greater confusion rather than clarity. Second, social enterprises – many of which are MSMEs – may not be well equipped to deal with additional regulatory burdens, and the resulting increase in costs. In sum, significant reforms are likely to be neither desirable nor necessary – at least in the near future.

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[197] Charities (Institutions of a Public Character) Regulations, reg. 4(3).

[198] Charities (Institutions of a Public Character) Regulations, reg. 5.

[199] Charities (Institutions of a Public Character) Regulations, reg. 6.

SOCIAL ENTERPRISES IN SWITZERLAND

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1. SOCIAL ENTREPRENEURSHIP IN SWITZERLAND: AN OVERVIEW

1.1. DEFINITIONS AND CONCEPTS

The greatest challenge in preparing a report on social entrepreneurship in Switzerland lies in the fact that there is no legal definition and no common

understanding of the term 'social enterprise'. In fact, the concept of social enterprises causes considerable confusion, as it varies not only according to the target group, but also depending on the region and language area of the country.[1] Two general interpretations of the term can be observed:[2]

1. social enterprises are organisations that provide occupational and social integration services and opportunities for people who are disadvantaged in the regular labour market;[3] or
2. social enterprises refer to any entrepreneurial activity that pursues a social objective.

This report is mainly based on the second, much broader, conceptual understanding of the social enterprise, which is also more represented in the public and the media.[4] For a clearer distinction from the second term, relevant actors, including the Federal Social Insurance Office, also use the term work integration social enterprises (WISEs) when referring to the first concept. Differences can be seen in the requirements for employment relationships and in the design of the economic and social objectives.[5]

The existing definitions of professional associations and actors of the social enterprise landscape present various similarities and differences. Common to all understandings is that they see social enterprises as having a dual purpose, following a multi-stakeholder approach that considers not only economic, but also social parameters. While their primary objective is the solution of specific social problems, they rely on market-based instruments to achieve them. Social entrepreneurs combine therefore an economic activity with a positive social impact. In this way, they differ from profit-oriented companies and purely donation-based organisations.[6]

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1 European Commission, *A map of social enterprises and their eco-systems in Europe. Country report: Switzerland*, Publications Office of the European Union, Luxembourg 2014, p. i.

2 D. Ferrari, S. Adam, J. Amstutz, G. Avilés, L. Crivelli, S. Greppi, A. Lucchini, D. Pozzi, D. Schmitz, B. Wüthrich and D. Zöbeli, *2016 Sozialfirmen in der Schweiz. Grundlagen zur Beantwortung des Postulats Carobbio Guscetti 'Rolle der Sozialfirmen' (13.3079)*, Bundesamt für Sozialversicherungen, Bern 2016, p. 3.

3 S. Adam, 'Sozialfirmen zwischen Wunsch und Wirklichkeit', *Panorama* 2009, p. 6.

4 Ibid.

5 For an overview of the differences of the definitions by the relevant professional associations, see: Report of the Swiss Federal Council to the postulate 13.3079 Carobbio Guscetti 'Role of social enterprises' [Bericht des Bundesrates in Erfüllung des Postulats 13.3079 Carobbio Guscetti 'Rolle der Sozialfirmen'] of 14 March 2013, 19 October 2016, pp. 6–8.

6 https://sens-suisse.ch/was-ist-soziales-unternehmertum/.

1.2. HISTORIC DEVELOPMENTS

The development of social enterprises is closely related to the development of the labour market. Because of the favourable economic environment, WISEs and social enterprises started to emerge later than in other European countries. Indeed, in contrast to other European states, Switzerland was spared the negative consequences of the first oil price shock in the 1970s and the following stagflation. Moreover, since the end of the Second World War, the unemployment rate in Switzerland has been consistently low. It was only in the 1990s, with the rise of unemployment and the structural changes of the economy, that social enterprises began to develop themselves at a larger scale.[7] Yet the first WISE social enterprises are reported to have already emerged in the 1970s, focusing mainly on the integration of people with disabilities in the labour market.[8]

2. THE SWISS SOCIAL ENTERPRENEURSHIP LANDSCAPE

The Swiss social enterprise landscape is characterised by its great heterogeneity. Over the last few years, the concept of social entrepreneurship has gained increasing attention. This development can also be attributed to the initiatives of the Swiss social entrepreneurship association SENS, which aims at promoting socially responsible entrepreneurship in Switzerland.[9] SENS derives its understanding of social entrepreneurship from the criteria established by the Organization for Economic Co-operation and Development (OECD)[10] and EMES, the Research Network on Social Enterprises.[11] Accordingly, social entrepreneurship is based on the following principles: (i) the purpose is to have a positive social, environmental or cultural impact; (ii) decision-making authority and responsibility lie autonomously with the enterprise; (iii) stakeholders are given opportunities to participate; (iv) at least 50% of revenues result from services or products; and (v) surplus income is largely reinvested for social impact.

Given the lack of a uniform definition of the concept of social enterprises, there are no official statistics on the spread of social enterprises. Yet, in 2019,

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7 Report of the Swiss Federal Council to the postulate 13.3079 Carobbio Guscetti 'Role of social enterprises' [Bericht des Bundesrates in Erfüllung des Postulats 13.3079 Carobbio Guscetti 'Rolle der Sozialfirmen'] of 14 March 2013, 19 October 2016, p. 4.

8 Ibid.

9 See Art. 2 I of the bylaws of SENS, https://sens-suisse.ch/wp-content/uploads/2020/05/Sens_Statuten_202009.pdf.

10 See OECD, 'Social Entrepreneurship in Europe', https://www.oecd.org/cfe/leed/social-entrepreneurship-oecd-ec.htm.

11 EMES Research Network on Social Enterprises, https://emes.net/.

SENS launched the Social Entrepreneurship Map with the idea of making the existence of social entrepreneurship easily and publicly accessible.[12] In order to be listed on the Social Entrepreneurship Map, enterprises need to fall within the scope of the criteria established by SENS:

1. their purpose is to create a positive social impact and to contribute to at least one of the United Nations' Sustainable Development Goals (UN SDGs);
2. their surplus income is largely reinvested for social impact;
3. they offer participation opportunities to stakeholders;
4. their headquarters are situated in Switzerland;
5. they do not qualify as public-law institutions;
6. they generate at least half of their revenues through production or services; and
7. they are not listed on the stock exchange.

At the time of writing (February 2022), 306 enterprises from a large variety of industries are listed in this database, which reflects the diversity of impact-oriented entrepreneurship in Switzerland. Almost all sectors of the economy are represented on the Social Entrepreneurship Map, going from energy and construction, to the health sector to the financial industry.[13]

Despite their differences, social enterprises have an important common denominator: they aim at creating value for society. Value creation, in turn, is delivered by an organisation's business model.[14] Through their business activities, social entrepreneurs strive to achieve social change, such as in relation the climate crisis, migration, inequalities of opportunities, inclusion or the increasing social division. The decisive difference with commercial or traditional ventures lies thus in the objectives they pursue. While traditional ventures create value for themselves or their stakeholders, social enterprises create value for their beneficiaries. In other words, traditional ventures focus on capturing value by generating financial profits, whereas social entrepreneurs aim at creating value.[15] Against that background, social enterprises see financial profits as a means to an end, but not as their primary purpose.[16]

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12 See https://map.sens-suisse.ch/de.

13 SENS Suisse, *Monitor soziales Unternehmertum Schweiz 2020*, p. 8.

14 S. Müller, 'Business Models in Social Entrepreneurship' in C. Volkmann, K. Tokarski, K. Oliver and E. Kati (eds), *Social Entrepreneurship and Social Business – An Introduction and Discussion with Case Studies*, Springer, Wiesbaden 2012, p. 106.

15 F. Santos, 'A positive theory of social entrepreneurship' (2012) 111 *Journal of Business Ethics* 335, 340.

16 S. Müller, 'Business Models in Social Entrepreneurship' in C. Volkmann, K. Tokarski, K. Oliver and E. Kati (eds), *Social Entrepreneurship and Social Business – An Introduction and Discussion with Case Studies*, Springer, Wiesbaden 2012, p. 106.

3. FORMS OF ORGANISATION

3.1. THE ABSENCE OF A SPECIALISED FORM OF ORGANISATION FOR SOCIAL ENTERPRISES

Swiss law does not provide any specific legal form of organisation for social enterprises. Introducing legal amendments to create a specific form of organisation for entities that pursue a hybrid purpose is currently not on the political agenda in Switzerland. The federal government rejected a parliamentary interpellation[17] suggesting the introduction of a specific legal form of organisation for social enterprises, arguing that the existing legal forms of organisation under Swiss law are well suited to implementing social entrepreneurship.[18]

Given the lack of a specific legal form for social enterprises, the question arises to what extent the existing legal vehicles permit the pursuit of a social mission. In the following subsections, we will briefly outline the principal legal structures that Swiss law offers for the organisation of businesses and discuss to what extent they are suitable vehicles for social enterprises.

3.2. CORPORATIONS

The two principal forms of organisation for businesses with a commercial purpose are the company limited by shares (LTD, Arts 620 et seq. Code of Obligations, CO) and the limited liability company (LLC, Arts 772 et seq. CO).[19] Both forms are incorporated with a separate legal personality and a membership based on capital requirements. One of their distinctive features is that their liability is limited to their own debts (Art. 620 III CO for the LTD and Art. 772 III CO). Whereas the LTD is a suitable vehicle for businesses of any size, the LLC has been designed specifically for small and mid-size enterprises (SMEs). Not only are the initial capital requirements lower for the LLC than for the LTD (CHF 20,000 instead of CHF 100,000; see Arts 621 and 773 CO), but the LLC also offers the possibility to limit the transferability of shares and requires that the identity of the partners are disclosed in the commercial register.

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[17] In Switzerland, a parliamentary interpellation is a procedure used by parliamentarians to request information from the federal government on important domestic or foreign events or on federal matters.

[18] Parliamentary interpellation 18.3455, Fabio Molina, 'La Suisse va-t-elle rater le train de l'entrepreneuriat social?', 6 June 2018, https://www.parlament.ch/en/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20183455.

[19] SENS Suisse, *Monitor soziales Unternehmertum Schweiz 2020*, p. 12; Federal Act on the Amendment of the Swiss Civil Code (Part Five: The Code of Obligations, CO) of 30 March 1911, SR 220.

As the supreme governing body of the corporation (Art. 698 I CO for the LTD and Art. 804 I CO for the LLC), the general meeting has the following non-transferable rights: to determine and amend the statutes; to elect the members of the board and the external auditors; to approve the annual report and the consolidated accounts; and to approve the annual accounts and resolutions on the allocation of the profit. In particular, the general meeting has the competence to set the dividend and the shares of profits paid to board members. Moreover, the general meeting votes on the discharge of the members of the board of directors.

Dividends are distributed on share capital unless the statutes provide otherwise. A social enterprise that is structured as an LLC or an LTD could include a restriction or prohibition on paying dividends in its statutes, provided that all shareholders agree to it.

3.2.1. For-Profit Corporations

According to traditional understanding, corporations aim at generating profits that are distributed among the shareholders or partners. Such a rigid conception, rooted in the social norm of shareholder primacy, is difficult to reconcile with the pluralistic approach of social enterprises.[20] Swiss corporate law offers discretion to serve stakeholder interests other than investors.

In recent years, the concept of corporate purpose has started to evolve. There is a growing tendency to recognise that commercial companies are not exclusively market actors, but also stakeholders in civil society, and, as such, they must adopt socially responsible behaviour. Accordingly, companies should pursue not only profits, but also other objectives of their stakeholders, including the environment and other public interests, including those of future generations.[21] Under Swiss law, stakeholder theory derives from Article 717 I CO (for LTDs) and Article 812 CO (for LLCs), providing that the members of the board must faithfully safeguard the interests of the company. It can thus be assumed that the company has a separate and independent interest from its shareholders. Conversely, this means that the interests of the shareholders are not the only parameter that the executive organs of the corporation must consider in their decisions.[22]

What are the limitations of this discretion for social entrepreneurs organised as a for-profit corporation? As long as business decisions serve the long-term

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20 V. Pfammatter and H. Peter, 'Sociétés hybrides, entreprises sociales, B-Corp: Le droit suisse est-il approprié?' (2021) 3 *Revue Suisse de droit des affaires et du marché financier* 289, 292.

21 G. Ferrarini, 'Corporate Purpose and Sustainability' (2020) 1 *EUSFiL Research Working Paper* 1, 5.

22 V. Pfammatter and H. Peter, 'Sociétés hybrides, entreprises sociales, B-Corp: Le droit suisse est-il approprié?' (2021) 3 *Revue Suisse de droit des affaires et du marché financier* 289, 292.

interests of the corporation,[23] for-profit corporations enjoy discretion to pursue a social mission and to serve stakeholder interests other than those of investors. They are allowed to embed stakeholder values in their statutes and to follow social-benefit interests in their decision-making process, provided that such decisions do not undermine the profit-making goal of the corporation.

Data from 2020 shows that the most common form of organisation for social enterprises (36%) is the limited liability company.[24] We can therefore assume that Swiss company law not only permits the pursuit of a social mission, but also that the legal form of the LLC is appropriate for many social enterprises.

3.2.2. Non-Profit Corporations

Corporations may declare themselves as 'non-profit' corporations in their statutes, as laid down in Article 620 III CO. Such entities are limited by shares, but are established with a non-commercial purpose, such as the promotion of culture, public goods, politics, leisure, etc.[25] The possibility for corporations to follow a non-commercial purpose has also been backed by case law, as well as by legal scholarship.[26]

3.3. COOPERATIVES

Social enterprises may also take the legal form of a cooperative, which are entities composed of at least seven individuals or commercial companies who join forces for the primary purpose of promoting or safeguarding their own interest (Arts 828–926 CO). Although their primary focus is the economic interests of their members (Art. 828 I CO), they may pursue other missions, including non-profit goals, as long as they also serve the interests of their members.[27] Profits may be distributed to the members of the cooperative, but only if the articles of association provide for doing so. Failing that, any net profit of the business activity accrues to the cooperative's assets.

Among social enterprises, compared to all market-based enterprises, there are an above-average number of cooperatives (19% compared to 1%).[28] Two

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[23] R. Bahar, 'Philanthropie et but lucratif : la quadrature du cercle' in R. Trigo Trindade, R. Bahar and G. Neri-Castracane (eds), *Vers les sommets du droit – Liber amicorum pour Henry Peter*, Schulthess, Geneva 2019, p. 465.

[24] SENS Suisse, *Monitor soziales Unternehmertum Schweiz 2020*, p. 12.

[25] V. Pfammatter, 'Hybrid entities in Switzerland' (2019) 3 *Expert Focus* 175, 177.

[26] Swiss Federal Court decision, 25 February 2016, B_3502/2014, para. 4.1. V. Pfammater, 'Hybrid entities in Switzerland' (2019) *Expert Focus* 175, 177; A. Meier-Hayoz and P. Forstmoser, *Droit suisse des sociétés*, Stämpfli, Bern 2015, p. 400.

[27] V. Pfammatter, 'Hybrid entities in Switzerland' (2019) 3 *Expert Focus* 175, 177.

[28] SENS Suisse, *Monitor soziales Unternehmertum Schweiz 2020*, p. 12.

famous examples are the two largest Swiss retail food stores, Coop and Migros, both cooperatives that provide in their articles of association that the cooperative must promote not only the interests of its members, but also those of consumers and other stakeholders.

Because the focus of the cooperative is not on profit-making but nonetheless allows for a limited distribution of dividends, it is fair to say that this seems to be a particularly suitable form of organisation for social enterprises.[29] Having a long-standing tradition in Switzerland, cooperatives are sometimes referred to as the precursors of today's social enterprises, a model of social entrepreneurship that existed even before the theory on social entrepreneurship was developed.[30] However, except for the particular case of housing cooperatives, new entities in Switzerland only rarely chose the cooperative as their legal form of incorporation, which might be due to the fact that the cooperative does not permit taking over control, given that all members, irrespective of their financial participation, are entitled to only one vote (Art. 885 CO).[31]

As the supreme governing body of the cooperative, the general meeting of members has wide participation rights (Art. 879 CO). It notably has the competence to adopt and amend the articles of association and, thus, to determine the purpose of the association. Further, the general meeting of members appoints the directors and auditors, approves the accounts and the balance sheet, and decides on the distribution of the net profit.

3.4. ASSOCIATIONS

Social entrepreneurs might also choose the form of an association (Art. 60 Swiss Civil Code, CC).[32] As laid down in Article 60 CC, an association may have a political, religious, scientific, artistic, charitable, social or any non-economic purpose. To achieve their purpose, associations may also carry out commercial activities. Yet there is an important difference with regard to the previously mentioned commercial entities of the Code of Obligations: associations do not have a share capital and may, therefore, not distribute any benefits.

Despite this limitation, the available data shows that the legal forms of associations and foundations are quite popular, as 15% of social enterprises chose

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29 V. Pfammatter, 'Hybrid entities in Switzerland' (2019) 3 *Expert Focus* 175, 178.

30 V. Pfammatter and H. Peter, 'Sociétés hybrides, entreprises sociales, B-Corp: Le droit suisse est-il approprié?' (2021) 3 *Revue Suisse de droit des affaires et du marché financier* 289, 295.

31 Ibid.

32 Swiss Civil Code of 10 December 1907, SR 210.

one of these forms (compared to only 2% of all market-based enterprises).[33] The popularity of the association for impact-driven businesses can probably be explained by the fact that its creation is relatively fast and free of hurdles. Indeed, an association gains legal personality when its intention to exist as a legal entity is expressed in its statutes. More precisely, a minimum of two founding members must hold a constitutive assembly to adopt the statutes, including the purpose of the association, appoint the members of the mandatory bodies of the association, and determine its seat (Art. 61 CC). Further, associations do not have an obligation to register in the commercial register unless they carry out commercial activities or if they are subject to mandatory external audit (Art. 60 III CC).

The general meeting of the members is the supreme governing body of the association (Art. 64 I CC). It notably decides on the admission and exclusion of the members, appoints the executive committee, and decides on all matters which are not reserved or delegated to other governing bodies of the association (Art. 65 I CC). It also acts as the supervisor of the governing body (Art. 65 II CC). All members have equal voting rights (Art. 67 I CC).

As organisations with their own legal personality, associations are only liable for their debts. Members of the association have no personal liability for the association's debts.

3.5. FOUNDATIONS

Social enterprises can also operate under the legal form of the foundation (Arts 80–89bis CC). Like associations, foundations have their independent legal personality and, therefore, are held liable for their debts. However, they differ from associations in that instead of members, they have pools of assets dedicated to a specific purpose. Even though foundations generally have an ideal purpose, Swiss law does not exclude foundations from having a commercial purpose or activity, as long as such purpose is lawful.[34] The typical use of the legal form of the foundation is either a charity or a pension fund.[35]

Foundations are established by a public deed or by a testamentary decree upon death (Art. 81 CC). They need to be registered with the commercial register. The board is the supreme governing body. It notably has all the competences that are not delegated to other bodies, as well as the fiduciary powers to represent the foundation.

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[33] SENS Suisse, *Monitor soziales Unternehmertum Schweiz 2020*, p. 12.

[34] Swiss Federal Court decision, 10 February 1984, 110 Ib 17, para. 3d.

[35] Thompson Reuters Foundation, *Philanthropy and Social Entrepreneurship: A Guide to Legal Structures for NGOs and Social Entrepreneurs in Switzerland 2017*, p. 25.

4. CERTIFICATIONS AND METRICS

There are no state designations or certifications available for social enterprises. Over the last decade, initiatives from the private sector have increasingly begun to develop certificate systems aimed at measuring a company's social and environmental performance. Supporting the view that social entrepreneurship should be business-driven, the federal government has explicitly encouraged the development of such private initiatives.[36]

The most widespread private certification system for social enterprises is the B Corp certification. Granted by the international non-profit organisation B Lab in a step-by-step procedure,[37] the B Corp certification allows companies to gain visibility and to become identifiable as impact-driven businesses.[38] To receive the B Corp label, companies first need to earn a minimum score of 80 in the Benefit Impact Assessment (BIA). This free and online platform evaluates how the company impacts on its workers, the community and the environment. In a second step, B Lab conducts a review and background check to make sure that the company applying meets the standards defined by B Lab.[39] B Corp certified companies strive for a positive impact, beyond making profit. Certified B Corporations are required to follow a stakeholder governance approach to business to meet the legal requirements for B Corp certification.[40] More precisely, this means that they must indicate in the statutes that their purpose is 'to promote the success of the business for the benefit of its shareholders, but also to strive for a material positive impact on the society and the environment'.[41] The B Corp certification also impacts the duties of directors and managers. In this regard, the statutes need to indicate that the members of the board are not just accountable to shareholders when making business decisions, but to all stakeholders, including shareholders, employees, suppliers, society and the environment.[42] It must be noted that the B Corp label is not a one-time achievement, but a process that requires continuous

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36 Parliamentary interpellation 18.3455, Fabio Molina, 'La Suisse va-t-elle rater le train de l'entrepreneuriat social?', 6 June 2018, https://www.parlament.ch/en/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20183455.

37 See https://www.blab-switzerland.ch/.

38 *Philanthropy and Social Entrepreneurship: A Guide to Legal Structures for NGOs and Social Entrepreneurs in Switzerland 2017*, p. 73.

39 See https://www.blab-switzerland.ch/.

40 See B Lab Switzerland, 'Legal Requirement Framework 2022', p. 1, https://assets.ctfassets.net/l575jm7617lt/pU8gkG7Nf87EMCyjcQarM/c88b1da9e440f6cbc9d3d329ef0889c3/B_Lab_Legal_Framework_Switzerland_SA_AG.pdf.

41 Ibid.

42 Ibid.

commitment.[43] That is why the B Corp certificate is initially valid for three years, after which it must be renewed.[44]

Since the first B Corps were certified in 2007, the number of registered businesses has grown exponentially ever since.[45] In the wake of the COVID-19 pandemic, which clearly highlighted the importance of socially sustainable businesses, we can expect that the number of businesses registering for B Corp certification will further increase. Although the B Corp movement reached Switzerland rather late – the first Swiss company was certified only in 2014 – the B Corp certification system is enjoying growing popularity. Currently there are 119 B Corp certified businesses in Switzerland, representing around 30 industries.[46]

5. SUBSIDIES AND BENEFITS FOR SOCIAL ENTERPRISES UNDER THE SWISS TAX FRAMEWORK

5.1. EXEMPTION OF ENTITIES PURSUING PUBLIC SERVICE OR PUBLIC INTEREST PURPOSES

Strictly speaking, Swiss tax law does not have a special tax treatment for social enterprises, neither at the federal nor at the cantonal levels. Preferential tax treatment is in general reserved for charitable-purpose legal entities only, and does not take into account the hybrid nature of social enterprises.[47] In particular, Swiss federal law exempts corporate profits of legal entities that are pursuing public service or public interest purposes and that are exclusively and irrevocably directing their profits to those purposes.[48] Those exoneration requirements apply both to Swiss-resident entities and to permanent establishments. Such requirements are not restricted to a specific corporate form: any legal entity, i.e. an entity that is deemed to have a separate legal personality (a company limited by shares, an association, a foundation, etc.), can apply for tax exemption in

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43 V. Pfammatter and H. Peter, 'Sociétés hybrides, entreprises sociales, B Corp: Le droit suisse est-il approprié?' (2021) 3 *Revue Suisse de droit des affaires et du marché financier* 289, 298.

44 See https://www.blab-switzerland.ch/faq.

45 S. Kim, M. Karlensky, C. Myers and T. Schifeling, 'Why Companies Are Becoming B Corporations' (2016) *Harvard Business Review*, https://hbr.org/2016/06/why-companies-are-becoming-b-corporations.

46 https://www.blab-switzerland.ch/.

47 R. Gani, 'Social entrepreneurship: Is it social or entrepreneurship? Tax treatment of social entrepreneurship in Switzerland' in *The Routledge Handbook of Taxation and Philanthropy*, Routledge, London 2021, p. 546.

48 Art. 56 para. 6 of the Direct Federal Tax Act (DFTA) of 14 December 1990.

relation to its public service or public interest activities. Similar or even identical norms exist in cantonal legislation. For instance, the cantonal law in the canton of Geneva states that legal entities pursuing public service or public interest goals are exempt from direct taxes, if such profit or equity is exclusively and irrevocably directed to these goals.[49] The exemption requirement is fundamental for charitable organisations, as only tax-exempt entities can receive tax-subsidised donations (which donors can deduct from their taxable income).

In this respect, the law specifically indicates that profit-seeking goals cannot be considered as public interest purposes. For instance, a legal entity may not get a tax exemption if its main purpose is to conduct a commercial activity (e.g. to run a restaurant), even if all the profits from this activity are allocated to charitable purposes. Acquiring and managing significant equity in business corporations could also be problematic. In particular, a tax-exempt entity should hold such equity for public interest purposes only and the goal of keeping such equity must be subaltern to its public interest goals.[50] The general rule is that the entity should hold such equity as a passive investor, merely managing its assets and liabilities. This is particularly true for holdings that exceed 50% of the equity of a business company.[51] A tax-exempt entity must not interfere in the profit-making activity of the underlying business company (for instance, having the same person with a right to vote on the boards of both the tax-exempt charitable entity and the underlying business company).[52] In addition, the investee company must make regular and substantial contributions to the exempted entity, which must in turn be effectively devoted to a public benefit activity.[53] Holdings of 100% must be considered particularly carefully. In a recent case, the Swiss Federal Supreme Court removed the tax exemption of a foundation whose only source of revenue derived from a commercial holding company, held 100% by this charitable entity. The Court held that in this particular case, holding shares of a commercial company was not subaltern to the foundation's public purpose goals, as its capacity to pursue such goals depended exclusively on the underlying business company and the revenue it generated.[54]

The Federal Court regularly emphasises that one of the main reasons for this restriction is to preserve competitive neutrality and equal treatment of

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49 Art. 9(f) of the Act on the taxation of legal persons, canton of Geneva (Loi sur l'imposition des personnes morales).

50 Art. 56 para. 6 DFTA.

51 Circular Letter No. 12 of the Federal Tax Administration of 8 July 1994 on the tax exemption for legal entities tax exemption for legal entities pursuing public service or purely public utility purposes (hereinafter: Circular Letter No. 12), p. 4.

52 N. Urech, Commentaire romand sur l'impôt fédéral direct, 2017, ad. Art. 56 DFTA Nos 76, 77–79, pp. 1035–1036; Circular Letter No. 12, p. 4.

53 G. Lideikyte Huber, 'Activité à but lucratif d'une entité d'utilité publique exonérée d'impôt : Notion et limites' (2019) 3 *Expert Focus* 215, 216 and quoted references.

54 Swiss Federal Supreme Court decision, 10 May 2021, Case no. 2C_166/2020.

competitors in the market.[55] Some authors, however, consider that some social enterprises do not disturb competition and thus could have a hybrid social and economic purpose.[56]

5.2. POSSIBILITIES FOR TAX-EXEMPT ENTITIES TO PURSUE A FOR-PROFIT ACTIVITY

Despite the seemingly strict legal framework described above, tax-exempt entities can in practice pursue certain commercial activities and keep their exempt status. Such entities in many ways start to resemble social enterprises more than pure charities. Due to such possibilities offered by tax law, the Federal Council in its 2016 report on social enterprises states that the vast majority of the social enterprises in Switzerland are tax-exempt, and organised as a foundation or in the form of a foundation or an association. They are subject to a ban on profit distribution.[57]

There are three ways in which commercial activity could be carried out by a tax-exempt entity for public interest or service purposes.[58]

An exempt entity may engage directly in a *small-scale for-profit activity*, as both administrative practice and legal authors agree that any profit-making activity in itself does not lead to the denial of the tax exemption.[59] The activity must, however, be 'at most a means to an end and cannot constitute the sole economic justification of the legal person'.[60]

Such an activity may even, depending on the circumstances, be indispensable for the achievement of the general interest purpose.[61] For example, a learning workshop (for children, disabled persons, etc.) can have a store that sells the products created in the workshops. However, in order to benefit from the exemption, this activity must in principle remain subsidiary to the entity's non-profit activity. Therefore, an exempt entity should not rely on such a for-profit activity to create a significant source of self-financing, at the risk of losing its exempt status; this last point was recently confirmed by the Federal Supreme

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55 22 September 1995, ATF 121 I 279, para. 4a and quoted references.

56 See R. Gani, 'Social entrepreneurship: Is it social or entrepreneurship? Tax treatment of social entrepreneurship in Switzerland' in *The Routledge Handbook of Taxation and Philanthropy*, Routledge, London 2021, pp. 536–46.

57 Report of the Swiss Federal Council to the postulate 13.3079 Carobbio Guscetti 'Role of social enterprises' [Bericht des Bundesrates in Erfüllung des Postulats 13.3079 Carobbio Guscetti 'Rolle der Sozialfirmen'] of 14 March 2013, 19 October 2016.

58 See more on this G. Lideikyte Huber, 'Activité à but lucratif d'une entité d'utilité publique exonérée d'impôt : Notion et limites' (2019) 3 *Expert Focus* 215, 216.

59 Ibid.

60 Circular Letter No. 12, p. 4.

61 Circular Letter No. 12, p. 4.

Court.[62] The acceptable amount of revenue generated by the entity from commercial activity varies and depend on cantonal practices. 30% of revenue is generally considered to be an upper limit.

If the tax-exempt entity seeks to develop a more significant commercial activity, it can also opt for a *partial tax exemption*. This concerns situations where the funds of the exempted legal entities cannot be exclusively and irrevocably devoted to the public purpose.[63] A partial exemption is subject to certain conditions. Firstly, the exempted activity must be significant, even though the law does not specify how the significance of the activity is to be measured.[64] Secondly, the funds for which the exemption is claimed must be clearly separated from the rest of the assets and income.[65] In practice, this means that the partially exempt entity must keep separate accounts for its for-profit and non-profit activities. Business profits of a partially exempt legal entity will then be taxed under the ordinary regime.

Finally, tax-exempt entities can also derive revenue through equity holdings in business corporations. However, such holdings cannot be defined as a social entrepreneurship activity, as Swiss law requires tax-exempt entities to assume a passive role when holding such an investment.[66] A clear separation must be established between the two entities, as the exempt entity (or its governing bodies) may not play any management role in the investee company.[67]

5.3. COMPANIES WITH IDEALISTIC PURPOSES

A novelty in the Swiss tax law framework is the tax exemption applicable to entities pursuing idealistic purposes.[68] Since January 2018, legal entities pursuing idealistic purposes and realising low profits that are exclusively and irrevocably directed to such purposes are exempt from federal and cantonal taxes for profits up to CHF 20,000. The Federal Council interprets 'idealistic' purposes as any non-commercial purposes, meaning that a legal entity must not seek to realise profits for itself or for its stakeholders.[69] An entity pursuing idealistic goals must

[62] Swiss Federal Supreme Court decision, 10 May 2021, Case no. 2C_166/2020.

[63] Circular Letter No. 12, pp. 4–6.

[64] G. Lideikyte Huber, 'Activité à but lucratif d'une entité d'utilité publique exonérée d'impôt : Notion et limites' (2019) 3 *Expert Focus* 215, 217.

[65] Ibid.

[66] Art. 56 para. 6 DFTA.

[67] See more on the conditions for such equity holdings in G. Lideikyte Huber, 'Activité à but lucratif d'une entité d'utilité publique exonérée d'impôt : Notion et limites' (2019) 3 *Expert Focus* 215, 217.

[68] Federal Act on the exoneration of legal entities with idealistic purposes, 15 March 2015.

[69] Dispatch on the Federal Law on the Exemption of Legal Entities Pursuing Ideal Goals of 6 June 2014, RS 14.051.

meet very strict conditions for realising profits. At the federal level, the term 'low profits' is defined as not exceeding CHF 20,000 (Art. 66a Direct Federal Tax Act, DFTA) (equivalent to approximately €20,000 or US$20,00 as well). At the cantonal level, the cantons were given the opportunity to determine the threshold of 'low' profits themselves. The ones who did not adapt their legislation by 1 January 2020 apply the federal threshold of CHF 20,000 directly (Arts 26a and 72t(1) Federal Act of 14 December 1990 on the Harmonisation of Direct Taxation at Cantonal and Communal Levels, DTHA). This reform does not apply to cantonal taxes on equity. Donations to companies pursuing idealistic goals are not deductible from donors' taxable income.

6. FUNDING MECHANISMS

Although no reliable and comprehensive data on investment in social enterprises is available, it is generally assumed that access to finance in Switzerland is easy for social enterprises.[70] Specialist investors, intermediaries or specific financial instruments targeted at social enterprises are the exception. Although comprehensive and reliable data on the size of the investments is lacking, there seems not to be a need for specialised funding, given that many commercial banks are keen to invest in social enterprises.[71] This is mainly due to the fact that access to credit is in general relatively easy in Switzerland, a circumstance that benefits all types of organisations, including social enterprises.[72] Moreover, private foundations are also quite important in funding social enterprises.[73] The funding options for social enterprises depend notably on their form of organisation. Access to credit is in general easy in Switzerland and open to all types of organisations.[74] Independently of their form of organisation, social enterprises can obtain loans from banks. If a social enterprise is structured as a corporation, the general meeting can decide to increase the share capital, in order to raise funds for the business (Arts 650 et seq. CO).

So far, Swiss social enterprises have not listed securities on the stock exchange. Although social enterprises technically have the option to raise funds on the stock market – securities regulation does not treat them any differently from other ventures – equity-based funding is quite limited for social enterprises.[75] It is notably only open to businesses that are structured as corporations.

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70 European Commission, *A map of social enterprises and their eco-systems in Europe. Country report: Switzerland*, Publications Office of the European Union, Luxembourg 2014, p. i.

71 Ibid.

72 Ibid., p. 7.

73 Ibid., p. i.

74 Ibid., p. 7.

75 Ibid.

Associations and foundations cannot obtain funds by way of equity investments, given that they do not have shares and may not distribute dividends.[76]

In their early years, social entrepreneurs tend to fund their business with their own savings. More than 60% of social entrepreneurship was financed with entrepreneurs' own savings in the five first years of their enterprises' existence.[77] Financing through business angels is the least frequent form of financing for social enterprises.[78] In contrast to the totality of Swiss start-ups, the revenues of social enterprises, however, account for a significantly larger share of the initial financing.[79] Most social entrepreneurs that responded to a survey conducted by SENS estimated that the impact orientation of their venture did not have a positive or negative influence on their initial funding. However, there seems to be a slight indication that impact-oriented businesses are well received by investors.

7. CONCLUSION

In conclusion, Swiss law accepts the duality of businesses that pursue a social mission, even though, contrary to other jurisdictions, Swiss law does not provide for a legal entity specially designed for social enterprises. The topic of social enterprises is not on the political agenda and, therefore, there are no prospective changes in the law to be expected in this area.

Yet this does not mean that Switzerland is a desert for social entrepreneurs. As the present report has shown, Swiss law allows for substantial flexibility for social enterprises. Almost every type of organisation may serve as a legal vehicle for a social venture, each with different advantages and limitations. In certain cases, social enterprises can also fall into the category of tax-exempt entities under the rules applicable to non-profits.

With the growth of the impact investing movement, investors are increasingly paying attention to ventures pursuing a social mission. Whereas specialist investors for social enterprises are limited, commercial banks and foundations are keen to invest in social enterprises.

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76 Ibid., p. 31; *Philanthropy and Social Entrepreneurship: A Guide to Legal Structures for NGOs and Social Entrepreneurs in Switzerland 2017*, pp. 20, 28.

77 SENS Suisse, *Monitor soziales Unternehmertum Schweiz 2020*, p. 30.

78 Ibid.

79 Ibid.

SOCIAL ENTERPRISES IN TAIWAN

Wen-Yeu Wang

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1. WHAT IS A SOCIAL ENTERPRISE?

In Taiwan, there is still no clear definition of a social enterprise. Some believe a social enterprise is a new form of entity that places equal emphasis on making profits and promoting specific social values, such as green consumption, fair trade and humanitarian assistance.[1] In other words, a social enterprise is an economic entity that places emphasis on social responsibilities and sustainable development goals as well.

To encourage the founding of social enterprises, the Ministry of Economic Affairs has given a rather broad definition of the entity type in its Social Enterprise Action Plan.[2] According to this definition, a social enterprise is a business with a mission to solve social or environmental problems, with any economic surplus

[1] Feng Yan, 'The development of Taiwan's social enterprises in recent years' (2016) 149 *Exchange Magazine*.

[2] The Social Enterprise Action Plan of the Ministry of Economic Affairs (2014–2016), http://10156659.myku.tw/k/10156659/m/20151002205239.pdf.

mainly used for reinvestment in itself. However, the same Action Plan also contains a narrower, contrasting definition of a social enterprise. Based on this second definition, a social enterprise refers to an enterprise whose articles of incorporation should clearly declare that its primary purpose is to contribute to social welfare or to solve social problems. At the end of each year, such an enterprise should issue financial statements verified by accountants, file them with the relevant authority, and present to the public its social welfare report. Moreover, it should reserve at least 30% of its economic surplus for social welfare purposes. According to the Social Enterprise Action Plan, the broad definition is used to accommodate a wide range of needs for general promotion measures. By contrast, the narrow definition is provided to conform to international standards, with a view to guiding listed companies to fulfil their corporate social responsibility (CSR) accordingly.

Social enterprises can be seen in many industries in Taiwan. For example, Dazhi Wenchuang Zhiye Co., Ltd. is a magazine publishing company that contributes to poverty alleviation by providing self-employed job opportunities for the homeless. Fresh Milk Shop, a tea shop, purchases milk from smallholder dairy farmers in order to help reduce unfair trading practices in the dairy industry. Light Source Social Enterprise Co., Ltd. promotes organic agriculture to improve indigenous people's lives while maintaining their sustainable economy and traditional culture.

Enterprises, including both social and traditional enterprises, can be imagined as existing along a continuum, with the creation of social impact as the main goal at one end and the creation of financial value at the other. One scholar has identified three key distinctions:[3]

1. social enterprises have a motivation grounded in the public welfare, while traditional enterprises are driven by profit;
2. social enterprises bear a responsibility to their stakeholders, which is not limited to people in the enterprise but also extends to all members of society; in contrast, traditional enterprises are primarily responsible to their shareholders; and
3. in social enterprises, income is mainly used to reinvest in enterprise operations and related social welfare projects, whereas in traditional enterprises profits are typically distributed to shareholders.

To put it simply, social enterprises combine social innovation with market mechanisms, leveraging business strategies to promote social progress and

[3] Fang Yuanyi, 'From Corporate Social Responsibly to Social Enterprise: On the Development of the Corporate-type Social Enterprise' (2019) 1 *Taiwan Financial and Economic Law Review* 133.

improve the living conditions of human beings. On the other hand, traditional enterprises primarily focus on promoting the best interests of the business and related stakeholders.

Based on statistical data, as of 15 February 2022, Taiwan is home to 94,946 non-profit organisations nationwide and 502 social enterprises in the form of companies.[4]

The very first social enterprise in Taiwan, Ruoshui International Co. Ltd., was founded in 2007 by Zhang Mingzheng, the chairman of Trend Micro, with the vision of using business and technology to improve the employment rate of people with disabilities. The company is in the field of BIM (building information modelling) and AI. It leverages the rise of cloud computing to address the employment needs of people with disabilities, aiming to achieve a win–win situation for both them and the enterprise itself. In addition to the assistance of software and hardware equipment, Ruoshui has provided free BIM vocational training courses, an online interactive course platform, and a teaching evaluation system for people with disabilities to obtain certification as AI data labellers. To date, 8,241 trainees have enrolled in these courses, and the pass rate is 87%.[5]

The next most prominent social enterprise in Taiwan is the Xihaner Foundation (Children Are Us Foundation). Running bakeries and Japanese restaurants, the Xihaner Foundation successfully helps people with Down's syndrome to step into society, allowing them to transition from being reliant on resources others provide to creating resources for others.[6] In Xihaner Foundation's programmes, people with Down's syndrome learn to cook and bake, which helps them attain self-sufficiency. Of all its related businesses, the Xihaner bakery is the most well known for its commitment to providing high-quality handmade pastries and bread while also mitigating the employment concerns of people with Down's syndrome. The Xihaner bakery has earned a good reputation for its products in Taiwan.

The largest social enterprise in Taiwan is likely the Tzu Chi Foundation.[7] In addition to charity affairs, it has branched out into medical care (Tzu Chi Hospital), education (Tzu Chi University), culture (magazines and monthly publications), media (Da Ai TV) and many other fields. However, there have been two controversial issues regarding this large social enterprise so far. First,

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[4] Data compiled by the Taipei City Industrial Development Bureau presented in the 2022 Taipei Social Enterprise Development Report, https://www-ws.gov.taipei/Download.ashx?u=LzAwMS9VcGxvYWQvMzAxL2NrZmlsZS9iOGE3NmVlNy02ZmVjLTQ1ZWItODk1NS1jNmRiM2Y2MDc3OTEucGRm&n=56S%2B5pyD5LyB5qWt5pS%2F562WIDA0MTgwOTAwLnBkZg%3D%3D&icon=.pdf.

[5] See the website of Ruoshui International Company, https://www.flow.tw/sdgs/.

[6] See the website of Xihaner Foundation, https://www.c-are-us.org.tw/.

[7] See the website of Tzu Chi Foundation, https://www.tzuchi.org.tw/.

following the 921 Earthquake, the Tzu Chi Foundation reconstructed many elementary schools in the disaster area by decorating them with Tzu Chi-style grey chevrons. In addition, rather than designing the campuses based on the environment and landscape of the local community, the Tzu Chi Foundation surrounded the campuses with green lotus railings, which imply a strong association with the Tzu Chi Foundation. The Tzu Chi Foundation has also been criticised for acknowledging donor contributions based on the amount donated. For instance, the red lotus flower on their member's ID card indicates an honorary director who has donated NT$1 million, which reflects a donor's capacity to give but may be unrelated to their underlying level of benevolence.

2. FORMS OF ORGANISATION FOR SOCIAL ENTERPRISES

Social enterprises can take the form of a non-profit foundation, a social association, a charitable trust or a company, each with its own funding sources. A foundation is a private legal person that is dedicated to the pursuit of public benefit purposes using property endowed by endowers, approved by the competent authority and registered with the court.[8] A charitable trust refers to the legal relationship in which the settlor transfers or disposes of a right of property and the trustee shall administer trust affairs according to the charitable purposes.[9] Funding for social enterprises established as foundations will mostly come from the property held by the foundation itself. A social association is a legal entity formed by a gathering of people.[10] Such an organisation's establishment is unrelated to its funding, which comes later.

There are currently four types of companies available under Taiwanese law: an unlimited company, a limited company, an unlimited company with limited liability shareholders, and a company limited by shares.[11] Each of these company forms are, by definition, 'for-profit' associations.[12] However, in an effort to facilitate the establishment of social enterprises (without promulgating special new legislation), the Ministry of Economic Affairs published an administrative rule in 2017 allowing incorporators of a company that intend to establish a

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8 See Article 2, paragraph 1 Foundations Act; Article 3, paragraph 1 Foundations Act defines 'competent authority' in the following way: 'the competent authority of foundations at the central level shall be the regulatory authority of the respective business; at the local level shall be the municipal government if it is in a municipality, or the county (city) government if in a county (city).'

9 See Article 1 Trust Law.

10 See Chapter 2 Civil Associations Act.

11 See Article 2, paragraph 1 Company Act.

12 See Article 1 Company Act.

social enterprise to simply specify this purpose in its articles of association.[13] The Ministry of Economic Affairs has yet to publish implementation rules and statistics on this type of company, however. Hence, it is unclear whether they in fact exist and how they fare in operation. The Law Amendment Committee for the Amendment of the Company Law has suggested adding a new chapter, introducing the concept of a 'benefit company' that pursues social or public welfare purposes instead of pure profit. Adopting such a definition would provide a specially designed form of entity for social enterprises,[14] but no action has been taken on this idea.

Post-establishment funding sources for social enterprises include government funding, fundraising, solicitation of investors for stock sales and crowdfunding. For instance, in 2015 the Fresh Milk Shop launched a crowdfunding campaign 'White Revolution' on FlyingV, which is the earliest rewards crowdfunding platform in Taiwan.[15] This campaign was supported by more than 4,900 sponsors, raising a total of NT$6.08 million. The money raised was acquired by the Fresh Milk Shop to buy its second ranch. In addition, the Ministry of Economic Affairs has specifically mentioned that raising funds on the GISA (Go Incubation Board for Startup and Acceleration Firms)[16] is a permissible strategy for social enterprises to pursue.

2.1. COMPANIES

Since a few Taiwanese social enterprises take the form of companies, additional elaboration on the proper objectives and governance and taxation of companies is useful.

All four types of companies noted earlier – the unlimited company, limited company, unlimited company with limited liability shareholders, and company limited by shares – have the purpose of making a profit. Their decision-makers have no obligation to pursue the interests of non-shareholder stakeholders,[17] but possess discretion to take actions that will promote public interests to fulfil the

[13] Ministry of Economic Affairs, Administrative Interpretation No. 10602341570 (2017) https://gcis.nat.gov.tw/elaw/consAction.do?method=viewCons&pk=8876.

[14] The suggestions of the Law Amendment Committee for the Amendment of the Company Law (2018), pp. 4-27–4-38, http://www.law.nccu.edu.tw/uploads/asset/data/5fc364a5dca3a31002009616/section3.pdf.

[15] 'White Revolution', *FlyingV*, https://www.flyingv.cc/projects/5717.

[16] The Incubation Board for Startup and Acceleration Firms (GISA) was launched by Taipei Exchange (TPEx) in 2014 to support small-sized non-public companies with creative ideas; 'About GISA', *Social Impact Platform*, https://si.taiwan.gov.tw/Home/Govproject/183.

[17] Yang Yueping, 'The New Company Act and the Past and Future of Corporate Social Responsibility: The Legislative Structure and Court Practices of Taiwan's Corporate Social Responsibility Theory' (2019) 18 *Chung Cheng Financial and Economic Law Review* 43.

company's social responsibilities so long as doing so will align with profit-making goals. The decision-makers in each company have the discretionary power to decide how to balance the interests of the company's shareholders and other stakeholders, but the overarching purpose of making a profit is primary. Should they act contrary to that purpose, they would be deemed to have broken their duty of care and be liable for damages.[18]

Shareholder rights and obligations differ by the type of company involved. Liability of shareholders of a limited company shall be limited to the extent of the capital contributed by each of them.[19] In contrast, shareholders of an unlimited company and certain shareholders of an unlimited company with limited liability bear unlimited joint and several liabilities for the company's debts.[20] In a limited company, a shareholder shall not, without the consent of a majority of all voting shares, transfer all or part of his contribution to the company's capital to another individual.[21] The transfer of shares in a company limited by shares, however, shall not be prohibited or restricted.[22]

Shareholder rights to participate in management vary along similar dimensions. A limited company shall select directors from among its shareholders to conduct business and those shareholders who do not conduct business may exercise the power to audit.[23] On the contrary, in a company limited by shares, the business is operated by the board of directors and shareholders usually do not participate in management.[24] However, when there is a major matter involved, such as applying for approval to cease business as a public company, modifying or altering the articles of incorporation, or transferring essential parts of the business or its assets, a shareholders' meeting will be held, allowing the owners of the company to participate in the decision.[25]

Shareholder voting power also depends on the type of company selected. In a limited company, each shareholder shall have one vote irrespective of the amount of his capital contribution.[26] In addition, any modification of the articles of incorporation, consolidation, or merger and dissolution shall be approved by a vote of two-thirds or more of all voting shares.[27] In a company limited by shares, however, a shareholder shall typically have one vote for each share in their possession.[28] Shareholders prescribed ownership thresholds or tenures

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[18] See Article 1, paragraph 1 Company Act.
[19] See Article 99, paragraph 1 Company Act.
[20] See Article 2, paragraph 1, subparagraphs 2 and 3 Company Act.
[21] See Article 111, paragraphs 1 and 2 Company Act.
[22] See Article 163 Company Act.
[23] See Article 108, paragraph 1 and Article 109, paragraph 1 Company Act.
[24] See Article 202 Company Act.
[25] See Articles 185 and 277 Company Act.
[26] See Article 102 Company Act.
[27] See Article 113, paragraph 1 Company Act.
[28] See Article 179, paragraph 1 Company Act.

may also convene or call upon the board to convene special meetings or submit a proposal for discussion at a regular shareholders' meeting.[29]

Regardless of the type of company selected, Taiwan's law does not provide much clarity regarding participation in the governance or management by other stakeholders. It only states that, under certain circumstances, the relevant authority may, 'ex officio or upon an application filed by an interested party, order the dissolution of a company.'[30] Stakeholders in limited companies and in companies limited by shares are not given voting rights and other governance rights under the current Company Act.

The decision-makers of a company shall undertake a duty of care when conducting business, or they will be liable for any resulting damages sustained by the company.[31] In addition, the board of directors shall abide by all relevant laws and ordinances, the articles of incorporation, and the resolutions adopted at the meetings of shareholders when conducting business.[32] Furthermore, the board of directors is obligated to convene shareholders' meetings and, in case a loss incurred by a company aggregates to one-half or more of the paid-in capital, the board of directors must convene and make a report to the meeting of the shareholders.[33]

Among all types of companies, only public companies are obliged to disclose information to the public. They must deliver a prospectus to subscribers of securities prior to a public offering.[34] The Taipei Exchange has added social responsibility disclosure reporting requirements for listed companies. Its rules stipulate that each year a TPEx-listed company shall prepare a corporate social responsibility report for the preceding year, referring to the Global Reporting Initiative (GRI) Standards and Sector Disclosures issued by the GRI, and other applicable rules according to its sector features.[35] The report shall include an assessment of environmental, social and governance (ESG) related risks and shall set out relevant performance metrics for managing its identified material goals.

Finally, all companies must file and pay for-profit enterprise income tax, business tax and tax on undistributed profits. The specific tax that owners of companies should file and pay is regulated based on the identity of the owner. If the owner is an individual resident of Taiwan, the gross amount of tax payable may be offset by the amount of a tax credit, based on 8.5% of the total amount of

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29 See Articles 172-1, 173 and 173-1 Company Act.

30 See Article 10 Company Act.

31 See Article 23 Company Act.

32 See Article 193, paragraph 1 Company Act.

33 See Articles 171 and 211, paragraph 1 Company Act.

34 See Article 31, paragraph 1 Securities and Exchange Act.

35 Securities and Futures Institute, 'Taiwan Stock Exchange Corporation Rules Governing the Preparation and Filing of Sustainability Reports by TWSE Listed Companies', http://eng.selaw.com.tw/LawArticle.aspx?LawID=FL075209&ModifyDate=1101207.

the dividends and earnings distributed. This credit has a ceiling set at NT$80,000 per year per individual income tax return. The taxpayer may opt to calculate the tax payable independently with the single tax rate of 28% on the total amount of the dividends and earnings. However, if the owner is an individual non-resident of Taiwan, he or she will have to calculate the tax payable using the tax rate of 21% on the total amount of the dividends and earnings.[36]

If the owner is a domestic legal entity, the total amount of the dividends and earnings shall not be included in its taxable income. In addition, the shareholder's deductible tax credit is included in the shareholder's deductible tax account. Furthermore, the undistributed surplus is subject to undistributed surplus tax. As for an owner that is an offshore legal entity, the tax it should file and pay is the same as an individual non-resident of Taiwan.

2.2. FOUNDATIONS, ASSOCIATIONS AND CHARITABLE TRUSTS

Notable limitations on purpose and non-distribution requirements apply to foundations and associations. For example, a social association should promote 'culture, academic research, medicine, health, religion, charity, sports, fellowship, social service, or other public welfare.'[37] The Foundations Act states that a foundation is a private legal person dedicated to public benefit purposes.[38] While foundations are allowed to engage in profit-seeking activities, any income derived must be used for public welfare and should not violate the charter of the endowment.[39] They also shall not distribute any residual from their endowment property, interest derived therefrom or other incomes.[40] Furthermore, because the endower does not have any legal relationship with the foundation after transferring the ownership of the endowment property to it, he or she should not receive allocations of profits either.[41] These purpose restrictions and limitations on profit distributions to owners might assist social enterprises taking these forms to maintain their pursuit of social purposes.

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36 See Article 15, paragraphs 4 and 5 Income Tax Act; Article 3, paragraph 1, subparagraph 1 Standards of Withholding Rates for Various Incomes.

37 See Article 39 Civil Associations Act.

38 See Article 2, paragraph 1 Foundations Act.

39 Ministry of Justice, Administrative Interpretation No. 10103111050 (2013) https://mojlaw.moj.gov.tw/LawContentExShow.aspx?id=FE255323&type=E&keyword=&etype=etype3; 'The Related Issues to the Choice of Application in Company Act or Foundations Act about Social Enterprises', *12th Taiwan Symposium on Innovation Economics and Entrepreneurship* (2021) https://www.lawbank.com.tw/treatise/dt_article.aspx?AID=D000024042.

40 See Article 22, paragraph 1 Foundations Act.

41 Tsai Chihyang, 'Analysis on the Basic Issues of Social Enterprise Legislation' (2015) *19 Taiwan Bar Journal* 84, *85*.

In addition to foundations, some associations that are dedicated to public purposes can play similar functions to foundations. Under Taiwan's Civil Code, associations can be divided into two categories: for-profit associations, such as companies; and non-profit associations, which include mid-range associations that are neither profit-seeking nor public-interest-seeking, for example alumni associations.[42] Only those non-profit associations that are dedicated to public interest purposes can be regarded as social enterprises. One example is the Wild at Heart Legal Defense Association, which was founded by Mr Robin Winkler, a naturalised Taiwanese American. The association is a platform for social, economic and political change through promotion of the ideas of deep ecology by means of litigation, dialogue, and conventional and unconventional educational activities.[43]

Another organisation form is the charitable trust. Taiwan's Trust Law includes a chapter on charitable trusts,[44] one example of which is Social Enterprise Revolving Trust (SERT).[45] A settlor wishing to set up a charitable trust can appoint a trustee to file an application with the government agencies responsible for the specific industry.[46] To provide an example, if someone wants to create a charitable trust to promote environmental cause, he or she should ask the designated trustee to file an application with the Environmental Protection Administration. Since the trust is a transplanted system from common law countries, the Taiwan government has yet to devise a suitable regulatory framework for charitable trusts. For instance, according to current laws and regulations, all charitable trusts are required to appoint a bank to serve as trustee.[47]

2.3. PROPOSED SOCIAL ENTERPRISE FORMS

As stated earlier, Taiwan has not created any specialised forms for social enterprise, although two reform proposals have been floated. These efforts take different approaches to differentiating proposed specialised forms from traditional for-profit or non-profit entities. The drafting committee that suggested development

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42 See Articles 45 and 46 Civil Code.

43 See the website of Wild at Heart Legal Defense Association, https://en.wildatheart.org.tw/.

44 See Chapter 8 Trust Law.

45 See the website of Social Enterprise Revolving Trust, https://sert.tw/.

46 See Article 70, paragraph 1 Trust Law.

47 See the Article 21 Trust Law; Article 3 Trust Enterprise Act; Article 4-3 Income Tax Act; Article 16-1 Estate and Gift Tax Act. (In order to achieve charitable purposes, the trustee must have sufficient expertise to administer or dispose of the trust property according to the stated charitable purposes of the trust. Although banks may have financial specialty and superior risk diversification capabilities, they may not be as familiar with charitable fields as some professionals or specialised entities. To put it simply, the legal framework of charitable trust in Taiwan is currently doubtful.)

of 'benefit companies' relied on purpose restrictions, suggesting that such a company's articles of association specify its 'general social purpose', and more than one 'specific social purpose'.[48] By contrast, the Draft Public-Interest Company Act of Taiwan[49] imposed a partial distribution constraint, providing that the total distribution of employee bonuses, compensation for directors, supervisors and other responsible persons, and the distribution of dividends and bonuses of a public-interest company shall not exceed the total amount of surplus that can be distributed.[50] They also differ in their recommendations for the composition of a social enterprise's board of directors. The Law Amendment Committee for the Amendment of the Company Law has suggested that its proposed benefit company should establish non-profit directors, who will be responsible for providing suggestions for the company's public welfare.[51] The Draft Public-Interest Company Act would require each public-interest company to have at least one independent director.[52]

3. LIFECYCLE

The legal steps necessary for forming a social enterprise using the different organisational forms above vary somewhat from form to form. A social enterprise established in the form of a company should apply for company registration with the Ministry of Economic Affairs.[53] In addition, since there are no special regulations regarding the operation of a social enterprise in the current Company Act, a company seeking to operate as a social enterprise should make stipulations in its articles of association to this effect. A social enterprise established in the form of a social association should register with the court whose jurisdiction covers the location of the main office,[54] and one established in the form of a foundation should be approved by the relevant authority and registered with the court.[55] A social enterprise organised in the form of a charitable trust, along with its trustee, shall be approved by the industry's authority.[56]

48 The suggestions of the Law Amendment Committee for the Amendment of the Company Law (2018), p. 4-36, http://www.law.nccu.edu.tw/uploads/asset/data/5fc364a5dca3a31002009616/section3.pdf.
49 Legislative Yuan, Agenda Related Documents No. 1775 (proposal of bills No. 16056) https://lci.ly.gov.tw/LyLCEW/agenda1/02/pdf/08/04/18/LCEWA01_080418_00018.pdf.
50 See Article 17 Draft Public-Interest Company Act.
51 The suggestions of the Law Amendment Committee for the Amendment of the Company Law (2018), pp. 4-35–4-37, http://www.law.nccu.edu.tw/uploads/asset/data/5fc364a5dca3a31002009616/section3.pdf.
52 See Article 11 Draft Public-Interest Company Act.
53 See Articles 5 and 6 Company Act.
54 See Article 11 Civil Associations Act.
55 See Article 2, paragraph 1 Foundations Act.
56 See Article 70, paragraph 1 Trust Law.

Existing organisations can also convert into social enterprises. If an organisation was formed initially as a non-profit, no legal transformation is needed. Conversely, if a conventional company wants to convert into a social enterprise, it should seek approval at a meeting of the shareholders or directors or clarify its purpose of promoting social welfare by amending its articles of incorporation.[57]

4. DISCLOSURE AND OVERSIGHT

Disclosure and auditing obligations, too, will be determined by the legal form a social enterprise adopts. A social enterprise in the form of a foundation shall disclose to the public:

1. the information submitted to the relevant authority for recording within one month after the initial submission;
2. the names of the grantors or donors and respective grant or donation amounts received by the foundation as well as the names of recipients of grants or donations from the foundation and respective amount in the preceding year; and
3. other information necessary to facilitate the public's supervision as designated by the relevant authority to be disclosed within a specified period.[58]

A social enterprise taking the form of a government-endowed foundation is subject to inspection of its operations, financial status and investment status by the relevant authority.[59] Such inspections may be undertaken in writing or by other methods, including on-site inspections, as the authority deems necessary. In conducting an inspection, the relevant authority may order the presentation of documents, books and relevant information for evidentiary purposes. The foundation shall cooperate in providing relevant materials and shall not avoid, impede or refuse to abide by the inspection.[60] Inspection rights over a public-endowed foundation are determined by the regulations of each foundation's relevant authority.[61]

Social enterprises using company forms may also have obligations to disclose to the public necessary information depending on the particular company form adopted. The Draft Public-Interest Company Act proposal would add

[57] See Articles 202 and 277 Company Act.
[58] See Article 25, paragraph 3 Foundations Act.
[59] See Article 56, paragraph 1 Foundations Act.
[60] See Article 56, paragraph 2 Foundations Act.
[61] See Article 61, paragraph 2 Foundations Act.

requirements for public-interest companies to prepare public welfare reports, publish financial statements online, and provide transaction information or other relevant information related to the public welfare purpose specified in its articles of association upon request by the relevant authority.[62]

Social enterprises seeking to cease their operations will again follow routes determined by their legal form. A social enterprise in the form of a company ceases operation in the same way a typical company does. At a meeting, the shareholders adopt a resolution to dissolve the company, after which the company files articles of dissolution with the Ministry of Economic Affairs.[63] In contrast, a social enterprise in the form of a social association may cease operation after the resolution of disincorporation is approved in the members' meeting.[64] However, a social enterprise in the form of a foundation cannot adopt a resolution to dissolve. It can only dissolve according to the endowment charter, or by order of the relevant authority.[65] These need not be approved by non-shareholder stakeholders or the employees of the enterprise itself. Furthermore, there are currently no provisions enabling a social enterprise that has ceased its operations to convert to a conventional legal form, nor can shareholders, employees or other constituencies force such a conversion.

As indicated above, charitable trusts can also be established to promote social welfare. Since foundations and associations are legal persons and have operated for a long time, the government has established a workable oversight regime through the legal person registration system. In contrast, since the government is not familiar with the structure of trusts, the bank/trustee exercises crucial oversight functions in practice, even though charitable trusts are required to be supervised by the industry's authority in accordance with the Trust Law.[66]

As there is no regulator empowered to monitor social enterprises in Taiwan, they receive little or no regulatory oversight. Foundations are generally self-supervised organisations, rarely necessitating intervention by supervisors. Therefore, the competent authorities will typically respect the self-assessments of social enterprises formed as foundations. The Draft Public-Interest Company Act proposes that the Ministry of Economic Affairs be empowered to adjust a social enterprise's field of business, public welfare plan or operation plan within a certain time limit if it finds the social enterprise inconsistent with the public welfare purpose stated in its articles of association.[67]

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62 See Articles 15 and 20 Draft Public-Interest Company Act.
63 See Article 315 Company Act.
64 See Article 27, subparagraph 5 Civil Associations Act.
65 See Article 65 Civil Code.
66 See Article 72, paragraphs 1 and 2 Trust Law.
67 See Articles 3 and 8 Draft Public-Interest Company Act.

5. STATE/PRIVATE CERTIFICATIONS AND METRICS

There is no social enterprise certification mechanism in Taiwan currently.[68] However, the Ministry of Economic Affairs commissioned the Self-Discipline Alliance of Public Welfare Organizations in 2015 to promote a social enterprise platform.[69] This platform is still in operation but has not been very active.[70] It might also be perceived that social enterprises whose establishment was assisted by the government (for example, those shown in the announcement on the Taipei City Government Industrial Development Bureau's website)[71] are government-certified social enterprises, although there is no formal certification process or set of criteria to qualify.

6. SUBSIDIES AND BENEFITS

The tax treatment of a social enterprise will depend on its legal form. Those formed as foundations may enjoy income tax exemption if they meet the purpose and activity requirements of the Income Tax Act.[72] This allows organisations or institutions established for educational, cultural, public welfare or charitable purposes to exempt their income derived from operations (and operations of their subsidiaries) from tax. However, in practice, stricter standards often apply and foundations meeting the basic requirements are not always entitled to tax exemption.[73] The Draft Public-Interest Company Act would expand tax benefits to social enterprises taking its proposed new form. Their non-distributable net income would be exempt from 10% of the profit-seeking enterprise income tax.[74]

Social enterprises taking the form of companies may also qualify for subsidies outside the tax system. For instance, the Taoyuan City Government provides

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[68] Zheng Shengfen, 'The methods and indicators of social enterprise certification in Taiwan' (2018) 6 *Public Governance Quarterly* 26.

[69] Cai Shufen, 'Civil Society Launches Self-Regulatory Platform for Social Enterprises', *Commercial Times* (22.12.2017) https://readers.ctee.com.tw/cm/20171222/a44ac8/861680.

[70] The website of Self-Regulatory Platform of Social Enterprises, https://socialenterprise-selfregulation.weebly.com/.

[71] 'Introduction to Good Social Enterprises in Taipei City (2015–2021)', *StartUP@Taipei*, https://www.startup.taipei/index.php?action=news_detail&typeid=1&id=829.

[72] See Article 4 paragraph 1, subparagraph 13 Income Tax Act.

[73] Chang Tsangwen, 'The Related Issues to the Choice of Application in Company Act or Foundations Act about Social Enterprises', *12th Taiwan Symposium on Innovation Economics and Entrepreneurship* (2021) https://www.lawbank.com.tw/treatise/dt_article.aspx?AID=D000024042.

[74] See Article 18 Draft Public-Interest Company Act.

start-up rents and equipment subsidies for companies established or registered in Taoyuan City for less than two years which promote social issues related to disadvantaged people, long-term care facilities, ecological and environmental protection, technological innovation, food and agriculture innovation, and fair trade.[75] The Taipei City Social Enterprise Promotion Project provides subsidies for social enterprises formed as companies, selecting recipients based on financial statements submitted and self-reported statements regarding their social mission and social influence, business performance, financial performance, core business process management, operations and risk management, culture and human resources, and counselling need.[76] A social enterprise applying for this subsidy must also describe the kind of social problems it aims to address, as well as its business model.

Social enterprises may also qualify for other benefits and advantages. For instance, the Small and Medium Enterprise Administration within the Ministry of Economic Affairs provides comprehensive guidance and counselling to social enterprises taking the form of companies, including holding various social enterprise-related counselling activities and facilitating social enterprises' cooperation and exchange of ideas with other business enterprises. The Administration has also designed special incentive mechanisms for the procurement of social innovation products and services, encouraging central and local government agencies, state-owned enterprises, private enterprises, and non-governmental organisations to purchase goods and services from social enterprises.[77]

Finally, the Taiwanese Ministry of Labour has also organised many lectures, holiday markets, international cooperation and exchanges, and other activities designed to promote social enterprises. It has also designated November as 'Social Enterprise Month' and set up a social enterprise portal to promote social enterprises and strengthen the links between domestic and foreign social enterprise communities.[78] This portal provides various government agencies with information related to social enterprises and updates the current status and achievements of social enterprise development in both Chinese and English.[79]

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75 See the website of Social Business Center of Taoyuan City, https://www.flow.tw/sdgs/.

76 See the website of the Department of Economics Development of Taipei City Government, https://www.doed.gov.taipei/News_Content.aspx?n=F28B775DFA6D1A44&sms=72544237BBE4C5F6&s=E948B21CB9622296.

77 https://0800056476.sme.gov.tw/kn_article_2.php?nid=3621&gid=5.

78 See the website of Social Economic Development Web Portal, https://se.wda.gov.tw/.

79 'Social Innovation Action Plan (2018–2022)', *Executive Yuan*, pp. 10–23, https://www.ey.gov.tw/File/CAFCE37E3CEAAB06?A=C; 'Social Enterprises in Taiwan', *Social Economic Development Web Portal*, https://se.wda.gov.tw/EN.

7. PRIVATE CAPITAL

There is currently no formal channel for social enterprises to raise funds. Most of their funds are raised through informal private channels. Moreover, no regulations on social enterprises have been included in Taiwan's Securities and Exchange Act yet. As long as it complies with the legal requirements applicable to any other firm, any social enterprise in the form of a company may file an application with a stock exchange for public listing. However, no social enterprise in the form of a listed company has emerged in Taiwan thus far. The Draft Public-Interest Company Act seeks to encourage foundation financing of social enterprises adopting its proposed form. It clarifies that foundations may invest in or establish a public benefit corporation that is aligned with their purpose.[80]

8. OTHER CONSTITUENCIES

Investors play a significant role in promoting the smooth operation and sustainable development of social enterprises. For social enterprises in the form of non-profit organisations, most funding comes from donations. Without those donations, it would be difficult for these organisations to operate in the long run.

In the case of social enterprises in the form of companies, it is investors that contribute the main sources of funding. Although conflict of interest concerns may arise where investors are concerned with a company's profits, rather than its social goals, there is still no denying that if a company wants to pursue social purposes, it has to rely on investors for funding.

In addition to investors, consumers play a very important role in social enterprises as well, regardless of whether the enterprise takes the form of a company or a non-profit organisation. For example, consumers' purchases of milk help the Fresh Milk Shop not only generate more income but also achieve its social purpose of helping small farmers. Another example is the Xihaner Foundation: as long as consumers keep purchasing its products, it can continue producing and selling goods, which not only helps create revenue but also encourages the foundation to provide more job opportunities to people with Down's syndrome.

Despite the fact that employees and customers play a critical role in the operation of social enterprises, there is currently no mechanism that specifically addresses their right to participate in the governance of social enterprises. No formal means has been provided for the stakeholders of a social enterprise to influence its operation and governance.

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[80] See Article 14 Draft Public-Interest Company Act.

9. PROSPECTIVE CHANGES IN LAW

During the past few years, the Executive Yuan has proposed both the Social Enterprise Action Plan and the Draft Public-Interest Company Act to promote the establishment and operation of social enterprises. We have also seen several proposed amendments to the Company Act dealing with issues involving social enterprises in the past several years. These proposals together suggest some appetite for establishing a special legal form for social enterprises in Taiwan. Doing so would offer a preferred choice of enterprise form to adopt when founding a social enterprise, something likely to prove attractive to entrepreneurs and investors hoping to contribute to society and participate in social welfare efforts. Because no special legal entities can now be set up, companies or individuals wishing to invest their resources in social welfare initiatives can only make donations to associations, foundations or charitable trusts. In addition, it would help people understand that, in addition to making profits, companies may also dedicate themselves to social responsibility. Establishing a special legal form for social enterprises is also in line with current international trends.

10. CONCLUSION

In addition to establishing favourable regulations and laws, raising the public's awareness of social enterprises is also a key step in the successful development of social enterprises. If the public can better understand social enterprises, there may be more investment in this area, enabling social enterprises to better achieve their social goals. Moreover, preventing social enterprises from neglecting their social purpose is a very important issue. What role should the government play here? What about the enterprise's decision-makers? Perhaps the Taiwan Stock Exchange Corporation Rules Governing the Preparation and Filing of Sustainability Reports by Taiwan Stock Exchange (TWSE) Listed Companies provide an instructive example. By regularly requiring social enterprises to disclose information and setting up litigation mechanisms for investors and stakeholders to supervise them, Taiwan could encourage social enterprises to achieve their social missions and improve society as a whole.

SOCIAL ENTERPRISES IN TURKEY

Ayşe Şahin

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This report will examine how social enterprise can be structured as a legal form, and whether it can be carried out under the existing legal corporate forms. This report also questions which regulations might be made in order to implement social enterprise in Turkish law.

1. LEGISLATIVE SITUATION AND DEFINITION

From the legislative perspective, apart from the ongoing work on social cooperatives, it may be too early to talk about a 'social enterprise law' yet in Turkey because current laws do not include any provisions for social enterprises. Social enterprise (SE) is not regulated as a legal entity or a model of organisation in Turkish law. There is not any public certification system concerning social enterprises either.

However, the concept of social enterprise, social cooperatives, and related concepts such as social aim and stakeholders' interests in business corporations has begun to garner interest as corporate sustainability is set out in the law, although not mandatory, as a principle for publicly held companies. In the event that the EU Commission's Directive Proposal on the Sustainability Due Diligence is adopted, many companies in Turkey that are part of the supply chain of EU companies will have to comply with the due diligence requirements as well.

As social enterprise is not defined in the law, as is the case in many other jurisdictions, it is hard to refer to a consistent and uniform definition.[1] Several common basic elements of the concept may be distilled from the publications, reports, academic theses and field surveys addressing the concept in Turkish law.[2] Social enterprise is generally seen as a kind of structure at the intersection of the private sector with the third sector, and in between socially responsible, ethical companies and non-profit entities (foundations and associations). It is generally understood as a concept that melts social benefit and profit in the same pot and that gathers social goals and business methods under the same roof. The two terms, 'social' and 'enterprise' refer to the basic elements and the hybrid character of the concept. But as the word order suggests, the social goal may be seen as the primary element. This dual character differentiates SEs from pure for-profits and pure non-profits.[3] Unlike charities and non-profits, there

[1] D. Gregory, 'The Politics, Policy, Popular Perception and Practice of Social Enterprise in the Twenty-first Century' in N. Boeger and C. Villiers (eds), *Shaping the Corporate Landscape Towards Corporate Reform and Enterprise Diversity*, Bloomsbury, Bristol 2018, p. 333.

[2] The following publications concern legal aspect of SEs in Turkey: British Council, 'The State of Social Enterprise in Turkey', 2019, pp. 26 ff., https://www.britishcouncil.org.tr/en/programmes/education/social-enterprise-research; D. Tarman, Z. Ayata, I. Onay, E. Arık, M.E. Oba and C. Veziroğlu, 'Türkiye'de Sosyal Girişimciliğin Hukuki Statüsü: İhtiyaçlar ve Öneriler' [Legal Status of Social Entrepreneurship in Turkey: Needs and Recommendations], June 2020, pp. 1–70, https://www.researchgate.net/publication/351874282; D. Uygur and B. Franchini, 'Social enterprises and their ecosystems in Europe. Country fiche: Turkey', European Commission, Publications Office of the European Union, Luxembourg 2019, pp. 1–67, https://europa.eu/!Qq64ny.

[3] For the distinctive features see D. Brakman Reiser and S.A. Dean, *Social Enterprise Law*, Oxford University Press, Oxford 2017, pp. 9–10; OECD, 'Designing Legal Frameworks for Social Enterprises: Practical Guidance for Policy Makers', Local Economic and Employment Development (LEED), OECD Publishing, Paris 2022, p. 16.

is a revenue-making enterprise working with methods that resemble those of business companies. And unlike for-profits, the revenue is used to realise the social goal.

To conceptualise social enterprise and define it, EU law is an important point of reference for Turkish law. In light of the EU Commission's definition,[4] three elements may be considered as the key aspects of social enterprise:[5]

- the primary objective of making a social impact;
- obtaining revenue from an enterprise that is managed in an entrepreneurial manner; and
- using its revenue to achieve its social objective.

And accordingly, although there are slightly differing definitions, in Turkey social enterprise is usually understood and defined as a business that carries out commercial activities to achieve a social goal, and the revenue generated is directed towards this social goal.[6]

Whether additional elements shall be required for a legal definition of the SE can be discussed. Among those that can be argued are: adopting a stakeholder approach,[7] financial sustainability as a differing criterion from non-profit organisations, constraints on the distribution of the profit or asset locks, the collectivity, i.e. the number of members,[8] and whether stakeholders take part in the direction or management, etc.

2. SOCIAL ENTERPRISE LANDSCAPE IN TURKEY

The situation in the field in Turkey is ahead of the legislative situation. There is an emerging ecosystem, which is developing rapidly, flourishing with many

4 https://ec.europa.eu/growth/sectors/proximity-and-social-economy/social-economy-eu/social-enterprises_en.

5 British Council, above n. 2, p. 27.

6 B. Ersen, D. Kaya and Z. Meydanoğlu, 'Sosyal Girişimler ve Türkiye, Ihtiyaç Analizi Raporu' [Report on Social Enterprises and Turkey, Needs Analysis], TÜSEV Yayınları 2010, p. 14, http://www.sosyalgirisim.org/sosyalgirisim.org/userfiles/document/Sosyal%20Girisimler%20ve%20Turkiye_web.pdf.

7 See EU Commission definition: https://ec.europa.eu/growth/sectors/proximity-and-social-economy/social-economy-eu/social-enterprises_en. For an idea of additional features of SE, see for example the definition of public benefit corporation in Delaware Code Title 8 §362(a), which mentions as one of its elements as 'to operate responsible and sustainable manner'. See A.S. Gold and P.B. Miller, 'Fiduciary Duties in Social Enterprise' in J. Yockey and B. Means (eds), *The Cambridge Handbook of Social Enterprise Law*, Cambridge University Press, Cambridge 2018, p. 330.

8 It can be asked whether collectivity is a necessary aspect or inherent to the concept of SE, which is usually based on collaborative, collective work.

new and young social enterprises, that are established in various sectors and aiming at tackling diverse social problems with innovative methods. Many of these organisations were established after 2015. There is also a wide range of intermediary organisations and stakeholders, such as civil society organisations, incubator centres, accelerators, funding organisations, and experts from the public sector or universities conducting projects.[9]

According to research findings, there are approximately 9,000 organisations that might have the characteristics of an SE and more than 20,000 civil society organisations in Turkey.[10] It is also reported that there are few B Corp-certified companies in Turkey.[11] B Corp is a certification system that measures a company's social and environmental impact, which started to operate in Turkey in 2014. It is carried out by S360, which is itself a B Corp-certified Turkish consulting firm and operates as a B Corp Turkey partner under B Lab Europe. Its aim is to introduce the global B Corp system to Turkey and support local companies to obtain B Corp certification.[12]

The industries in which social enterprises are involved in Turkey are mostly education, manufacturing, creative industries, agriculture, farming, gardening, retail sale of clothing and food, recycling, and the environment.[13]

SE entrepreneurs, i.e. the founders, are reported to be mostly young entrepreneurs under 35, women and highly educated.[14] Most of these organisations are micro or small organisations with an approximate income of US$85,000 in 2018.

Before today's social enterprise concept started up in Turkey in the 2000s, similar kinds of organisations had already been established a long time ago. These organisations are considered the precursors to social enterprises or even current examples, since they were founded for social objectives and to a certain extent use commercial methods. One of the oldest examples is Darüşşafaka School, founded in 1872 with a social mission to support the education of poor

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9 For the ecosystem stakeholders and accelerators in Turkey see UNDP, 'The Impact Investing Ecosystem in Turkey: Stakeholder Mapping and Preliminary Analysis of the Ecosystem', November 2019, pp. 38 ff., https://www.iicpsd.undp.org/content/istanbul/en/home/library/the-impact-investing-ecosystem-in-turkey.html#:~:text=Turkey's%20position%20is%20particularly%20advantageous,challenges%20observed%20in%20the%20region.

10 There is no official database or registration for SEs in Turkey. Field data in this section is based on the research and report of the British Council. However, the report mentions that the numbers will not stay up to date for long, because there are always new SEs established (p. 22). British Council, above n. 2, pp. 29, 33. However, the number of SEs in Turkey is reported differently, approximately between 1,776 and 1,906 in D. Uygur and B. Franchini, above n. 2, p. 12.

11 D. Uygur and B. Franchini, above n. 2, pp. 35. For the up-to-date list and number of B Corp certified firms see https://www.bcorporation.net/en-us/find-a-b-corp/?refinement%5BhqCountry%5D%5B0%5D=Turkey.

12 https://www.bcorpturkey.org/.

13 British Council, above n. 2, p. 56.

14 Ibid., pp. 50–52.

and orphaned children, which still carries out its activities, some of which on a commercial basis.[15] Zeynep Kâmil Hospital was founded in 1862 to reduce the deaths of women and children and still continues to provide health services today.[16] Among other well-known and current examples, the following are usually mentioned:[17] OTSIMO,[18] founded as a joint stock company (JSC) and offering special education for children with autism; Fazla Gıda, providing those in need with food that would normally otherwise go to waste; Evreka, aiming to reduce the carbon emissions and costs of the waste-collection process;[19] Tarlamvar, renting land/fields to those who want to cultivate them; Down Café, a chain of small cafés and restaurants in Turkey that employs persons with Down's syndrome; and Buğday (Wheat) Ecological Living Association,[20] established with the goal of providing access to healthy and safe food, disseminating nature-friendly production and consumption habits and strengthening ties between rural and urban life, and which operates several different kinds of enterprises on a commercial basis.

3. MAIN SOURCES OF FUNDING

For an SE to sustain and achieve its social mission, funding and capital are necessary.[21] SEs can benefit from donations, investments or traditional finance tools, such as initial capital or bank loans. Sources of funding can vary depending on the legal model adopted. For non-profit models such as associations and foundations, the main sources are donations, membership fees, and special financial support, incentives or grants provided by public authorities. One potential source of public financial support in Turkey is the grants provided for small and medium-sized enterprises by KOSGEB, an institution of the Ministry of Industry and Technology.[22]

SEs operating as commercial companies, JSCs and LLCs have easier access to some other types of capital, however. In addition to bank loans, founders can contribute with initial capital, or external investors can provide financial support by participating as a partner in a commercial company. JSCs can issue securities including bonds and debentures, which do not grant ownership/

15 For its history and today's activities see https://www.darussafaka.org/en.
16 https://zeynepkamilkdch.saglik.gov.tr/EN-463329/our-history.html.
17 These are cited as examples of social enterprises by the sources referred to in this study, as they use entrepreneurial methods to attain their social goal.
18 For a detailed illustration see D. Uygur and B. Franchini, above n. 2, pp. 33–34.
19 For the last two examples see UNDP, above n. 9, p. 37.
20 B. Ersen, D. Kaya and Z. Meydanoğlu, above n. 6, p. 24; https://www.bugday.org/blog/.
21 D. Brakman Reiser and S.A. Dean, above n. 3, p. 13.
22 KOSGEB is the abbreviation of 'Small and Medium Scaled Industry Development and Support Directorate'; D. Tarman et al., above n. 2, p. 64.

shareholder title to their owner. However, to date, it has not been common in Turkish practice to use these securities to fund SEs, since they are issued mostly by publicly held JSCs, rather than the private (closed) JSCs. On the other hand, the for-profit structure can sometimes be an obstacle to qualifying for special incentives/prizes provided for social good initiatives.[23]

However, for many SEs in Turkey, access to funding is a significant challenge. Although 65% of SEs seek external funding, they mostly use 'internal' resources such as personal financial sources, family support or government grants.[24] Banking legislation in Turkey can create hurdles for access to bank loans due to the general difficulty of the loan conditions, such as high interest rates, collateral requirements or bureaucratic procedures.[25]

4. FORMS OF ORGANISATION FOR SOCIAL ENTERPRISES

4.1. WHICH LEGAL FORMS CAN BE ADOPTED?

No specialised legal forms for social enterprises or any hybrid entity, such as a kind of social benefit company,[26] have yet to been regulated in Turkish law. Social enterprises have the option to adopt a wide range of existing traditional for-profit or non-profit legal forms. Among social enterprises in the field, one finds the for-profit forms of cooperatives (28.7%), limited liability companies (LLCs) and solo traders (18.6%) and corporations (JSCs) (13.2%), and the non-profit forms of associations (14%) and foundations (3.1%).[27] Currently, there are many enterprises operating like social cooperatives as well. New legislation to define social cooperatives is underway, which would provide a suitable form for SEs. In some instances, social enterprises may be established and structured using two separate but interconnected legal entities. There are examples where a JSC or an LLC is established alongside a non-profit association to meet the need for hybrid purposes.[28]

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23 See also donations regarding commercial companies, ibid., pp. 61, 65.

24 It is reported that there are gender imbalances, women entrepreneurs have lower external financing than men. British Council, above n. 2, pp. 42, 63, 66.

25 D. Tarman et al., p. 64. In 2019, 86% of the participants of a field survey mentioned that they did not use bank loans. British Council, above n. 2, p. 66.

26 Such as the benefit company models in other jurisdictions, e.g. the *società benefit* in Italy, community interest company (CIC) in the UK, or public benefit corporation in Delaware, USA.

27 British Council, above n. 2, p. 54.

28 Ibid., p. 54; D. Tarman et al., p. 61.

The above-mentioned most-used[29] legal entities for social ventures have several common organisational features. JSCs, LLCs, cooperatives and associations are managed and directed via their two main bodies, the board of directors and the general assembly. Only large-scale JSCs and LLCs are subject to an independent audit.[30] There are also common regulations concerning tax exemptions applicable to all for-profit companies. According to the Corporate Tax Law (CTL), certain enterprises and certain economic activities are exempted from corporate income tax.[31] Furthermore, depending on the region, firms may benefit from reduced corporate income taxes.[32]

Below these legal forms are examined further to see how suitable they are generally for social enterprise ventures, especially in terms of their main features, social purpose, dual characteristic, profit-sharing and asset locks.

4.2. UNINCORPORATED FORMS

4.2.1. Solo Traders

An individual entrepreneur aiming to realise a social good by operating an economic enterprise may register in the trade registry (or tradesman registry) as a 'solo trader' (or 'tradesman'). Compared to legal entities, there are fewer formalities for registration and also closing the enterprise, and there is no minimum capital requirement. If yearly income reaches a certain level, the enterprise would be qualified as a commercial enterprise and the trader will have the title 'merchant' and will be subject to income tax.[33] However there are tax exemptions for self-employed persons and tax exceptions (i.e. partial tax exemption for part of their earnings) for young entrepreneurs for commercial agricultural activities, and some other tax exemptions and exceptions.

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[29] Fewer collective companies and commandite companies are left generally in Turkey due to their disadvantages (such as unlimited liability). They are not preferred by social entrepreneurs either and are of limited relevance and will not be discussed in this report; For the classification of corporations in Turkish law see T. Ansay, 'Business Associations' in T. Ansay and E.C. Schneider (eds), *Introduction to Turkish Business Law*, Seçkin, Ankara 2014, pp. 89–110.

[30] TCC Art. 397/4. For the rest, i.e. the small and medium-sized JSCs, another kind of audit is being envisaged, the particularities of which will be set out in a President's regulation (TCC Art. 397/5–6).

[31] CTL no. 5520 Arts 4 and 5. For example, passenger transport enterprises and agricultural enterprises belonging to villages or village unions, operated in the villages for the common good, are among the exempted enterprises (CTL Art. 4/1-I).

[32] CTL Art. 32/A.

[33] Law on Income Tax no. 193. If the enterprise remains below a certain scale, it will be qualified as a tradesman and will benefit from income tax exemption (Art. 9).

However, compared to legal entities, solo traders have difficulties obtaining funding.[34] Banks are often reluctant to extend credit to solo traders and require personal security. Furthermore, there is usually a requirement to be a legal entity to apply for public incentives, grants and support; without a legal entity, access to these funding sources is also hindered.

4.2.2. *Simple Partnerships*

A simple partnership is a union of persons and is defined as an agreement in which two or more persons combine their goods and labour to achieve a common purpose. The simple partnership has no legal personality. The legal regime based on contract liberty provides for easier establishment, management and liquidation procedures with less formality compared to corporations. There is no requirement for a written partnership agreement to be registered in the trade registry, with a few exceptions.[35]

Concerning its suitability for an SE in terms of social purpose, simple partnerships can be established for any 'common purpose' not contrary to law. Article 620/1 of the Turkish Code of Obligations leaves entrepreneurs free to adopt this model for any purpose. However, Article 622 states that '[p]artners ought to share all earnings belonging to the partnership due to its nature'. The general approach in Turkish law is to interpret this provision as 'partners benefit jointly from the good obtained in the partnership'. Although there are minority opinions asserting that the common purpose can only be profit-sharing, it is generally accepted that the common purpose of the simple partnership should not be restricted solely to profit-making or economic purpose.[36]

However, in terms of taxation, if the partnership operates a commercial enterprise of a certain scale, partners must be registered in the trade registry and each partner will have the title 'merchant' and will be subject to commercial law provisions and income tax. Natural person partners will be subject to income tax, while legal entity partners will be subject to corporate income tax.[37] As partnerships have no legal personality, taxation will be based on the status of each partner.[38] Notably, joint ventures are subject to the law concerning partnerships, but although they have no legal personality, they are corporate income taxpayers.[39]

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[34] In this regard it is recommended that social enterprises carry out their activities under the umbrella of a legal entity. See D. Tarman et al., above n. 2, pp. 11, 60.

[35] See Communiqué of the Ministry of Commerce, OJ 01.04.2009 no. 27187.

[36] R. Poroy, Ü. Tekinalp and E. Çamoğlu, *Ortaklıklar Hukuku vol. I*, 15th ed., Vedat Kitapçılık, İstanbul 2021, n. 77; A.S. Altay, *Anonim Ortaklıklar Hukuku'nda Sermayeye Katılmalı Ortak Girişimler*, Vedat Kitapçılık, İstanbul 2009, pp. 146–47. Similarly see A.S. Gold and P.B. Miller, above n. 7, p. 332; D. Brakman Reiser and S.A. Dean, above n. 3, p. 20.

[37] Law on Income Tax no. 193; CTL Art. 2.

[38] D. Tarman et al., above n. 2, p. 21.

[39] CTL Art. 2.

Partners in a simple partnership also have joint ownership of the company's assets and are jointly and severally and personally liable for the company's debts. This mandatory personal liability regime cannot be changed in the partnership agreement, although partners contributing only their personal labour can be exempted from the obligation to participate in partnership losses. The personal ownership structure and the personal and joint liability regime render it difficult to change the partners and transfer the ownership, which requires unanimous approval of all the partners unless an easier decision-making mechanism – a majority regime – is stipulated in the partnership agreement.

Partners are default managers of the partnership unless they elect directors among themselves or third persons. There is an agency relationship between the directors and partners. Accordingly, directors have fiduciary duties and can be held liable to partners for breach and for damages. There is no specific regulation concerning the management or voting rights of stakeholders in a partnership, although the libertarian legal regime applicable to simple partnerships would seem favourable for specific legal arrangements, such as the appointment of employees, their representative, or other stakeholders' representative as directors for example. Thus, partnerships can be attributed a social purpose and can meet certain organisational features that a social enterprise venture would require. However, the biggest legal impediments are that legal transactions cannot be realised on behalf of the partnership, as the partnership has no legal personality, and that the partners are personally liable for the company's debts.

4.3. COOPERATIVES

4.3.1. General Features of Cooperatives

Most of the SEs in Turkey are formed as cooperatives. This feature of the Turkish social enterprise landscape is not very different from the EU countries generally, where most social enterprises have been found to operate as social cooperatives.[40]

To establish and register a cooperative in the trade registry, the Ministry of Trade or the Provincial Directorate must provide authorisation. Its written articles of association must be signed by at least seven natural or legal persons and their signatures must also be approved by the trade registry office. Cooperatives are regulated by the specialised Code on Cooperatives no. 1163 and other laws concerning cooperatives.

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[40] https://ec.europa.eu/growth/sectors/proximity-and-social-economy/social-economy-eu/social-enterprises_en.

Cooperatives are incorporated companies, have the status of 'merchant' and are subject to corporate income taxation.[41] However, with few exceptions, cooperatives can be exempted from corporate income tax under certain conditions.[42] To remain exempt, they must:

- not distribute profits;
- not give a share of the profit to members of the board of directors;
- not distribute the reserved funds to members; and
- do business only with members.

Importantly, this exemption leaves no room for the distribution of even a small part of the profit and is considered too restrictive, which renders the exemption regime unfavourable for SEs.[43]

Although the cooperative is a corporate company, unlike other incorporated forms, its purpose is not defined as profit-making and sharing,[44] but instead is defined as protecting economic interests and meeting the professional and livelihood needs of its members through mutual assistance and cooperation. This purpose has led to discussions on whether cooperatives should qualify for the status of merchant. The Turkish Court of Cassation has issued conflicting judgments, some recognising the merchant status of cooperatives and others rejecting it. Finally, on 12 November 2021, Unification of Precedents Grand General Assembly of the Court of Cassation decided that cooperatives would be considered merchants and thus will be subject to the repressive rules of the Turkish Commercial Code (TCC) applied to merchants, including bankruptcy procedures.

Concerning profit distribution, there should be an explicit provision in the articles of association for the distribution of the profit among members. Without such a provision, the profit cannot be distributed. The articles of association may opt for unlimited liability[45] or limited liability for the cooperative debts, and additional payment obligations for partners. With all these legal features, cooperatives appear as a model that would comply with the particularities of SEs regarding social purpose, dual characteristic and profit-sharing.

[41] CTL Art. 2/1.

[42] CTL Art. 4/1-k.

[43] D. Tarman et al., above n. 2, p. 67.

[44] S. Arkan, *Ticari İşletme Hukuku*, 28th ed., Banka ve Ticaret Hukuku Enstitüsü, Ankara 2022, p. 134; K. Oğuzman, Ö. Seliçi and S. Oktay-Özdemir, *Kişiler Hukuku (Gerçek ve Tüzel Kişiler)*, 19th ed., Filiz Kitabevi, İstanbul 2020, p. 331; For the definition see Code on Cooperatives Art. 1.

[45] Members can be liable without any limitation only in case of the cooperative's bankruptcy (Code on Cooperatives Arts 29, 30).

4.3.2. Social Cooperatives

Social cooperatives constitute a specific category of cooperatives. Turkish law does not yet set provisions concerning social cooperatives or a legal definition.[46] Since all cooperatives serve social purposes in a sense, it is reasonable to question the features that distinguish social cooperatives from regular cooperatives. Social cooperatives have been explained as cooperative organisations that value and produce more social surplus than material surplus compared to regular cooperatives.[47] In a special Project on Social Cooperatives of the Turkish Ministry of Trade, the social cooperative is described as a social enterprise model and is defined as a cooperative that prioritises public interest, does not seek profit, and follows public needs and social goals with its activities, which distinguish it from regular cooperatives. Social cooperatives are viewed as a means of providing benefits for disadvantaged groups in society. In the Turkish context, asset constraints have been understood as a key distinguishing feature: social cooperative members cannot have access to the profit obtained from the cooperative's activities, which is reserved for reinvestment in the activities.[48]

There are many examples of organisations that carry out their activities in accordance with the social cooperative model and define themselves as social cooperatives in Turkey.[49] There is not an official register providing an accurate estimate of the number of social cooperatives operating.[50]

Concerning the legal situation, there is not yet any special law or legislation concerning social cooperatives; therefore they are subject to Code on Cooperatives no. 1163 like other cooperatives,[51] and the same income tax as

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46 Parliamentary Minutes of the Subcommittee on Social Cooperatives, 14.10.2021, p. 9, https://www.tbmm.gov.tr/Tutanaklar/KomisyonTutanaklariDonemTutanaklari?Kodu=10277&DonemKodu=27&YasamaYili=5.

47 TUSEV (Third Sector Foundation of Turkey), 'Sosyal Kooperatifçilik: Yasal Mevzuat Açısından Avrupa Birliği Örnekleri ve Türkiye'deki Gelişmeler', 2018, p. 7, https://tusev.org.tr/usrfiles/images/TUSEV_SosyalKooperatifBilgiNotuTR.08.11.18.pdf.

48 Parliamentary Minutes of the Subcommittee on Social Cooperatives, 14.10.2021, p. 27, the term, 5th legislative year, 8–9; TUSEV, above n. 47, p. 7.

49 For instance, SADA is a cooperative founded in 2019 in the eastern part of Turkey as a women's initiative, to support local and refugee women and as part of the 'Project for Increasing the Resilience of Syrian Women and Girls'. The project is funded by the EU and the Government of Japan and carried out by UN Women, ILO and the municipality of Gaziantep in cooperation. At SADA, women from Turkey, Syria and Afghanistan make and sell handcrafted products, and carry out other similar commercial activities. See https://sadacoop.com/Sayfa/Hakkimizda. TUSEV, above n. 47, p. 6.

50 Parliamentary Minutes of the Subcommittee on Social Cooperatives, 14.10.2021, p. 15.

51 Ministry of Trade, news bulletin dated 18.10.2019, https://esnafkoop.ticaret.gov.tr/haberler/genel-mudurlugumuzce-sosyal-kooperatifler-mevzuati-ve-iyi-uygulama-ornekleri-cali.

other business enterprises.[52] However, projects[53] and studies have been carried out to discuss the recognition of social cooperatives as separate legal entities and how to regulate them.[54] As noted earlier, the Directorate General of Cooperatives (affiliated with the Ministry of Trade) carried out a project in 2018 with the purpose of supporting and fostering social cooperatives, and providing field data for a legislative study.[55] As part of the project, the 'Train of Social Cooperatives' has been visiting nearly 20 cities in Turkey for field research. The Train project brings together representatives of the Ministry, experts and social cooperatives for joint workshops and discussions, and collects field data to identify the need for legislation. In addition, there has been comparative law study, especially as regards the Italian Code no. 381 on Social Cooperatives, which gave legal status to social cooperatives in 1991. Detailed information was gathered and shared with the related subcommittee of the Turkey's National Assembly, for legislative preparatory work concerning the definition, types and supervision of social cooperatives, and the definition of public interest.[56]

Preparatory works at the National Assembly ramped up especially in 2021. On 14 July 2021, a subcommittee on social cooperatives was established.[57] A draft law with a set of 10–15 articles to complement the basic Code on Cooperatives has been discussed at the subcommittee. The priority is to define the social cooperative and determine which corporate structures will be included within its scope. It is also suggested that disadvantaged groups shall be defined as broadly as possible to include groups such as refugees, persons with disabilities, addicts and ex-convicts. It was even discussed and suggested that stray animals should be included as well. Additionally, draft articles of association for social cooperatives have been prepared.[58] Considering the social value created by social cooperatives, their taxation in the same way as other commercial enterprises poses an obstacle to them fulfilling their social purpose. Consequently, tax exemptions, exemptions on the social security premiums of employees, and VAT exemptions will be considered as part of the draft law.[59]

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52 Parliamentary Minutes of the Subcommittee on Social Cooperatives, 05.01.2022, p. 11.

53 A 'Cooperatives Supporting Programme' (Koop-Des) has been implemented with the aim of fostering cooperatives. Koop-Des gives financial support every year to more than 100 cooperatives, predominantly to those whose members are mostly women, to support women's labour. See Ministry of Trade, https://ticaret.gov.tr/kooperatifcilik/koop-des.

54 TUSEV, above n. 47, p. 8.

55 Ministry of Trade, news bulletin dated 18.10.2019, https://esnafkoop.ticaret.gov.tr/haberler/genel-mudurlugumuzce-sosyal-kooperatifler-mevzuati-ve-iyi-uygulama-ornekleri-cali.

56 Ibid.

57 Decision concerning the establishment of the Subcommittee on Social Cooperatives, see Parliamentary Minutes of the Petition Committee, 14.07.2021, p. 27.

58 Parliamentary Minutes of the Subcommittee on Social Cooperatives, 14.10.2021, pp. 14, 16.

59 Parliamentary Minutes of the Subcommittee on Social Cooperatives, 14.10.2021, p. 14; Parliamentary Minutes of the Subcommittee on Social Cooperatives, 05.01.2022, Seda Ekmen Özçelik presentation, pp. 11–12. During the deliberations, there have been criticisms

On the other hand, basic organisational issues such as establishment, governance and supervision of social cooperatives will be subject to the Code on Cooperatives no. 1163. It is suggested that social cooperatives shall be subject to the same supervision system applied to regular cooperatives. As in some other jurisdictions, like in Italy for example, the Code on Social Cooperatives will address only specific issues, such as the social objective, the definition and scope of social cooperatives, the definition of the disadvantaged group, and tax exemptions.[60] Once the legal status of social cooperative is recognised by law, social cooperative can be a suitable and preferred model for social enterprises in Turkish practice.

4.4. INCORPORATED ENTITIES

4.4.1. Joint Stock Companies

As social enterprises use business methods and operate an economic enterprise, the suitability of commercial companies for SEs should be assessed. For this, firstly legal characteristics of JSCs will be introduced. In Turkish law there are two types of JSCs. These are closed JSCs[61] and publicly held JSCs regulated by the Capital Market Code no. 6362 and the related legislation consisting of numerous communiqués. However, in the social enterprise landscape in Turkey, currently, it is hard to see examples of SEs founded as listed companies or publicly held companies. Accordingly, this report discusses mainly closed JSCs and LLCs and the related TCC provisions, which are very much in line with the provisions of the Swiss Code of Obligations concerning JSCs and LLCs.

JSCs can be established by one or more natural or legal persons, with a minimum share capital of 50,000 Turkish liras, by registering in the trade registry its articles of association, which shall be approved by the notary. The trade registry can only review the articles of association in terms of compliance with mandatory rules, not in terms of expediency, for example suitability for the market or public interest. In principle, there is no requirement of approval from the Ministry of Trade or other public or administrative authorities, except that JSCs operating in certain specific sectors such as banks, publicly held JSCs, holding companies, etc. A JSC, as an incorporated capital company, enjoys the status of merchant and is among the corporate income taxpayers.[62]

that there is no special regulation regarding donations or donators for social cooperatives, thus social cooperatives are currently subject to a high rate of inheritance and transfer tax for donations.

60 Parliamentary Minutes of the Subcommittee on Social Cooperatives, 14.10.2021, p. 17.

61 Regulated by TCC Arts 329–563.

62 CTL Art. 2/1.

Can the JSC be considered a suitable model for social enterprises? One well-known example of a social enterprise founded as a JSC in Turkey is OTSIMO, which has a primary social objective of developing a special game-based education method for children with autism. It operates basically on commercial methods and collected €295,000 via crowdfunding for its project.[63]

Concerning social purpose, the permissible object of a JSC is defined as 'any economic purpose not prohibited by law'. Thus, JSCs cannot be founded for a non-economic purpose.[64] TCC Article 331 mentions and requires an 'economic purpose' and not 'profit-sharing among shareholders'. Nevertheless, this article is usually understood in Turkish law as profit-making and sharing among partners.[65] It may be questioned whether the economic purpose may be interpreted more broadly than making and sharing profit to allow JSCs to operate as social enterprise with a primary social objective. Many authors interpret economic purpose as providing an economic benefit *in favour of shareholders.* Consequently, it is mentioned that the revenue cannot be used for the benefit of third persons other than the shareholders.[66]

This is because in Turkish JSC law every shareholder has the right to participate in the net profit to be distributed.[67] This does not mean that there is a requirement to distribute on a regular basis at the end of every financial year. However, not distributing the profit for a long time[68] or never distributing might lead to a violation of shareholders' dividend rights and may give them the right to sue the company,[69] unless there are reasonable causes on the part of the company, such as new investments or allocation of funds for financial difficulties.

This profit distribution imperative is one of the main drawbacks of the JSC form for social enterprises.[70] Profit-sharing renders it difficult for JSCs to build

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[63] https://otsimo.com/en/; D. Uygur and B. Franchini, above n. 2, p. 33. There are few crowdfunding platforms providing funding for SEs. One of them is Fongogo, a crowdfunding platform that brings together the capital needed for the realisation of all kinds of projects including social benefit ventures, see https://fongogo.com/About. However, field research shows that crowdfunding is not very often used as a funding model by social enterprises in Turkey. British Council, above n. 2, p. 66.

[64] F.H. Şehirali Çelik, İ. Kırca and Ç. Manavgat, *Anonim Şirketler Hukuku, vol. 1: Temel Kavram ve İlkeler Kuruluş Yönetim Kurulu*, Sözkesen Matbaacılık, Ankara 2013, p. 57. The Swiss Code of Obligations Art. 620/3, which allows a JSC to be established for a non-economic purpose, has no equivalent in Turkish law.

[65] R. Poroy, Ü. Tekinalp and E. Çamoğlu, above n. 36, n. 436.

[66] F.H. Şehirali Çelik, İ. Kırca and Ç. Manavgat, above n. 64, p. 57.

[67] TCC Art. 507/1.

[68] Cases where the profit was not distributed 10 years consecutively even though the company is profitable can be given as example.

[69] TCC Art. 531; R. Poroy, Ü. Tekinalp and E. Çamoğlu, above n. 36, n. 436; A. Şahin, *Anonim Ortaklığın Haklı Sebeple Feshi*, Vedat Kitapçılık, İstanbul 2013, pp. 162 ff.

[70] For the opinion that profit-sharing is the main obstacle to creating a corporation fit for social purpose, see L. Talbot, 'Capitalism: Why Companies are Unfit for Social Purpose and How they Might be Reformed' in N. Boeger and C. Villiers (eds), *Shaping the Corporate Landscape Towards Corporate Reform and Enterprise Diversity*, Bloomsbury, Bristol 2018, p. 121.

trust on the part of the investors, who may be concerned about whether the revenue is used primarily for the social mission.[71] At this point, to reassure investors and attract funding and investment, it may be argued whether a 'distribution constraint' or a 'non-distribution' clause can be implemented in the company's articles of association. Drawing on practice, cooperatives and capital companies, i.e. JSCs and LLCs, are sometimes required to commit not to distribute profits for a limited term, in order to apply for some grants and public support funds. It is controversial whether a non-distribution clause, the non-distribution of a part, a percentage of the profit or a constraint on distribution for a limited time may be implemented to reserve profit for social purposes in the articles of association, in respect of TCC Article 340.[72]

Under the current legislation, complete non-distribution, like an asset lock, will infringe dividend rights and be contrary to the law. However, it can be argued whether time or percentage limits can be stipulated in the articles of association, such as a distribution of only 35% or 50% of the profit. TCC provisions allow the allocation (thus non-distribution) of some part of the profit as special reserves in the articles of association.[73] But it is not mentioned up to what percentage of the profit can be set aside as reserve funds. Setting very high percentages may be considered equivalent to not distributing at all and thus would be contrary to the law.[74] However, a more flexible approach is adopted concerning shareholders' right to participate in residuals on liquidation, and the law allows the company to allocate the final residual sum to third parties at the liquidation, by so stipulating in the articles of association.[75]

Another aspect that relates to social enterprises is the fiduciary duties of directors. One question is to what extent the social purpose will be considered in decision-making. In Turkish literature, although there are opinions favouring the approach of a contract of employment, it is generally accepted that the relationship between the company and the members of the board of directors is an agency relationship and is usually based on a contract of mandate. Accordingly, members of the board of directors and third parties in charge of management have a fiduciary responsibility to perform their duties with the care of a prudent manager and safeguard the company's interests.[76] The duty of care refers to the

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71 D. Brakman Reiser and S.A. Dean, above n. 3, pp. 24, 26.

72 There is also the question of whether such a clause will bind those joining the company afterward. See D. Tarman et al., above n. 2, pp. 11–12, 62–63. On the other hand, the board of directors has wide discretion in deciding the method of distributing the profit see K. Çelikboya, *Anonim Şirketlerde Pay Sahibinin Kâr Payı Hakkı*, On İki Levha, Istanbul 2021, p. 66.

73 TCC Arts 521, 522.

74 The dividend right that is derived from the benefit purpose of the company is considered an inalienable right in Turkish law, i.e. one of those rights that cannot be removed even with the consent of its owner. See R. Poroy, Ü. Tekinalp and E. Çamoğlu, above n. 36, nn. 898a ff.

75 TCC Art. 507/1.

76 TCC Art. 369.

business judgment rule, which provides directors with a certain scope of discretion in business decisions. Article 369 outlines the duty of loyalty as 'protecting the interests of the company'. In the event that a social enterprise is established as a JSC, directors will have to balance dual goals and consider, in addition to the company's interest, the social mission too when taking decisions.[77] The fact that the text of the law explicitly mentions only the interests of the company complicates integrating the protection and consideration of the social mission and stakeholders' interests into the duty of loyalty on the part of directors. This may be overcome by giving a broader meaning to the 'company's interests'. In other words, in JSCs the company's interests may be interpreted more broadly than the interests of its shareholders to include a bigger circle of interests accordingly with the social mission of the enterprise.[78] Similarly, a drawback linked to the hybridity of an SE may occur in the other decision-making mechanism of the company as well, and reflect on the shareholders' representation in the general assembly. The hybridity may cause duality in the company and deadlocks in the general assembly between those who care about the social mission and those who are more oriented toward profit-making. In that case, corporate legal tools may then be adopted to prevent or resolve deadlocks.

There is not a provision in the law referring to stakeholders' interests. However, the answer to whether there is a discretionary area is not so clear because of the way the duty of loyalty is formulated, i.e. as protecting the company's interests. Whether it can be stipulated in the articles of association that the interests of stakeholders will be taken into account in decision-making is not so clear due to the 'mandatory rules' principle.[79] A strict interpretation would not allow stipulating stakeholders' interests in the articles of association. On the other hand, it is stated in the preamble of TCC Article 340 that this provision does not prevent the implementation of corporate governance principles. Moreover, there are several TCC provisions aimed at protecting JSCs' stakeholders other than investors, which might be interpreted in favour of directors' discretionary power concerning non-shareholder interests. Legal provisions aiming at protecting company assets and capital are all directed to protect creditors. Certain statutory provisions protecting employees may be set out in the articles of association. For example, a JSC may create funds for directors, employees and workers by reserving a part of the profit.[80]

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77 D. Brakman Reiser and S.A. Dean, above n. 3, p. 21.

78 M. Helvacı and R. Cankat, 'Karşılaştırmalı Hukukta Şirket Menfaati Kavramı' in İ. Kırca et al. (eds), *Prof.Dr. Sabih Arkan'a Armağan*, On İki Levha Yayıncılık, İstanbul 2019, pp. 547–48.

79 According to TCC Art. 340, 'no clause contrary to the mandatory provisions of TCC can be included in the articles of association unless it is allowed expressly in the law'.

80 TCC Arts 522, 523.

Concerning representation in the board of directors, groups of shareholders, certain categories of shares, or minority shareholders (that represent at least 10% of the capital in closed JSCs) may be given the right to be represented in the board of directors.[81] However, it is up to the company to grant this representation. Stakeholders and employees are not entitled by law to a special right to participate in management, unless elected as a member of the board of directors, a CEO, a CFO or similar (by the general assembly). The above-mentioned specified right to be represented in the board of directors (TCC Art. 360) can only be granted to a group of shareholders or a group of shares. To put it another way, there is no special provision concerning stakeholders' or employees' participation in management. However, there is no legal obstacle to giving the right to be represented on the board of directors or to be elected as a member of the board of directors, since third persons can be elected according to law.[82]

Although shareholders have no managerial power, they may have an impact on the decision-making mechanisms of the company through governance rights. The right to participate in the general assembly and the voting rights allow every shareholder to have an impact and even indirectly intervene in the decision-making in a JSC. Governance rights, such as the right to participate in the general assembly, and related rights, such as voting rights, the right to information and inspection, the right to instigate a special audit, minority rights, and various other rights to sue the company or directors, are granted exclusively to shareholders. Stakeholders, on the other hand, are not entitled to any kind of governance right or any possibility to join the decision-making mechanisms of the corporation. However, establishing usufruct on shares in favour of third persons will grant voting rights and the right to participate in the general assembly. Furthermore, although not regulated in the TCC, through contractual legal mechanisms such as 'stock options' or 'vesting', employees may be given the possibility to acquire shares of the company and thus may obtain and use voting rights and other shareholders' rights attached to a share.

As a result of the anonymous nature of the ownership in the *société anonyme*, shares can be freely transferred. However, the TCC gives a certain possibility to restrict transfers, but not the option to completely forbid. Restrictive contractual clauses may be incorporated in the articles of association, but only if they can be qualified as 'important reasons'. Only the reasons regarding the composition

81 TCC Art. 360.

82 For the stakeholder representative proposal see J.H. Murray, 'Stakeholder Representatives for Social Enterprise' in B. Sjåfjell and C. Bruner (eds), *The Cambridge Handbook for Corporate Law, Corporate Governance and Sustainability*, Cambridge University Press, Cambridge 2019, pp. 375 ff.

of the shareholders' circle that justifies the refusal of transfer in terms of the subject matter or the economic independence of company can be considered as important reasons. The company can also refuse to approve a transfer by offering to purchase the transferor's shares at their real value.[83]

The limited liability is set out in the first TCC provision on JSCs, Article 329, as the fundamental principle of business corporations. Accordingly, the only duty of shareholders toward the company is to pay to the company the capital contribution they have committed.[84] They cannot held liable for the company's debts against the company's creditors.

Concerning reporting in closed JSCs, 15 days before the general assembly meeting, financial statements, the annual report of the board of directors and audit reports, and the profit distribution proposal shall be made available to all partners. The articles of association and the general assembly's decisions that are registered in the trade registry are announced in the trade registry gazette, which is open to the public, i.e. can be accessed by third persons. Considering all these particularities, the suitability of JSCs for SEs will be assessed in section 5.

4.4.2. Limited Liability Companies

The limited liability company is a popular business model in Turkey and there are many more LLCs than JSCs in Turkey.[85] The legal characteristics of LLCs will be briefly introduced to assess their suitability for SEs. An LLC can be established with one or more natural or legal persons and a maximum of 50 persons, with a minimum share capital of 10,000 Turkish liras, by registering its articles of association in the trade registry. The share capital can be paid up to two years later and there is no requirement of approval by the notary, i.e. the LLC can be founded more easily, faster and with less cost. An LLC is an incorporated capital company, has the status of merchant and is a corporate income taxpayer.[86]

The LLC can be considered a smaller version of the JSC overall, since many provisions concerning JSCs are applicable to LLCs as well. The issues discussed above in respect of JSCs concerning the permissible object, limited liability, owner rights to participate in management, possibility to participate in management by other stakeholders, fiduciary duties of directors, voting rights, other governance rights of investors and other stakeholders, and the principle of 'mandatory rules' are overall regulated with a similar approach, and will not be re-explained here.

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[83] For the restrictions on the transferability see A. Şahin and T. Semerci Vuraloğlu, 'Essentials of Turkish Company Law' in Ş. Kılıç (ed.), *Introduction to Turkish Business Law*, Peter Lang, Berlin 2022, pp. 346 ff.

[84] TCC Art. 329/2.

[85] 1,092,619 limited liability companies versus 179,994 joint stock companies. Data bulletin of Turkish Ministry of Trade for December 2022, https://ticaret.gov.tr/.

[86] CTL Art. 2/1.

An issue of particular importance for LLCs, however, is profit-sharing. TCC Article 577/1-j allows explicitly provisions to be put in the articles of association on the use of profit. Consequently, a non-distribution clause for a limited term that is usually required by fund-giving institutions[87] may be stipulated in the articles of association so long as the dividend rights are not infringed.[88]

The TCC provisions concerning LLCs give promoters/partners greater possibilities to personalise and 'craft' the company according to their expectations, through implementing specific provisions in the articles of association.[89] For instance, the TCC allows restrictions or prohibition of share transfers to be set out in the articles of association.[90] The transfer also normally requires the approval of the other partners (in the form of a general assembly decision) and shall be registered in the trade registry. The LLC still preserves on some points its 'private' and personal firm character originating from its historical roots.

Considering that founders and partners have a greater possibility to shape an LLC according to their expectations, LLCs may be more suitable for realising the dual purposes of SEs.[91] Nevertheless, the partners' liability for the company's *public* debts remains a considerable drawback of an LLC, which is one reason why in Turkish practice business entrepreneurs may prefer a JSC in general.

4.5. NON-PROFIT LEGAL FORMS

4.5.1. Associations

Many Turkish ventures pursuing social good have been carried out under the legal form of an association. Associations are endowed with legal personality and are regulated in the Code on Associations no. 5253 and the Civil Code. Associations are directed by their general assembly and board of directors and are supervised by their auditing board. The association is defined as a union that is established with at least seven natural or legal persons, who constantly combine their knowledge and labour to achieve a certain and common purpose, other than profit-sharing.[92]

Thus, associations may pursue any specific and common purpose that is not prohibited by law, other than profit-sharing.[93] There might be a slight difference

[87] See also non-distribution clauses under the title of joint stock companies.
[88] D. Tarman et al., above n. 2, pp. 62–63.
[89] Partners may be granted the first option, pre-emption, and purchase rights or encumbered with the obligation to make additional financial contributions. The prohibition of competition may also be envisaged for partners in the articles of association.
[90] TCC Arts 577/1-a, 595/3.
[91] See D. Brakman Reiser and S.A. Dean, above n. 3, p. 20.
[92] Civil Code Art. 56.
[93] Civil Code Art. 56/1, Code on Associations Art. 2/1-a.

between 'profit-sharing' and 'economic purpose'. The economic purpose is that a business aims for a monetary result, i.e. making a profit.[94] Whether an association can pursue an economic purpose (other than profit-sharing) is controversial in Turkish law.[95] Associations can operate a commercial enterprise; there are no trade restrictions. In this respect, it is generally accepted in Turkish law that associations can be established to meet the financial needs of third persons who are members of a certain profession/group that is wider than that of the association's members.[96] In any case, the revenue obtained can only be used for the association's purpose and cannot be distributed among its members.[97] It may be questioned whether this non-distribution constraint for associations (as well as for foundations) suits social enterprises well, as they are founded with capital investment.[98] In addition, associations that operate an enterprise of a certain scale, i.e. a commercial enterprise, will be considered merchants and the enterprise will be subject to corporate income tax, like other business enterprises.[99]

On the other hand, associations that gain the status of 'public benefit association', under certain conditions, are not considered merchants and can benefit from certain exemptions and exceptions of corporate income tax and some other taxes. The conditions are that the association's aim and activities must address the needs and problems of society at the local or national level and contribute to social development. In addition, at least half of the yearly income shall be spent on the social purpose and a decision of the President of the Republic is required. Thus, public association status may suit social enterprises to a certain extent.[100]

4.5.2. Foundations

Foundations are the oldest legal institutions in Turkey. There have long been schools, hospitals, libraries, dormitories or hostels that have been established as foundations.[101] Foundations are regulated in the Code on Foundations no. 5737 and the Civil Code (right after the associations), are directed by their board of directors. Foundations are defined as asset unions with legal personality created

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94 R. Poroy, Ü. Tekinalp and E. Çamoğlu, above n. 36, n. 58.

95 It is mentioned that an association can be established, for example, to meet the short-term credit needs of its members, but not to share profit; see S. Arkan, above n. 44, p. 136.

96 K. Oğuzman, Ö. Seliçi and S. Oktay-Özdemir, above n. 44, pp. 363, 331, nn. 127–28.

97 D. Uygur and B. Franchini, above n. 2, p. 29; D. Tarman et al., above n. 2, p. 27. Non-distribution is the boundary between non-profit and for-profit, see D. Brakman Reiser and S.A. Dean, above n. 3, p. 31.

98 See discussions in the General Report in this volume, pp. 16–17.

99 CTL Art. 2.

100 D. Tarman et al., above n. 2, pp. 28–29.

101 K. Oğuzman, Ö. Seliçi and S. Oktay-Özdemir, above n. 44, p. 395.

by the allocation of sufficient assets and rights of *one or more* natural or legal persons for a defined and perpetual goal.[102]

Foundations can operate a commercial enterprise, and found business corporations to achieve their goals, with the condition that their revenue is allocated only to their goals. These foundations will be considered merchants and their enterprise will be subject to corporate income tax.[103] Under certain conditions, foundations can be given exemptions mainly from the corporate income tax, but also from some other types of taxes.[104] The overall conditions for exemption are that the foundation should aim to carry out activities in the fields of health, welfare, education, scientific research and development, culture, or environmental protection; these activities of the foundation should be open to the public; and they should be carried out in such a way as to reduce the public service burden of the state. It must be stipulated in the articles of foundation that at least two-thirds of the revenue will be used for its social purpose. Foundations aiming to serve only a certain region or a certain group cannot benefit from the exemption.

5. PROSPECTIVE CHANGES IN LAW

5.1. WHICH LEGISLATIVE APPROACH?

There might be different legislative approaches for regulating and recognising social enterprise. Different legal systems can choose to legislate social enterprise in different ways, i.e. different legislative methods may be adopted. Social enterprise may be legislated as a legal entity, i.e. as a specialised new corporate form.[105] On the other hand, there are jurisdictions where social enterprise is not regulated as a legal entity, but rather is recognised as a 'legal status' where, for example, a certification system would certify the SE qualification of an enterprise.[106] In other jurisdictions, in addition to the possibility of benefiting

[102] Civil Code Art. 101/1. 'Trust', as a legal institution, is not regulated in Turkish law.

[103] Code on Foundations Art. 26/1; CTL Art. 2.

[104] Law on Tax Exemption for Foundations no. 4962 Art. 20; D. Uygur and B. Franchini, above n. 2, p. 25.

[105] For new hybrid forms see D. Brakman Reiser and S.A. Dean, 'Hunting Stag with Fly Paper: A Hybrid Financial Instrument for Social Enterprise' (2013) 54 *B.C.L. Rev.* 1495, 1506 ff. For European jurisdictions (Denmark, France, Luxembourg, Malta, Romania and the UK) that have introduced new corporate forms see J.S. Liptrap, 'The social enterprise company in Europe: policy and theory' (2020) 20(2) *Journal of Corporate Law Studies* 495 ff. Generally on the tendency to formalise hybridity see A.S. Gold and P.B. Miller, above n. 7, pp. 328, 331.

[106] It is mentioned that, with some exceptions, European countries tend to favour certification rather than creating new legal organisational forms, see D. Tarman et al., above n. 2, p. 59; C. Liao, 'Social Enterprise Law: Friend or Foe to Corporate Sustainability?' in B. Sjåfjell and

from such legal status and certification, social enterprise either is regulated as a legal entity, or other 'hybrid' corporate forms are available.[107]

Can legislating new forms be suggested for Turkish law? In Turkey, currently existing legal forms of organisation are widely used by social enterprises and are considered sufficient by many social entrepreneurs in the field.[108] As mentioned above, non-profits (foundations and associations) and for-profits (JSCs, LLCs and cooperatives) have certain common organisational features, such as legal personality, foundation with the articles of association and direction by the board of directors. If a new corporate form is legislated for social enterprises, these organisational features would be similar to the existing entities.[109] Describing the distinctive characteristics of the concept of social enterprise and questioning which corporate and organisational legal regulations[110] would best meet the distinctive characteristics *de lege ferenda* is not particularly the aim of this report. But it can be said that, despite several legal questions, the approach in Turkey is rather to integrate and adapt the main distinctive features, such as social objective, hybrid structure and commercial kind of activities, to existing legal forms.

Open questions linger, however, concerning JSCs and LLCs. It is unclear whether their economic, profit-making purpose and the profit-sharing imperative will frustrate their use as social enterprises. The economic purpose of JSCs and provisions favouring shareholder primacy may cause hesitations over the adoption of JSCs for SEs. This may be overcome by a broad interpretation of economic purpose and the duty of loyalty of directors to include social objectives. Concerning profit-sharing, a clause to prohibit profit-sharing entirely appears to

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C. Bruner (eds), *The Cambridge Handbook for Corporate Law, Corporate Governance and Sustainability*, Cambridge University Press, Cambridge 2019, p. 659.

107 Italy and the UK are examples of countries where SEs are regulated as a legal entity. For different lawmaking examples in different countries see C. Liao, above n. 106, pp. 657 ff.; D. Tarman et al., above n. 2, p. 58.

108 Many entrepreneurs believe that social enterprise should not be legislated as a specialised legal form but should be given tax exemptions and incentives. See A. Tunar, 'Social Entrepreneurship and Legal Status: A Study on Social Entrepreneurs', unpublished Master's thesis, Marmara University Institute of Social Sciences, Istanbul 2020, pp. 47 ff.

109 See J.S. Liptrap, above n. 105, p. 508.

110 For example, it can be discussed whether special representation mechanisms or special committees would be required *de lege ferenda* to meet the dual character of an SE, or whether a completely different decision mechanism that would better reflect the collective structure and dual interests could be suggested. This is because in JSCs and LLCs decision mechanisms are structured in principle around the capital share. Voting rights are based in principle on the share part of shareholders, as these are capital companies. So what is determinant is how much capital a shareholder contributes. Does this general principle suit SEs and will decision mechanisms depend on the capital contribution? These questions require further and more comprehensive research. Creating a new legal form can be discussed so long as it is concluded that blending special legal regulations in one entity requires a special form and SE activities can be realised better through a new form.

be against the existing provisions (TCC Art. 340), as the dividend right is an alienable right that cannot be removed completely, even unanimously. However, certain provisions[111] do allow the allocation of some part of the profit as reserve funds but do not mention up to what percentage of profit can be reserved and not distributed. High percentages might be considered impermissible, but this should not be an impediment to the adoption of JSCs and LLCs for SEs.[112] Social enterprises established as commercial companies should be allowed to stipulate in their articles of association limitations on profit-sharing. For this and the other above-mentioned reasons, at least for now the latest opinions in the Turkish literature[113] seem to opt for conferring legal status and certification that would benefit from several advantages and exemptions, instead of creating new forms of organisation.

Another legislative approach may be adding new features to already existing forms, such as in the case of social cooperatives. Social cooperatives seem to be an example of adapting and shaping an old model to new needs, which would require special provisions but on a smaller scale. Social enterprises and cooperatives may have an important role in Turkey's economy due to the prevalence of agricultural activity and because collaborative work is inherent in the traditional lifestyle in rural regions of Turkey.[114] Cooperatives and social cooperatives would also be very convenient legal models for social enterprises since the law allows them to formulate their purpose for social good and not distribute the profit among members, but rather use their profits for their purpose.

5.2. RECOMMENDATIONS

5.2.1. Conditions

If Turkey were to adopt a legal status for SEs, to qualify for such a status several conditions should be required. These conditions should be specified in more

[111] TCC Arts 521, 522.

[112] For the idea that JSCs and LLCs are well suited to social enterprise see D. Tarman et al., above n. 2, p. 61. For the idea that there is a public interest in permitting the use of the JSC model for social purposes see K. Çelikboya, above n. 72, p. 69.

[113] For the idea that in the short term there is no need for the creation of a new legal entity see D. Tarman et al., above n. 2, p. 59; A. Tunar, above n. 108, pp. 47 ff. Opting for the status of 'non-profit company' and for regulation in the TCC and for a new legal entity model see B. Ersen, D. Kaya and Z. Meydanoğlu, above n. 6, pp. 19, 29.

[114] *Imece usulü* refers to the Turkish traditional collaborative working style in rural areas of Turkey. Imece is also a social innovation platform and an accelerator in the ecosystem, bringing together persons related to social aims, see https://imece.com/en. British Council, above n. 2, p. 41. Cooperatives could help with economic development and unemployment in the least developed regions of Turkey.

detail with further research. Here only a general framework is sketched. A social enterprise should at least:

1. have primarily a social objective;
2. operate an economic venture based on commercial methods; and
3. operate for at least one year prior to certification.

To meet the first condition, the social objective should be defined in the articles of association and a word signifying 'social enterprise' should be included in the business name of the enterprise.[115] Concerning the third requirement, the founders should be allowed to apply one year after founding for the legal status of social enterprise in order to benefit from the associated exemptions and advantages, which are mentioned below. The application date may be arranged to assure that these exemptions apply from the beginning of the first fiscal year, i.e. from the beginning of its operation upon founding. In addition, a special registration system (separate or within the trade registry) for tracking and monitoring social enterprises would be beneficial.

Which additional conditions should be required must be discussed with more precision in further and deeper comparative research. For instance, conditions that are widespread in many jurisdictions – such as the requirement to allocate a part of the profit to the social aim, a constraint on profit-sharing, and asset constraint on dissolution – should be considered. Accordingly, it could be required in the law and stipulated in the articles of association that a minimum percentage of profit shall be spent for the social mission. A dividend cap, as a partial asset lock, i.e. a maximum percentage or time limit for profit distribution, is a further alternative. Likewise worth exploring are complementary restrictions on the use of the assets allocated to the social purpose at liquidation, and a requirement to transfer them to some extent to another social economy entity, in case of loss of social enterprise status, dissolution of the social enterprise or restructuring transactions, such as conversion.[116] Finally, Turkey might follow the approach of setting out more than one type, i.e. a 'menu' of SE statuses, with varying conditions and a rating system varying depending on the compliance mechanisms adopted.[117]

Failure to satisfy any of the conditions required in the law should cause the withdrawal of the SE status and advantages attached to it. Effective public or private supervision, an audit system, and transparency mechanisms should be envisaged to ensure compliance. A specialised supervision system would be

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115 For similar recommendations and that only under certain conditions shall the right to use 'social benefit' in the business name be given, see D. Tarman et al., above n. 2, pp. 68–69.

116 For the requirement to transfer the allocated fund to another SE, see J.S. Liptrap, above n. 105, pp. 535 ff.

117 As is the case in China, see the General Report in this volume, pp. 31–32.

complementary and help to form a self-sufficient ecosystem in a social economy. Accordingly, social enterprises should perhaps be required to prepare an annual report to present their fidelity and dedication to their social mission, to be assessed by the supervision body and to be assessed and accessed at least by the stakeholders, which would contribute to transparency and accountability.

5.2.2. Exemptions and Other Advantages

Since social enterprises are designed to make a social impact and solve social problems that usually enter the sphere of public service, and because there are limitations on profit-sharing, social enterprises should be exempted from corporate income tax and other taxes (such as estate tax, inheritance tax, transfer tax, value-added taxes and stamp tax) and from the costs of social security premiums. Social enterprises should also be entitled to apply for special grants and incentives especially designed for social enterprises under easier conditions.

Social enterprises and intermediary or complementary organisations may constitute an ecosystem, an alternative economic structure, i.e. a social economy including the third sector. Special organisations, funding and credit institutions[118] or supervising bodies that are adapted and structured especially to complement the activities of social enterprises would help to create an ecosystem where social enterprises may be operated in a sustainable manner.

6. CONCLUSION

Although a great number of social enterprises are flourishing in Turkey, legal regulations are still lagging behind. Nevertheless, the Parliament's relevant commission has recently been carrying out legislative preparatory work concerning social cooperatives. The concept of SE is not yet defined in Turkish law. An SE can be defined basically as a structure that operates a commercial enterprise to attain a social aim as its primary objective.

This report explains the legislative situation and examines existing legal forms in Turkish law, i.e. non-profits and for-profits, from the perspective of their suitability for social enterprises. Of these, public association status or public foundation status can both be considered suitable for social enterprises, although obtaining either of these statuses depends on certain conditions. Concerning the suitability of joint stock companies and limited liability companies, the

[118] For the recommendation that financial institutions such as Triodos Bank, Co-operative & Community Finance, Charity Bank and the Unity Trust Bank may be established in Turkey, see D. Tarman et al., above n. 2, p. 64.

fact that their purpose is defined as an economic one and that there is a profit-sharing imperative during the lifecycle of the company can create some hurdles to adopting them for SEs. However, it might be possible through a broad interpretation of their economic purpose and by adopting certain constraints on profit-sharing.

Finally, there is the question of whether SE should be legislated as a legal entity, as a hybrid form (i.e. a corporate structure) or simply as a legal-economic status to be ratified with a certification system. This report concludes that, for the present moment, a certification system that could cover both non-profits and for-profits would be appropriate and practical for Turkish law. The legislation of new hybrid legal forms may be discussed further depending on the evolution of the 'hybrid' approach to business in the landscape.

SOCIAL ENTERPRISES IN THE UNITED ARAB EMIRATES

Abdul Karim Aldohni

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1. INTRODUCTION

This report is structured to examine the evolution and development of social enterprise as a new form of business enterprise in the United Arab Emirates (UAE). Therefore, it is essential, first, to define the concept of social enterprise in order to draw the parameters within which this concept will be integrated in the context of the UAE. In addition, addressing the evolution of this concept in the broader context of the Middle East will help demonstrate the distinctive features of social enterprise in the UAE.

What is 'social enterprise'? A significant volume of the writings on the subject of social enterprise suggests that despite becoming a recognised and established concept in business, there is not a clear definition of social enterprise agreed among scholars. Therefore, it might mean something different depending on the context in which it is discussed and the jurisdiction in which it is practised.[1] For example, some differences in conceptualising social enterprise can be linked to differing European traditions compared to that of the USA, and the UK for that matter.[2]

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[1] A.M. Pedro and M. McLean, 'Social Entrepreneurship: A Critical Review of the Concept' (2006) 41 *Journal of World Business* 56, 56–57. See also G. Galera and C. Borzaga, 'Social Enterprise: An International Overview of its Conceptual Evolution and Legal Implementation' (2009) 5 *Social Enterprise Journal* 210, 210.

[2] G. Galera and C. Borzaga, 'Social Enterprise: An International Overview of its Conceptual Evolution and Legal Implementation' (2009) 5 *Social Enterprise Journal* 210. See also

One approach to understanding social enterprise is to conceptualise it as a spectrum on which there is a range of firms serving, one way or another, a social purpose, and each can be described as a form of a social enterprise. This means that on one end of the spectrum there are charitable organisations with a clear social mission, and on the other end there are socially responsible for-profit companies driven by private objectives, and a mix of hybrid forms in between.[3] It is important to note that the analysis in this report does not subscribe to this approach. Rather, it identifies a number of characteristics examined in the broader literature, which are required in an enterprise in order to qualify as a social enterprise.[4] These features are: adopting a social goal and acting to create social value; taking an innovative and adaptive approach to opportunities in order to serve the social goal;[5] engaging with trading and the market; limited distribution of profits;[6] stakeholder participation and governance;[7] and organisational autonomy.[8]

First, it is the social goal of the enterprise that distinguishes it from other commercial enterprises. This social mission must be clearly and explicitly defined and should aim to address the underlying causes of the problem rather than dealing with its manifestations.[9] Therefore, an enterprise driven by profit generation for its shareholders, yet which is socially responsible, would not fulfil this criterion.[10] Further, the enterprise should deliver on creating

R. Ridley-Duff and C. Southcombe, 'The Social Enterprise Mark: A Critical Review of its Conceptual Dimensions' (2012) 8 *Social Enterprise Journal* 178.

3 J.G. Dees, 'Enterprising Nonprofits' (1998) January–February *Harvard Business Review* 55. See also K. Alter, 'Social Enterprise Typology', Virtue Venture LLC, November 2007, http://www.globalcube.net/clients/philippson/content/medias/download/SE_typology.pdf; G. Hall, *Virtue and Social Enterprise*, Springer Nature, 2022, pp. 89–91; and T.K. Reis and S.J. Clohesy, 'Unleashing New Resources and Entrepreneurship for the Common Good: A Philanthropic Renaissance' (2001) 32 *New Directions for Philanthropic Fundraising* 109.

4 This is more in line with the approach adopted by G. Hall, *Virtue and Social Enterprise*, Springer Nature, 2022.

5 J.G. Dees, 'The Meaning of "Social Entrepreneurship"' (2001), p. 4, https://centers.fuqua.duke.edu/case/wp-content/uploads/sites/7/2015/03/Article_Dees_MeaningofSocialEntrepreneurship_2001.pdf.

6 G. Hall, *Virtue and Social Enterprise*, Springer Nature, 2022, pp. 86–88.

7 G. Hall, *Virtue and Social Enterprise*, Springer Nature, 2022, p. 88; and see also J.G. Dees, 'The Meaning of "Social Entrepreneurship"' (2001), p. 4, https://centers.fuqua.duke.edu/case/wp-content/uploads/sites/7/2015/03/Article_Dees_MeaningofSocialEntrepreneurship_2001.pdf.

8 G. Hall, *Virtue and Social Enterprise*, Springer Nature, 2022, p. 88.

9 J. Austin, H. Stevenson and J. Wei-Skillern, 'Social and Commercial Entrepreneurship: Same, Different or Both?' (2006) 30 *Entrepreneurship Theory and Practice* 1, 3; and J.G. Dees, 'The Meaning of "Social Entrepreneurship"' (2001), p. 4, https://centers.fuqua.duke.edu/case/wp-content/uploads/sites/7/2015/03/Article_Dees_MeaningofSocialEntrepreneurship_2001.pdf. See also A.M. Pedro and M. McLean, 'Social Entrepreneurship: A Critical Review of the Concept' (2006) 41 *Journal of World Business* 56, 59.

10 G. Hall, *Virtue and Social Enterprise*, Springer Nature, 2022, pp. 90–91.

social value associated with its social mission through its socially impactful and sustainable performance.[11]

Second, there can be no enterprise without an entrepreneur acting as its driving force. Being a business leader does not necessarily mean that you are an entrepreneur, however.[12] Generally, there are certain qualities that an entrepreneur has, key among which is being innovative in pursuing opportunities to achieve the enterprise goals, which on many occasions may exceed the resources under the entrepreneur's control.[13] As for social enterprise, it has been suggested that a social entrepreneur is a 'rare breed'[14] as they need to use these identified characteristics in more challenging conditions. For instance, the fact that the enterprise has a social mission and it is not financially driven makes it harder for the entrepreneur to access the traditional sources of funding. It also makes it more difficult for the entrepreneur to hire or retain the required expertise, as social entrepreneurs may not have the financial means to match market rates.[15]

Third, whether social enterprise should adopt business-like strategies and engage with the market practices, such as taking risks and generating profits, has been widely debated.[16] It can be argued that it is essential for a social enterprise to apply principles and strategies from profit-making business in order to sustain and expand its operations.[17] Doing so may enable it to deal with the financial limitations identifies earlier. However, this adaptation must be

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11 J.G. Dees, 'The Meaning of "Social Entrepreneurship"' (2001), p. 4, https://centers.fuqua.duke.edu/case/wp-content/uploads/sites/7/2015/03/Article_Dees_MeaningofSocialEntrepreneurship_2001.pdf.

12 J.G. Dees, 'The Meaning of "Social Entrepreneurship"' (2001), p. 5, https://centers.fuqua.duke.edu/case/wp-content/uploads/sites/7/2015/03/Article_Dees_MeaningofSocialEntrepreneurship_2001.pdf.

13 J. Austin, H. Stevenson and J. Wei-Skillern, 'Social and Commercial Entrepreneurship: Same, Different or Both?' (2006) 30 *Entrepreneurship Theory and Practice* 2, 4. Stevenson provides an in-depth analysis of the characteristics of an entrepreneur under the following headings: 'strategic orientation', 'commitment to opportunity', 'commitment to resources' and 'control of resources'; see H.H. Stevenson, *A perspective on entrepreneurship*, Harvard Business School, Boston 1983.

14 J.G. Dees, 'The Meaning of "Social Entrepreneurship"' (2001), p. 5, https://centers.fuqua.duke.edu/case/wp-content/uploads/sites/7/2015/03/Article_Dees_MeaningofSocialEntrepreneurship_2001.pdf.

15 J. Austin, H. Stevenson and J. Wei-Skillern, 'Social and Commercial Entrepreneurship: Same, Different or Both?' (2006) 30 *Entrepreneurship Theory and Practice* 2, 11–12.

16 A.M. Pedro and M. McLean, 'Social Entrepreneurship: A Critical Review of the Concept' (2006) 41 *Journal of World Business* 56, 57–61. See also M. Pomerantz, 'The Business of Social Entrepreneurship in a "Down Economy"' (2003) March/April *In Business* 25, 26; and J.G. Dees, 'Social Entrepreneurship is About Innovation and Impact, Not Income', *CASEconnection Newsletter* (October 2004), https://centers.fuqua.duke.edu/case/wp-content/uploads/sites/7/2015/02/Article_Dees_SEisAboutInnovationandImpactNotIncome_2003.pdf.

17 M. Pomerantz, 'The Business of Social Entrepreneurship in a "Down Economy"' (2003) March/April *In Business* 25, 26.

practised under a few conditions. For one, the social mission of the enterprise should remain the core of its business and the delivery on its social goals the only matrix to measure its success. In addition, limiting the distribution of profits to reinvest and sustain the social enterprise will protect the social enterprise from the temptation of profit maximisation. It has been suggested that having a legal requirement in the form of 'asset lock' helps preserve both assets and surplus of the social enterprise for the pursuit of its social mission.[18]

Fourth, the requirement of democratic governance for a social enterprise is common feature among many conceptualisations of 'social enterprise'.[19] This feature simply means taking a stakeholder approach to the governance of the enterprise, which allows all those who are affected by the enterprise to participate or be represented in the decision-making process.[20] This feature has been deemed a particularly important mechanism to manage the risks associated with allowing for limited distribution of profits and to make more effective and efficient decisions.[21] It also provides for consideration of the interests of the whole community that the enterprise serves.[22] It is important to note, however, that democratic governance alone is not enough on its own to make an enterprise a social one, despite its significance to the concept of 'social enterprise'.

Finally, in order for the entrepreneur to focus on the core social mission, a social enterprise needs to be independent and autonomous.[23] The main challenge to this could come from the owner of capital, whose commitment in principle should be to the social mission rather than to the maximisation on profits. However, as mentioned earlier, raising the required finance for a social enterprise remains a major challenge to this sector. The 'cooperative structure' has been widely discussed in the literature as a potential solution to these issues in the context of social enterprise.[24]

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18 G. Hall, *Virtue and Social Enterprise*, Springer Nature, 2022, p. 88.

19 R. Ridley-Duff and C. Southcombe, 'The Social Enterprise Mark: A Critical Review of its Conceptual Dimensions' (2012) 8 *Social Enterprise Journal* 178, 180–82; G. Galera and C. Borzaga, 'Social Enterprise: An International Overview of its Conceptual Evolution and Legal Implementation' (2009) 5 *Social Enterprise Journal* 210, 217–21; and see also G. Hall, *Virtue and Social Enterprise*, Springer Nature, 2022, p. 88.

20 G. Hall, *Virtue and Social Enterprise*, Springer Nature, 2022, p. 88.

21 G. Galera and C. Borzaga, 'Social Enterprise: An International Overview of its Conceptual Evolution and Legal Implementation' (2009) 5 *Social Enterprise Journal* 210, 217–18.

22 G. Galera and C. Borzaga, 'Social Enterprise: An International Overview of its Conceptual Evolution and Legal Implementation' (2009) 5 *Social Enterprise Journal* 210, 217–18.

23 G. Hall, *Virtue and Social Enterprise*, Springer Nature, 2022, p. 88.

24 See for example G. Galera and C. Borzaga, 'Social Enterprise: An International Overview of its Conceptual Evolution and Legal Implementation' (2009) 5 *Social Enterprise Journal* 210; R. Ridley-Duff and C. Southcombe, 'The Social Enterprise Mark: A Critical Review of its Conceptual Dimensions' (2012) 8 *Social Enterprise Journal* 178; and G. Hall, *Virtue and Social Enterprise*, Springer Nature, 2022.

The examination of social enterprise in the UAE requires understanding these institutional parameters, but it also requires a good understanding of the broader geopolitical environment of the UAE. In this respect, it is fair to suggest that the concept of 'social enterprise' as defined earlier is entirely new to the Middle East. The term 'social entrepreneurship' translates in Arabic to *riyadet ala'mal alejtema'yah*. For any native Arabic speaker, this is not a term that rolls off the tongue. It is a complicated construct put together to provide a description for a new phenomenon that started to emerge in the region. There is no one word in Arabic that is the equivalent to 'entrepreneur'; therefore, the terms *riyadet ala'mal* and *ra'ed ala'mal* are used to convey the meaning of entrepreneurship and entrepreneur respectively. The term *riyadet ala'mal* coveys the meaning of leadership, innovation and risk-taking in the business context, while the word *alejtema'yah* is added to convey the social mission and focus of the business.

Relatively recent research on social enterprise in the Middle East and North Africa (MENA), which only focused on Lebanon, Jordan, Egypt and Palestine, showed that although the region is riddled with some major systematic problems it is 'ripe' for the roll out of social enterprises.[25] This research went further to suggest that social enterprises in the region could be part of the solution to many of its social and economic difficulties. However, the research also highlighted major challenges to the development of social enterprises in the region, key among which are: regulatory landscape and financing, lack of public knowledge and understanding of social enterprise, and underdeveloped means to measure the social impact of social enterprises.[26]

2. CONTEXTUALISING SOCIAL ENTERPRISE IN THE UAE

Despite being a rich oil-producing county, the visionary leadership of the UAE realised the need to diversify the economy and reduce the federation's dependence on oil revenues. Since the early 1990s, the UAE, more specifically Dubai and Abu Dhabi, has invested vastly in the trade and finance sectors to maintain high levels of economic growth.[27] The UAE now offers investors more

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25 S. Halabi, S. Kheir and P. Cochrane, 'Social Enterprise Development in the Middle East and North Africa: A Qualitative Analysis of Lebanon, Jordan, Egypt and Occupied Palestine' (2017), p. 15, https://wamda-prod.s3.amazonaws.com/resource-url/e2981f10ea87448.pdf.

26 S. Halabi, S. Kheir and P. Cochrane, 'Social Enterprise Development in the Middle East and North Africa: A Qualitative Analysis of Lebanon, Jordan, Egypt and Occupied Palestine' (2017) https://wamda-prod.s3.amazonaws.com/resource-url/e2981f10ea87448.pdf.

27 A.K. Aldohni, 'The Emergence of Islamic Banking in the UK: A Comparative Study with Muslim Countries' (2008) 22 *Arab Law Quarterly* 180, 184–85.

than 40 interdisciplinary free zones that cater to wide range of businesses.[28] In almost 20 years, Dubai International Financial Centre has become a leading financial hub in the Middle East, Africa and South Asia (MEASA), connecting the emerging markets in these countries with developed economies in Asia, Europe and the USA, and facilitating the flow of trade and international investments across MEASA.[29] These significant achievements have been helped by a developed and responsive regulatory environment, which is capable of supporting these national and international businesses and earning their trust and confidence. The UAE has a flexible tax system, leads the region on the protection of intellectual property rights and has an advanced system for dispute resolution.[30] It must also be noted that the stable political environment that the UAE has enjoyed since the establishment of the federation, and even during the turbulent years of MENA uprisings over the last decade, has been central to its success story.

The clear message that the UAE is sending to the world is that the country not only is open for business but offers a world-class environment to grow and develop your business. This is not exclusive to established investors and businesses but also available to innovative and disruptive entrepreneurs. Although the concept of entrepreneurship, *riyadet ala'mal*, may not be native to the Arab world, there are some factors that make the UAE a fertile ground for entrepreneurship.

First among these is the strong Islamic influence over the culture, in the broad sense that includes business culture, in the UAE. Despite being a cultural hub hosting more than 200 nationalities,[31] the UAE maintains its authentic Islamic identity.[32] It can be argued that Islam's approach to business is rather entrepreneurial in nature. Islamic Sharia[33] reiterates a clear principle; namely, while all individuals' wealth and any benefits or profits they make are only given by God, they must work hard and strive to earn their material rewards in this worldly life. The Quran reminds humans that when it comes to earning a living they are required to walk the earth and search for opportunities,[34] and they need to take the initiative. In addition, the Quran refers to trade on

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28 UAE Ministry of Economy, https://www.moec.gov.ae/en/free-zones.

29 Dubai International Financial Centre, https://www.difc.ae/about/.

30 J. Grant, F.S. Golawala and D.S. McKechnie, 'The United Arab Emirates: The Twenty-First Century Beckons' (2007) 49 *Thunderbird International Business Review* 507, 515–19.

31 https://u.ae/en/about-the-uae/fact-sheet.

32 A.K. Aldohni, 'The Emergence of Islamic Banking in the UK: A Comparative Study with Muslim Countries' (2008) 22 *Arab Law Quarterly* 180, 185–86.

33 The comprehensive code of governance that Muslims believe that can govern all aspects of their lives, which includes the Quran and the Sunnah. The Quran is the words of God Allah revealed to his last messenger, the Prophet Mohamad. The Prophetic Sunnah is the Prophet's statements, actions and his tacit approval.

34 For example, the Quran [67:15] and [62:10].

many occasions as a legitimate way of making profits, as long as it is conducted within the boundaries of Sharia.[35] This is, to an extent, in line with the key traits of an entrepreneur: innovative, in constant search for opportunities, and not afraid of taking risks.

It is important to note that the influence of Islam can be seen not only in the culture of the UAE but also in its legal system. The UAE Constitution states that: 'Islam is the official religion of the Federation and the Muslim Sharia is a main source of its legislation'.[36] This demonstrates the prominence of Islam as a source of law in the federal legal system of the UAE. Further, the Explanatory Memorandum of the Civil Transactions Code (Civil Code) refers to Islamic Sharia jurisprudence as the basis for the majority of its provisions.[37]

Second, there is the political will to support the growth of entrepreneurship. In 2016, the UAE launched a new strategy to further diversify the economy, in which it envisaged a central role for entrepreneurship.[38] In addition to the goal of diversification of the economy, entrepreneurship has been considered a powerful means to create jobs for a growing youth population.[39] The UAE has made significant efforts to create the required ecosystem for entrepreneurship. In 2019, the UAE was ranked first in the Arab world and 19th among all countries in terms of the ease of doing business according to the World Bank.[40] Further, the UAE introduced the 'golden visa' system that provides its holders with long-term residency of five to 10 years and many other benefits, and includes 'entrepreneurs' as one of the eligible categories for participation.[41] This allows the UAE to benefit from a broader pool of talents beyond its national entrepreneurs and positions the country as a mecca for entrepreneurship in the region and beyond.

The same factors that contributed to the UAE becoming a fertile ground for commercial entrepreneurship can be extended to social entrepreneurship, *riyadet ala'mal alejtema'yah*.

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35 For example, the Quran [4:29] and [2:275].

36 Article 7 of the UAE Constitution, www.elaws.gov.ae/EnLegislations.aspx.

37 B.S.B.A. Al-Muhairi, 'The Islamisation of Laws in the UAE: Case of the Penal Code' (1996) 11 *Arab Law Quarterly* 350, 358–59. See also Chapter One, Section I, Article 1 of the Civil Transactions Code (Civil Code), https://legaladviceme.com/legislation/126/uae-federal-law-5-of-1985-on-civil-transactions-law-of-united-arab-emirates.

38 Global Entrepreneurship Monitor, 'Global Entrepreneurship Monitor 2021/2022 Global Report' (2022), p. 185, https://gemconsortium.org/file/open?fileId=50900.

39 Global Entrepreneurship Monitor, 'United Arab Emirates 2016/17 Annual Report' (2017) https://www.gemconsortium.org/file/open?fileId=50191.

40 World Bank, https://data.worldbank.org/indicator/IC.BUS.EASE.XQ and https://data.worldbank.org/indicator/IC.BUS.EASE.XQ?locations=1A&most_recent_value_desc=false.

41 UAE Golden Visa, https://u.ae/en/information-and-services/visa-and-emirates-id/golden-visa#:~:text=If%20you%20are%20an%20entrepreneur,nature%20based%20on%20risk%20%26%20innovation.

First, the key governing principles of Islamic business, founded in the Sharia, demonstrate the centrality of the social mission in any business enterprise. Central to the thesis of Islamic business ethics[42] is the concept of *khilafah*. This means that human beings are God's vicegerents, and they are entrusted with all the resources on earth.[43] Although this concept has a simple premise, its social, economic, and environmental implications are significant. The concept of *khilafah* establishes that God is the ultimate owner of all resources and wealth, and humans are God's trustees, which makes them accountable to God regarding the use of the wealth and resources conferred upon them by this trust.[44] In this respect, there is a delicate balance that needs to be struck. On the one hand, as God's vicegerent, each human is required to work and strive to benefit themselves.[45] On the other hand, while advancing their own interests, humans are reminded that earth and all its resources are for the benefit of all humans.[46]

Further, God's entrusted resources and wealth must not be wasted or destroyed.[47] Such actions fall within the prohibited act of spreading *fasad* (corruption – viciousness),[48] which applies equally in the environmental and social contexts. Individuals and their businesses are responsible for protecting the environment and limiting any damage caused by their business activities. Further, the concept of *khilafah* has a clear connotation of collective responsibility,[49] which extends beyond the protection of natural resources. The individual's use of his or her wealth and property is restrained by the mutual responsibility owed by each individual towards their fellow humans. This has been envisaged as a brotherhood bond that prevents an individual from purely optimising his or her self-interest without helping to fulfil the needs of others.[50]

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42 For more detailed discussion on Islamic business ethics see A.K. Aldohni, 'Islam and Business Ethics' in D. Poff and A.C. Michalis (eds), *Encyclopaedia of Business and Professional Ethics*, Springer, 2021.

43 The Quran [6:165].

44 The Quran [10:14].

45 The Quran [67:15].

46 The Quran [2:29].

47 The Quran [7:56].

48 M.U. Chapra, *Islam and the Economic Challenge*, Islamic Economic Series 17, The Islamic Foundation and The International Institute of Islamic Thought, 1995, p. 207.

49 The Quran [10:14].

50 M.U. Chapra, *Islam and the Economic Challenge*, Islamic Economic Series 17, The Islamic Foundation and The International Institute of Islamic Thought, 1995, pp. 206–07; see also M.I. Anjum, 'Eternal Challenge of Islamic Economics to Capitalism and Communism' (1996) 12 *Umanomics* 53, 61; and A.K. Aldohni, 'Islamic Financial Institutions and Corporate Sustainability: A Study of Oman, Dubai and Malaysia' in C. Burner and B. Sjåfjell (eds), *Cambridge Handbook of Corporate Law, Corporate Governance and Corporate Sustainability*, Cambridge University Press, 2020, pp. 490–503.

Therefore, being a vicegerent of God enhances the individuals' sense of societal responsibility while conducting their business affairs.[51] This should ensure that all economic functions of human beings have social solidarity and cooperation as essential features. This sense of societal responsibility is empowered by individuals' spiritual commitment to please God. Islamic Sharia makes it clear that the most favoured human being to God is the most helpful to his or her fellow humans.[52] In this regard, businesses and corporations owe a duty of care to the community within which they operate. This community is not limited only to those who work for them but also includes the wider society they interact with in the course of their business. As many foundational aspects of the concept of social enterprise are already enshrined in the religion that has significant influence over the business culture in the UAE, the concept should be well received. Introducing an enterprise with a clear social mission to serve while ensuring that those who are involved in the enterprise are participating in its governance would not be an alien concept to the UAE business culture.

Second, since the adoption of the 2030 Agenda for Sustainable Development by the member states of the UN,[53] the UAE's leadership has demonstrated a strong commitment to delivering on these sustainable development goals (SDGs). The UAE established the National Committee on SDGs in 2017, which serves as a 'platform for multi-stakeholder engagement and coordination; it provides the whole-of-government systems and procedures for information-sharing, policy coherence and progress review'.[54] Accordingly, the membership of the National Committee on SDGs includes the relevant ministries in the federal government and some key public agencies. The National Committee also established a number of councils to support its mission including: the UAE Private Sector Advisory Council, the SDG Young Leaders Programme, and the Global Councils on SDGs.[55] Further, all the 17 SDGs map to a pillar in the UAE's 2021 National Agenda.[56] Development of social entrepreneurship in the UAE would further strengthen these efforts to deliver on the UN SDGs.

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51 M.B. Alsader, *Our Economy (Iqtisadona)*, Dar Altaaruf, 1987, pp. 534–36.

52 The Quran [49:13] and the Prophetic Sunnah, the Book of Sahih Muslim.

53 United Nations, 'Transforming our World: The 2030 Agenda for Sustainable Development', https://sdgs.un.org/2030agenda, and 'The 17 Goals', https://sdgs.un.org/goals.

54 'UAE and The 2030 Agenda for Sustainable Development: Excellence in Implementation' (2017), https://sustainabledevelopment.un.org/content/documents/20161UAE_SDGs_Report_Full_English.pdf.

55 National Committee in Sustainable Development Goals, 'UAE and The 2030 Agenda for Sustainable Development: Voluntary National Review 2022' (2022), p. 17, https://sdgsuae-fcsa.opendata.arcgis.com/documents/2022-uae-and-the-2030-agenda-for-sustainable-development-excellence-in-implementation-voluntary-national-review/explore.

56 National Committee in Sustainable Development Goals, 'UAE and The 2030 Agenda for Sustainable Development: Voluntary National Review 2022' (2022), p. 40, https://sdgsuae-fcsa.opendata.arcgis.com/documents/2022-uae-and-the-2030-agenda-for-sustainable-development-excellence-in-implementation-voluntary-national-review/explore.

3. FORMS OF ORGANISATION AND LIFECYCLE

In the UAE, there is no special legal structure that is designed to serve social enterprises similarly to some other countries, such as the UK.[57] The predominant structure for enterprise is the limited liability company (LLC). This type of legal structure is governed by the Commercial Companies Law.[58] LLCs consist of a number of shareholders (two to 50),[59] although they can also be incorporated and owned by one 'physical or juristic person'.[60] The management of the company is elected from among the shareholders or third parties.[61] Where the number of shareholders in an LLC is over 15, they are allowed to appoint a supervisory board that consists of three shareholders for three years that can be renewed by the general assembly, and the managers do not vote on the appointment or dismissal of the supervisory board.[62]

There are many issues concerning the use of the LLC for social enterprises. This structure is business- and shareholder-orientated, and is designed to advance financial gains, rather than social goals. Indeed, the Global Entrepreneurship Monitor UAE in its Social Entrepreneurship Report (2019/2020) found that only 7.9% of social entrepreneurs in the UAE have a strong social mission.[63]

The LLC's governance structures also map poorly to social enterprise. Although the law provides for the appointment of a supervisory board, its composition is designed to advance the shareholders' interests, as it does not allow for the appointment of stakeholders, for example employees. As such, this structure also does not provide for the democratisation of governance, which was identified earlier as one of the main characteristics of a social enterprise. Further, the nature of the LLC structure and its governance makes it impossible to expect any limitations on distribution or a legal 'assets lock'. These central mechanisms to maintain the focus of the enterprise on the social core mission and to prevent it from engaging in profit maximisation behaviour are unavailable in the LLC form.

It must be noted that recently (November 2022) the UAE has passed a new law[64] concerning the cooperative business structure. It aims to develop the use of the cooperative structure across the UAE, as the new law enables them to open branches in the UAE, and to grow the sector in order to improve its

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[57] Community Interest Companies, Companies (Audit, Investigations and Community Enterprise) Act 2004.

[58] Federal Law Decree-Law no. 32 of 2021 on Commercial Companies.

[59] Federal Law Decree-Law no. 32 of 2021 on Commercial Companies, Article 71(1).

[60] Federal Law Decree-Law no. 32 of 2021 on Commercial Companies, Article 71(2).

[61] Federal Law Decree-Law no. 32 of 2021 on Commercial Companies, Article 83.

[62] Federal Law Decree-Law no. 32 of 2021 on Commercial Companies, Article 88.

[63] Global Entrepreneurship Monitor UAE, 'Social Entrepreneurship Report 2019/2020' (2020) https://www.gemconsortium.org/file/open?fileId=50673.

[64] Federal Decree-Law no. 6 of 2022 on cooperatives.

role in achieving sustainable development goals.[65] However, as yet the research does not show any evidence of the use of the cooperative structure for social enterprise in the UAE.

4. STATE CERTIFICATIONS AND METRICS

There is no specific licence for social enterprise in the UAE at the federal level, which compounds the lack of a tailor-made legal structure. Further, the non-profit NGO and charitable sector in the UAE is segregated from the commercial for-profit sector in terms of licensing and legal framework.[66] Any for-profit corporate structure needs a business licence and its requirements will depend on the nature of the activity, the Emirate in which it is operating, and whether it is on shore or in a free zone.[67] As for charities, their licence would require an application to the Ministry of Community Development.[68] In Dubai and Abu Dhabi, setting up an NGO would require a licence to be issued by the relevant governmental department at the Emirate level.[69]

This strict separation has proved to be problematic, from a licensing and recognition point of view, when an enterprise has a core social mission yet it is aiming to engage with the market and generate profits to sustain its operations in order to achieve its social mission.[70] For example, research has showed that although the Department for Economic Development in Dubai offers three categories for business owners to register under (professional, commercial and industrial), within which there are over 200 activities to choose from for

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[65] Ministry of Economy, 'New Cooperatives Law and its Role in Ensuring National Economy Competitiveness', https://www.moec.gov.ae/en/-/ministry-of-economy-explains-new-cooperatives-law-its-role-in-ensuring-national-economy-s-competitiveness.

[66] S. Johnsen, 'Social Enterprise in the United Arab Emirates' (2017) 13 *Social Enterprise Journal* 392, 400.

[67] 'Establishing Business in the UAE', https://www.moec.gov.ae/en/establishing-business-in-the-uae.

[68] 'Setting up a Charity', https://u.ae/en/information-and-services/charity-and-humanitarian-work/ways-of-doing-charity-in-the-uae#:~:text=Setting%20up%20a%20charity,-UAE%20nationals%20wishing&text=Expatriate%20residents%20need%20to%20submit,decision%20on%20registering%20the%20organisation.

[69] Department of Community Development – Abu Dhabi, 'Licensing of Non-Governmental Organisation', https://addcd.gov.ae/en/Licensing-of-Non-Governmental-Organization and see also 'Setting up a Charity', https://u.ae/en/information-and-services/charity-and-humanitarian-work/ways-of-doing-charity-in-the-uae#:~:text=Setting%20up%20a%20charity,-UAE%20nationals%20wishing&text=Expatriate%20residents%20need%20to%20submit,decision%20on%20registering%20the%20organisation.

[70] D. Abdo and C.M. Paris, 'Social Entrepreneurship in the UAE: Challenges and Recommendations' (2017) https://core.ac.uk/download/pdf/132845916.pdf; and see also S. Johnsen, 'Social Enterprise in the United Arab Emirates' (2017) 13 *Social Enterprise Journal* 392, 404.

licensing purposes, social enterprise or business is not featured on that list.[71] Local advocates recognise that 'social enterprises are distinct from non-governmental organisations and charities in that they apply business principles, such as cost efficiency and financial viability'.[72] But the federal regulatory context does not easily accommodate them.

The UAE also does not have a scheme to measure the social impact of its social enterprises.[73] Having a national scheme to measure the success of the delivery on the core social mission of enterprises is essential to optimise the benefits of social entrepreneurship. It allows for funding to be directed to the most worthy social enterprises and creates a mechanism to illuminate the ineffective ones, improving the system of accountability.[74]

However, exciting progress is being made on the Emirate level. In February 2019, the Department of Community Development in Abu Dhabi established the Authority of Social Contribution (Ma'an) to coordinate the efforts of the Abu Dhabi government, the private sector and civil society to develop social innovation, including social enterprise.[75] In October 2022, Ma'an announced the launch of its social enterprise accreditation scheme, which is the first in the UAE to provide a certificate of recognition for social enterprises. The key requirements are:

- Organizations with a social mission;
- Organizations licensed in Abu Dhabi;
- Commit to reinvesting at least 30% of profits into business, social causes;
- Commit to generating at least 40% of capital from services, trading;
- All citizens and residents.[76]

An enterprise that does not fulfil all the criteria can still apply, although they must demonstrate that they have fulfilled all the criteria within the first year of being certified when they apply for the renewal of the certificate.[77]

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[71] D. Abdo and C.M. Paris, 'Social Entrepreneurship in the UAE: Challenges and Recommendations' (2017), para 2.4, https://core.ac.uk/download/pdf/132845916.pdf.

[72] Clare Woodcraft-Scot, Chief Executive of the Emirates Foundation for Youth Development cited in S. Locke, 'UAE Must Recognise Social Enterprise as a Business Entity', *The National* (29 April 2015) https://www.thenationalnews.com/business/uae-must-recognise-social-enterprise-as-a-business-entity-1.43659.

[73] D. Abdo and C.M. Paris, 'Social Entrepreneurship in the UAE: Challenges and Recommendations' (2017), p. 15, https://core.ac.uk/download/pdf/132845916.pdf.

[74] J. Austin, H. Stevenson and J. Wei-Skillern, 'Social and Commercial Entrepreneurship: Same, Different or Both?' (2006) 30 *Entrepreneurship Theory and Practice* 1, 9–10.

[75] Authority of Social Contribution (Ma'an), https://maan.gov.ae/about/.

[76] Authority of Social Contribution (Ma'an), 'Certificate of Social Enterprises', https://programs.maan.gov.ae/en-US/programs/program-details/?id=b491219a-fc43-ed11-bba2-0022480da241.

[77] Authority of Social Contribution (Ma'an), 'Certificate of Social Enterprises', https://programs.maan.gov.ae/en-US/programs/program-details/?id=b491219a-fc43-ed11-bba2-0022480da241.

5. SUBSIDIES AND PRIVATE CAPITAL

One of the key issues identified in the context of social enterprise in the UAE is the need for more funding to support the growth of this sector.[78] The Global Entrepreneurship Monitor UAE in its Social Entrepreneurship Report (2019/2020) found that only 37% social entrepreneurs reported the use of government programmes or grants. Securing finance through government programmes and grants is central to ensuring the autonomy and independence of the social enterprise. It allows social entrepreneurs to focus on the social mission of the enterprise without being concerned with the economic rewards that they need to generate for investors.

While there are a number of governmental entities that support enterprise and entrepreneurship in general in the UAE,[79] there is not a designated one for social enterprise at the federal level. Ma'an is the only governmental entity that has grants programmes designated to social entrepreneurship, for which only its certified social enterprises can apply, and this certification is limited to Abu Dhabi.[80]

Further, some empirical research has revealed a lack of awareness of the concept of social enterprise among UAE angel investors and venture capitalists.[81] Social enterprise is often mistaken for charity, and the lack of a clear conceptualisation of social enterprise causes investor hesitancy.[82]

6. CONCLUSION

The UAE has the required foundations for social enterprises to evolve and flourish, though targeted legal reforms are necessary for it to reach its full potential. The business culture influenced by Islam introduces key concepts, such as vicegerency and the brotherhood bond, with profound impact on how individuals expect to conduct their business. Islam requires its followers to

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78 Global Entrepreneurship Monitor UAE, 'Social Entrepreneurship Report 2019/2020' (2020) https://www.gemconsortium.org/file/open?fileId=50673; D. Abdo and C.M. Paris, 'Social Entrepreneurship in the UAE: Challenges and Recommendations' (2017), pp. 13–14, https://core.ac.uk/download/pdf/132845916.pdf; and see also S. Johnsen, 'Social Enterprise in the United Arab Emirates' (2017) 13 *Social Enterprise Journal* 392, 404.

79 'Entities Supporting Projects of Emirati Entrepreneurs', https://www.moec.gov.ae/en/entrepreneurship-support-entities.

80 Authority of Social Contribution (Ma'an), 'Certificate of Social Enterprises', https://programs.maan.gov.ae/en-US/programs/program-details/?id=b491219a-fc43-ed11-bba2-0022480da241.

81 D. Abdo and C.M. Paris, 'Social Entrepreneurship in the UAE: Challenges and Recommendations' (2017), p. 15, https://core.ac.uk/download/pdf/132845916.pdf.

82 S. Johnsen, 'Social Enterprise in the United Arab Emirates' (2017) 13 *Social Enterprise Journal* 392, 404.

seek opportunities and strive to succeed, while also putting social good and collective responsibility at the heart of any business venture. Moreover, there is the political will and vision in the UAE to create a sustainable business ecosystem. However, this is not enough for social entrepreneurship in the UAE to excel and take its expected role in the sustainable development agenda.

The lack of a special legal organisational structure designated for social enterprise remains a major obstacle. Developing a special legal business structure would ensure that some of the key identified characteristics of social enterprise are available to adopters. For example, a specialised legal form could require a key social mission to be identified by the social entrepreneur as part of the establishment process, include legal requirements that limit distribution and impose an asset lock, and set governance standards that involve stakeholders in the governance of the enterprise. A designated legal structure should serve the unique nature of social enterprise by protecting the enterprise's social mission while allowing it to apply business principles and market practices.

Establishing a special business legal structure would also help streamline the licensing of social enterprises. Once an enterprise has fulfilled the legal requirements of the structure, it could be licensed as a social enterprise. This simplification will be welcomed by any social entrepreneur who is keen to operate in the UAE yet could be put off by the lack of certainty and clarity as to how to go about it. Although the social enterprise accreditation scheme by Ma'an is a welcome development, it does not fully address this concern. It broadly describes qualifying enterprises as 'organisations with social mission', without specifying what this means. Moreover, its application is limited to one Emirate: Abu Dhabi.

Funding of social enterprise also remains a major challenge. This can be addressed through taking a number of steps. First, a governmental grant scheme specifically designated to social enterprise should be developed at the federal level. This may require having an authority similar to Ma'an in Abu Dhabi, but which would operate at the federal level. In addition, improving the public understanding of social enterprise as a concept will help improve the availability of private capital. The UAE educational system will need to play a major role in this process.

SOCIAL ENTERPRISES IN THE UNITED KINGDOM

Nina Boeger

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1. INTRODUCTION

In the United Kingdom, social enterprises are understood as businesses with primarily social objectives, whose surpluses are principally reinvested for that

purpose in the business or in the community rather than being driven by the need to maximise profit for shareholders or owners.[1] Legal tools to develop social enterprises have improved and diversified in recent times, including a corporate form, the Community Interest Company (CIC), tailored to social enterprises. While the CIC continues to grow in popularity, the majority of social enterprises continue to choose incorporation as a simple limited company (typically, without share capital) and adapt their constitutional documents to embed a social mission commitment and, often, an asset lock.

The features of the CIC also provide a fuller understanding of social enterprise, supported by considerable work that the sector itself has committed to developing a definition of social enterprise. It centres on: (i) a trading activity; (ii) a constitutionally defined primary social mission; (iii) a mission lock to align decision-making and control with its social objective; and (iv) restrictions on the distribution of profits (and transfer of assets) other than for the purpose of furthering its mission.

There are currently more than 100,000 businesses in Britain operating as social enterprises based on these characteristics, contributing £60 billion to the UK economy and employing around 2 million people.[2] Britain has also seen a significant evolution in practical leadership to support social enterprise, including a network of organisations like Social Enterprise UK (SEUK), UnLtd and the British Council. In terms of political leadership, recent policies and funding to support social enterprises have been made available mainly at local level. At national level, the current Conservative government tends to focus on broader sustainable finance initiatives with 'the development of scalable financial vehicles that harness private capital for public good'[3] and including investment in 'mission-led' companies that are concerned with wider societal impact but also fully profit-distributing.[4] The availability of B Corp certification in the UK since 2015 also reflects this movement.

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1 The roots of modern social enterprise extend to the New Labour government under Prime Minister Tony Blair, which introduced the social enterprise concept as a strategic policy tool. Department for Trade and Industry, *Social Enterprise: A Strategy for Success*, HMSO, London 2002. These initiatives formed part of Blair's 'third way' politics, committed to integrating market mechanisms and civil society into the British welfare state while withdrawing some direct state provision of public welfare services, which led to both reorganisation of the voluntary sector and extensive reform of public service delivery.

2 Social Enterprise UK, *No Going Back: Social Enterprise Survey 2021*, https://www.socialenterprise.org.uk/state-of-social-enterprise-reports/no-going-back-state-of-social-enterprise-survey-2021/.

3 Impact Taskforce, *Mobilising Institutional Capital towards the SDGs and a Just Transition*, Workstream B Report, 2021, https://www.impactinvest.org.uk/wp-content/uploads/2021/12/Workstream-B-Report.pdf.

4 Advisory Panel to the Mission-led Business Review, *On a Mission in the UK Economy*, 2016, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/574687/Advisory_Panel_Report_-_Mission-led_Business.pdf.

This has given rise to some concern that funding earmarked for commercially more restricted social enterprises might drain away as a fully profit-distributing model of mission-led firms attracts further attention. Many social enterprises are, on the other hand, also looking to become more business-oriented and financially agile. For example, fewer social enterprises today than in the past identify as civil society organisations, but see themselves primarily as businesses.[5]

Against the backdrop of these developments, the aim of this report is to present recent trends in the social enterprise sector in Britain relating to law, policy and finance, enabling comparative analysis with other jurisdictions. In second place, the report highlights the frontier between traditional social enterprise on the one hand, and a wider field of more commercially permissive businesses that pursue societal impact but without the same level of restrictions as social enterprises.

2. WHAT IS A SOCIAL ENTERPRISE?

2.1. TRADE

Social enterprises are private organisations that operate, or aim to operate, in an economically sustainable way by deriving at least half of their income from trading activities. It is this organisational feature which renders them distinct from purely charitable institutions reliant exclusively on donations or grant income, and from public organisations. Two-thirds of UK social enterprises finance themselves 75–100% through trade[6] but many that identify as or aspire to be social enterprises continue to pursue mixed income streams, including grant funding. There is notable 'give' on this point in the social enterprise concept as commonly understood in the UK. In fact, leading sector associations today address themselves also to those organisations that are working towards a baseline of 50% trade income.[7] They would accept that trading thresholds are not always rigid boundaries but are often aspirations in economic circumstances where many organisations will also rely on some non-trade income.

Many successful social enterprises rely on trading with the public sector, and some of the most prominent social enterprises operate exclusively to provide public services, often starting out as public sector spin-out firms, particularly

5 Social Enterprise UK, *No Going Back: Social Enterprise Survey 2021*, p. 13, https://www.socialenterprise.org.uk/state-of-social-enterprise-reports/no-going-back-state-of-social-enterprise-survey-2021/.

6 Ibid., p. 25.

7 British Council, *Social Enterprise in the UK*, 2015, p. 2, https://www.britishcouncil.org/sites/default/files/social_enterprise_in_the_uk_final_web_spreads.pdf.

in health and social care. Sirona Health, for example, is currently reported as the UK's largest social enterprise, having operated for over 10 years as a public health spin-off with a current turnover of £45 million and providing health care services to over 1 million people in the West of England. The firm played a role in the UK COVID-19 vaccination programme and increased its turnover in this way during the pandemic.[8]

2.2. SOCIAL MISSION

Most commonly, according to combined data from 2015 to 2021, UK social enterprises define for themselves a social mission relating to (in this order) improving health and well-being, benefiting a particular community, supporting vulnerable people, creating employment opportunities and addressing social exclusion.[9] They operate in a range of sectors, mostly education and skills, retail, business support, creative industries and health care.[10] Social enterprises also play a role in work inclusion (WISE) schemes in the UK.[11]

Defining a social mission can create complications for social enterprises. Those that incorporate as CICs are required legally to incorporate an irrevocable 'community interest' mission in their articles of association, although its content may be changed subject to regulatory approval. They must demonstrate that a reasonable person would consider them to provide benefit to the community but, acknowledging some need for flexibility, the regulator responsible for CICs concedes that while 'everything that the CIC does should in some sense benefit the community', some of its activities may do so indirectly.[12]

Their social mission is expected to take priority over financial commitments to members or shareholders, and decision-makers must carefully weigh what commercial opportunities they pursue to avoid mission drift. Individual decisions may be commercially driven, but in aggregate they must give strategic priority to their social mission. In this, the social enterprise concept differs from a wider category of 'profit-with purpose' or 'mission-led' firms where directors have wider discretion in balancing profit and social objectives than

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8 SEUK, above n. 2. See generally, N. Boeger, 'Public Procurement and Business for Value: looking for alignment in law and practice' in A. Sanchez-Graells (ed.), *Smart Public Procurement and Labour Standards: Pushing the Discussion after Regiopost*, Hart Publishing, Oxford 2018, pp. 115–40.

9 SEUK, above n. 2, p. 36.

10 Ibid., p. 21.

11 R. Hazenberg, *The role of social enterprise in developing skills and creating employment opportunities in the UK*, State of the Art Review for the Enterprise Research Centre, 2021, https://www.enterpriseresearch.ac.uk/wp-content/uploads/2021/04/No50-The-role-of-social-enterprise-in-developing-skills-and-creating-employment-opportunities-in-the-UK-R.-Hazenberg.pdf.

12 Ibid., p. 18.

in social enterprises.[13] These are businesses that commit to generating profits for shareholders while at the same time pursuing the interests of society or the environment and minimising or avoiding externalities that their profit-making activities might otherwise produce.

2.3. MISSION LOCK

The social mission is written into the constitution of a social enterprise, and reflected in its legal ownership and governance structure. The scope of this protection depends both on the legal format of the social enterprise and on legal drafting. Certain legal forms, including the CIC and community benefit society, carry a statutory requirement to incorporate an irreversible social mission clause (statutory mission lock). A voluntary mission lock, on the other hand, can be incorporated into the governing documents of, for example, a simple limited company: a simple clause is inserted to define the social purpose of the organisation and adjust the company directors' duties (simple mission lock), often coupled with a device to strengthen the protection and ensure against 'mission drift' (reinforced or entrenched mission lock). Clauses that require a 'supermajority' to amend governing documents are a relatively common entrenchment device. More complex structures involve, in the case of a company limited by shares, golden shares (redeemable or non-redeemable) that are held by a third party which is either a charity or social-purpose organisation in its own right. Consent of the golden shareholder is required to amend the governing documents.[14]

A mission-locked constitution may provide for stakeholder ownership, but not necessarily. While a proportion of social enterprise are cooperatives or employee-owned businesses, these are in the minority.[15] Indeed, some of the most important employee-owned businesses in Britain would typically fall outside the common understanding of a UK social enterprise, primarily because their mission is focused on sharing benefits amongst members but they lack a defined primary social mission to benefit the community. The John Lewis Partnership, for instance, as one of the most prominent examples in this category, operates as a member-owned partnership structure enabling employees to share in both control and profits. What distinguishes it from a social enterprise, however, is

[13] N. Boeger, *Amending UK Company Law for a Regenerative Economy*, Institute of Directors Centre for Corporate Governance, Regenerative Business Working Group, 2021, https://static1.squarespace.com/static/603e23e8cd5ee7681ca07ba8/t/60a64d914dcb02030b2294f0/1621511578429/IoD+CG+Centre+Amending+UK+Company+Law.pdf.

[14] UnLtd, *Spotlight Paper: purpose, growth, impact – mission locks*, 2017, https://www.unltd.org.uk/uploads/general_uploads/UnLtd-Spotlight-Purpose-Growth-impact-Digital.pdf.

[15] SEUK, above n. 2.

the fact that its mission remains committed to making profit for its members. There are synergies between cooperative and employee ownership, and social enterprise in the UK, but conceptually these forms operate distinct from one another in the UK economy. Institutionally, too, there is a visible divide between associations that represent social enterprises (e.g. SEUK) and those advocating for cooperative (e.g. Cooperatives UK) and employee ownership (e.g. UK Employee Ownership Association).

2.4. ASSET LOCK

The question of what restrictions social enterprises can be expected to place on the distribution of their profits and on their assets in order to protect their social mission is the subject of debate. For individual social enterprises, this requires careful planning in order to achieve, on the one hand, the benefit of strong lock-ins to convince others (markets, public authorities, funders and investors, etc.) that they can credibly and sustainably deliver social impact, while, on the other hand, retaining enough commercial flexibility required to implement and scale up their venture (e.g. with further access to private investment). The scope of restrictions to which an organisation commits, relating to both its profits and assets, depends on its chosen legal format and on legal drafting.

A proportion of social enterprises incorporate restrictions into their governing documents to ensure that their assets are legally protected and permanently 'locked' for the benefit of their social mission – that they cannot be bought out, for example by a commercial party. Such an 'asset lock' may typically provide that (i) during the lifetime of the organisation, its assets will not be transferred for less than their market value except to further the social mission, and (ii) upon winding up, assets remaining after debts are settled will be transferred to another asset-locked organisation or with a similar mission. Asset locks apply to undistributed profits that are reinvested in the firm but they do not affect profits when they are initially earned. A separate profit lock, however, may impose a restriction on the distribution of such profits, for example by way of dividend, either during the lifetime or upon liquidation. While the two restrictions are strictly speaking distinct, it is common practice (e.g. in relation to the CIC format) for the description of an asset lock to be used for restrictions on both profits and assets.[16]

In relation to profits, all UK social enterprises are expected to commit in their governing documents to reinvest at least half of any surplus generated from their activities back into the business or to give it away (e.g. to charity or the community)

[16] Social Impact Taskforce, Mission Alignment Working Group Subject Paper, *Profit-With-Purpose Businesses*, 2014, p. 3, https://gsgii.org/reports/profit-with-purpose-businesses/.

for the benefit of their social mission. In addition, a further-reaching 'full' asset lock can be particularly critical where public assets are transferred to a social enterprise, to ensure these continue to be used for a social purpose. However, other social enterprises do not receive public funds or assets, but may have benefited from personal investment by an entrepreneur who, at some point, will want or need her money back. Not all organisations therefore may be willing or able to fully commit to a legal lock on assets, or they might simply wish to make this decision at a later point in time. To accommodate this flexibility, while the asset lock is a typical feature of the social enterprise concept in the UK and seen as desirable, it is also generally accepted that the asset lock cannot always be seen as essential.[17]

Certain legal forms in the UK, notably the CIC and community benefit society (where this choice is optional), come with a statutory asset lock (described further below). Others, including the limited company format, require the incorporation of a voluntary restriction clause. Voluntary clauses can be drafted more flexibly and incorporated into the governing documents of any limited company, including even a simple commitment to reinvest a substantial proportion of any surplus generated to further the organisation's social mission. While a simple clause offers a relatively low level of commitment in the sense that it is reversible by amendment of the governing documents, it has the benefit of ease of adoption and flexibility if required. As with the mission lock, it is possible to entrench these restrictions (e.g. by a supermajority clause) but without going as far as fully asset-locking the organisation.

The key difference between a social enterprise and the wider 'mission-led' business format that features increasingly in recent UK policy initiatives revolves precisely around the question of what is an acceptable level of restrictions on profits and assets. While social enterprises accept a level of restrictions to protect and guarantee their social mission (albeit to varying degrees), the newer movement of mission-led firms do not typically implement any such restrictions. They remain 'profit-distributing businesses for social impact'.[18]

3. FORMS OF ORGANISATION

3.1. LIMITED COMPANY

Social enterprises today adopt a diversity of legal forms. Among them, limited company formats are by far the most popular, and only a minority adopt other

[17] Social Enterprise UK, *What makes a social enterprise*, 2012, https://www.socialenterprise.org.uk/wp-content/uploads/2019/02/What_makes_a_social_enterprise_a_social_enterprise_April_2012-1.pdf.

[18] Social Impact Taskforce, above n. 16.

available legal forms, such as the cooperative and community benefit society. Almost a third of social enterprises (28%) in the UK are incorporated as a company without share capital (a company limited by guarantee or CLG), while 17% operate as a company limited by shares (CLS). Among start-up social enterprises in the last three years, uptake of the corporate format limited by shares is slightly higher at 23%. Whether this uptick will develop into a longer-term trend remains to be seen, but clearly the ability to access suitable finance to scale up their business constitutes a significant factor for many social entrepreneurs in selecting their organisational form.[19]

Without the ability to issue share capital, the CLG is unable to distribute profit to members but is open to grant and debt funding. Membership can be opened up to community members on a one-vote-per-member basis, which is attractive for some community social ventures. Some CLG social enterprises make use of a permanent custodian member, such as a local authority, with a right to veto any amendment to the governing documents (articles of association), to entrench these features. The CLS, on the other hand, which allows for equity investment where members become shareholders in the business and may receive dividends, is currently less popular among social enterprises. Where social enterprises choose to adopt the CLS format, they typically impose a limit in their articles of association on the payment of dividends.

UK company law permits but does not require companies to define specific corporate purposes in their articles of association. Absent specification, a company's purpose and the fiduciary duty of its directors is promotion of the success of the company for the benefit of its members as a whole. Directors are required to have regard to certain other stakeholders, including employees and business customers. The obligation, however, is only procedural, imposing on directors a duty to take a degree of care in their decision-making process – foremost, to encourage long-term sustainable business success – while overall giving priority to the interest of members.

For companies that operate as social enterprises, members will define and incorporate a social purpose for their venture into the company's articles of association, imposing on company directors a legal duty to promote the defined corporate purpose above the interest of members (section 172(2) UK Companies Act 2006). Provisions to entrench their social mission and provide for a voluntary asset lock are also written into the articles of association. While a voluntary asset lock can be reversed by future amendment of the articles, legal drafting, including the requirement of a supermajority, can temper this possibility.

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[19] SEUK, above n. 2.

3.2. COMMUNITY INTEREST COMPANY

The CIC format in particular has seen an upwards trend in popularity, with a considerable increase in CIC registrations between April 2020 and March 2021. In this period, the CIC register grew by about one-quarter, outpacing the growth in general corporate registrations. The government regulator responsible for CICs explains the rise predominantly as a result of the COVID-19 pandemic, reporting that '[d]ue to the impact of the pandemic, we have seen communities coming together to help those in need, which has made a huge difference to the sheer volumes of CIC applications the team has received throughout 2020–21.'[20] Overall, CICs currently represent 38% of social enterprises registered in the UK.[21] Of these, less than one-fifth of registered CICs issue shares. The majority of CICs register without share capital.[22]

The CIC offers a tailored legal format,[23] with irreversible mission lock and asset lock features legally incorporated, for social entrepreneurs who wish to set up a company with a primary mission to provide a benefit to the community and to use their assets and the majority of any surplus generated to fulfil this mission. The 'community interest test', which CICs must satisfy for registration and in their annual reports (see also above), is not as tightly defined as the scope of permissible charitable purposes in UK law. There is flexibility in what constitutes a community interest and what activities may contribute to it, but excluded are activities detrimental to the community interest. Unlike a charity, the CIC does not have trustees and its directors can receive reasonable remuneration.

To become a CIC, a social enterprise will incorporate a limited company either as a CLG or CLS and subject itself to an additional legal regime overseen by a designated Regulator of Community Interest Companies (CIC Regulator). The CIC's company legal form has the advantage of being familiar to the business community while offering enough flexibility to adapt to most organisational forms, from a single member to a cooperative company.[24] A CIC may be a public limited company (plc) in principle, although in practice no CIC has currently set up in this format.

[20] Regulator of Community Interest Companies, *Annual Report 2020/21*, p. 11, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1005991/cic-21-3-community-interest-companies-annual-report-2020-2021.pdf.

[21] SEUK, above n. 2.

[22] Regulator of Community Interest Companies, above n. 20.

[23] Companies (Audit, Investigations and Community Enterprise) Act 2004 and Community Interest Company Regulations 2005.

[24] Office of the Regulator of Community Interest Companies, *Frequently asked questions for funding organisations*, 2016, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/605431/13-782-community-interest-companies-frequently-asked-questions-for-funding-organisations.pdf.

The role of the CIC Regulator forms a central piece of this legal framework designed to ensure that both the community benefit and commercial components of the CIC are adequately accounted for. To strike such a balance, the Regulator operates a light-touch regime in terms of the intensity and extent of her reviews and investigations, enforcement and sanctioning. The point is to enable organisations to operate relatively freely in a commercial sense, intervening only when there is clear concern that this will undermine their community interest mission. In this vein, the CIC is subject to the same reporting requirements to Companies House as commercial companies. In addition, every CIC is under a legal obligation deliver an annual community interest company report detailing its activities for the public record, including details of asset transfers, dividend payments, directors' remuneration and stakeholder involvement. The CIC Regulator files all reports on the public register.[25]

It is a legally mandated governing clause for all CICs that assets may only be transferred out of the business if there is a transfer at full market value, or to another specified or approved asset-locked body, or to benefit the community. Where CICs issue shares, a statutory cap is imposed on the level of dividend that can lawfully be distributed to shareholders (currently set as a maximum aggregate dividend at 35% of yearly distributable profits). These legal restrictions are designed to firmly lock in and preserve the value of the company's assets and profits while also providing for some flexibility to access share capital and provide return to investors. Similarly, a CIC can still use its own assets as loan collateral, even if it means that assets may have to be sold to repay debt.

The CIC is generally seen as a success project for the UK social enterprise sector. Numerically, the proportion of social enterprises incorporating as CICs has risen significantly – to currently over 26,000 registered CICs[26] – and the trend has somewhat accelerated during the pandemic.[27] In another interesting statistic produced by SEUK, female-led social enterprises and those led by someone from an ethnic minority are more likely to register as CICs than other social enterprises.[28] Overall, however, still only a minority of social enterprises incorporate as CICs,[29] and in particular the uptake of the format of CIC (CLS) has not been as fast as some predicted. These developments, while overall encouraging, explain recurrent debates around the limits imposed by the statutory asset lock and dividend cap.

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25 Office of the Regulator of Community Interest Companies, *CIC34: community interest company report*, https://www.gov.uk/government/publications/form-cic34-community-interest-company-report.

26 Regulator of Community Interest Companies, above n. 20.

27 Ibid., and see also SEUK, above n. 2, pp. 7 and 12.

28 SEUK, above n. 2, p. 12.

29 Ibid.

3.3. REGISTERED SOCIETIES

The community benefit society (CBS) and cooperative society are corporate bodies registered under the Cooperative and Community Benefit Societies Act 2014 and are regulated by the Financial Conduct Authority (FCA). They are set up as organisations that conduct trade either for the interest of their members, in the case of a cooperative society, or, in the case of the CBS, for the wider benefit of the community. Both formats offer their members the benefit of limited liability and an organisation with separate legal personality. They are governed by a management committee and subject to the principle of 'one member, one vote' to enable democratic control.

Cooperative societies[30] can distribute surplus to members as a dividend, determined not by share capital but typically by the level of a member's transactions with the society. While legislation imposes no limits on dividend rates, and the FCA offers no guidance on the matter, the management committee of a cooperative society is expected to propose reasonable rates (which are approved by members) that further the objects of the society. Unlike a cooperative society, the surpluses that a CBS receives must be used to benefit the community and cannot be distributed to members by way of dividend. Interest on share capital is an operating expense, not a profit distribution, and the CBS accounts annually in its reports for how the use of its funds benefits the community.

Neither the cooperative society nor the CBS are automatically asset locked, but both may incorporate a voluntary asset lock by adjusting their articles. For the CBS, the FCA requires the incorporation of a voluntary asset lock. In addition, CBSs have the option of adopting statutory entrenched wording to ensure that assets are locked exclusively for the benefit of the community, including in the case of a sale or conversion of the organisation, or merger with another organisation.[31] The FCA has certain legal powers that relate to the enforcement of a statutory asset lock. On the other hand, those CBSs that choose not to adopt a statutory asset lock typically do so in order to benefit from a certain flexibility that the voluntary asset lock provides, for example to make changes to their articles and apply for charitable status in future, which is impossible for CBSs with a statutory asset lock in place. The statutory asset lock is not available for cooperative societies, but most choose to adopt a voluntary asset lock provision.

30 Cooperatives UK, *Distributions in Cooperative Societies*, https://www.uk.coop/resources/community-shares-handbook/6-share-interest-and-use-profit-or-surplus/62-distributions-co.

31 Community Benefit Societies (Restriction on Use of Assets) Regulations 2006.

3.4. UNINCORPORATED ASSOCIATION

Very few social enterprises operate as unincorporated associations, governed by a simple constitution and without separate legal personhood. This legal format means that members themselves remain responsible for entering into contracts and for any debt that the association incurs. It is an advantage of unincorporated associations that they are easy to set up and administer, without any oversight from Companies House or another regulatory body (unless they are registered charities). This legal form restricts, on the other hand, the financing opportunities that might be available to them, limited largely to grant funding and unsecured loans. Registering as a charity can help unincorporated associations in raising funds, though it also means further administrative and regulatory burdens.[32]

3.5. CHARITY

According to SEUK, only one in 10 social enterprises in the UK describe themselves as a charity.[33] Social enterprises incorporated as a CLG or CBS (but not a cooperative society) may apply for charitable status, provided they satisfy the required public benefit test.[34] This results in a double layer of regulation by both the Charity Commission and Companies House (in the case of a CLG) or the FCA (in the case of a CBS). The charitable incorporated organisation (CIO) offers an alternative legal form designed specifically for charities which is regulated by the Charity Commission only.[35] The CIO is a corporate body (although it is not subject to regulation by Companies House), and it offers the benefit of limited liability for members and has separate legal personality. It is a requirement that the CIO satisfies the criteria for being a charity, and its assets and surpluses must be used to further the CIO's charitable purposes. CICs cannot be a charity because the CIC legal and regulatory regime is considered separate from the charitable framework, but it is possible since 2018 for a CIC to convert directly to a CIO (though not, for example, to a limited company).[36]

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32 Grant Thornton, *Setting up a Social Enterprise*, 2017, p. 11, https://www.grantthornton.co.uk/globalassets/1.-member-firms/united-kingdom/pdf/publication/setting-up-a-social-enterprise.pdf.

33 SEUK, above n. 2.

34 Charity Commission, *Public benefit: rules for charities*, 2014, https://www.gov.uk/guidance/public-benefit-rules-for-charities.

35 Part 11 of the Charities Act 2011 and Charitable Incorporated Organisations (General) Regulations 2012, as well as Charities Act 2011 (Charitable Incorporated Organisations) (Constitutions) Regulations 2012 and Charitable Incorporated Organisations (Insolvency and Dissolution) Regulations 2012.

36 Charitable Incorporated Organisations (Conversion) Regulations 2018.

It is also possible for a CIC to be set up by a charity, much like setting up a charitable trading company. In this situation, the CIC would be used as the 'trading arm' of the charity, and the charity would indirectly benefit from the benefits of a CIC.[37]

4. LIFECYCLE

All legal forms of organisation in the UK are subject to certain administrative requirements to gain regulatory authorisation of their incorporation, as well as further annual requirements relating to the submission of accounts and reports. These are, generally speaking, not perceived as overly problematic and are subject to regular review. It is generally seen as an advantage, for example, that setting up a CIC is relatively fast, simple and cheap, with pre-formulated statutory clauses and a light-touch annual reporting regime and regulatory oversight. Choice of legal form determines what regulatory regime applies and where, ultimately, political responsibility for their regulation rests. Data from SEUK indicates that 78% of UK social enterprises are now regulated by Companies House (which also accommodates the CIC Regulator), situated within the UK Department for Business, Energy & Industrial Strategy. Around 11% of social enterprises incorporate as registered societies, which fall under the responsibility of the FCA within HM Treasury. In addition, the 11% of the sector that choose to apply for charitable status are overseen by the Charity Commission, operating within the UK Department for Digital, Culture, Media & Sport. Registering as a charity generally increases levels of regulation for social enterprises but can make it easier to obtain grant funding.[38]

UK law affords flexibility to social enterprises wishing to convert their organisation from one legal form to another. Typically, conversion requires a members' special resolution (75% majority). For example, a limited company may convert into a registered society or a CIC,[39] provided the legally required conditions are satisfied. A cooperative society or a CBS operating without statutory asset lock may convert into a company.[40] Certain limitations, however, apply in situations where a need exists to ensure continuity of the

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37 J. Korchak, *Advantages and Disadvantages of the Community Interest Company*, Inform Direct, 2018, https://www.informdirect.co.uk/company-formation/community-interest-company-cic-advantages-disadvantanges/.

38 Grant Thornton, above n. 32, p. 11.

39 Office of the Regulator of Community Interest Companies, *CIC business activities: forms and step-by-step guidelines*, 2021, https://www.gov.uk/government/publications/community-interest-companies-business-activities/cic-business-activities-forms-and-step-by-step-guidelines#convert-an-existing-company-to-a-cic.

40 Sections 112–113 Co-operative and Community Benefit Societies Act 2014.

statutory protection afforded, especially under the CIC or CBS format. A CIC, for example, may not convert into a cooperative society, and it may convert into a CBS only if a statutory asset lock provision is selected for continuity.[41] Similarly, a CBS that operates with a statutory asset lock may convert into a limited company only if provision is made for it to transfer residual assets to another similarly asset-locked organisation.[42] In relation to the CIC format, the CIC Regulator has set out detailed guidance on the rules and processes applicable to incorporation and conversions (from another format into a CIC and from the CIC into another format).[43] Since 2018, it is possible to convert a CIC directly into a CIO.[44] Detailed advice is available also in relation to incorporation and conversion of registered societies.[45]

Converting charitable organisations is generally possible only with approval by the Charities Commission. Restrictions apply to protect charitable objectives. CIOs for example cannot be converted into another corporate form (but they can be merged with other CIOs). It is however possible, subject to approval by the Charity Commission, to dissolve a CIO and transfer residual assets to another charity, such as a charitable CBS. Similarly, a charitable CLG can be converted into a charitable CBS, but only if the Charities Commission consents. A charitable CBS may in principle convert to a CIO, but the legal framework has been described as incomplete.[46] To achieve a similar outcome, it is possible for a charitable CBS to act as sole corporate trustee of a CIO.

Dissolving a social enterprise requires care, especially where an asset lock is in place and to ensure the continuation of its social mission. For the CIC format, termination is tightly regulated. Voluntary termination is possible only through dissolution or by 'converting' the CIC to a charity.[47] A CIC cannot be converted into an ordinary limited company. To dissolve a CIC, an application must be made on behalf of the directors and several criteria must be satisfied.[48] Upon dissolution, the CIC transfers residual assets to the asset-locked body named in its articles. If no such body is named, the CIC may still identify such an organisation, subject to the CIC Regulator's consent.[49] To 'convert' a CIC to

[41] Section 6A Community Interest Company Regulations 2005.

[42] Sections 112–113 Co-operative and Community Benefit Societies Act 2014.

[43] Office of the Regulator of Community Interest Companies, above n. 39.

[44] Charitable Incorporated Organisations (Conversion) Regulations 2018.

[45] Cooperatives UK, *Societies Legislation*, https://www.uk.coop/resources/community-shares-handbook/2-society-legislation.

[46] Cooperatives UK, *Converting a society into a charitable incorporated organisation*, https://www.uk.coop/resources/community-shares-handbook/2-society-legislation/26-converting-legal-forms/265-converting.

[47] Section 53 Companies (Audit, Investigations and Community Enterprise) Act 2004.

[48] Companies House, *Company strike off, dissolution and restoration*, 2014, https://www.gov.uk/government/publications/company-strike-off-dissolution-and-restoration.

[49] Form CIC53 for consideration by the CIC Regulator during the striking-off procedure.

a charity, the CIC amends its articles to nominate the new asset-locked charity as the body that will receive its assets on dissolution and registers this change with Companies House. It then transfers the assets to the charity (without need for CIC Regulator approval) and applies to Companies House for voluntary dissolution.

5. CERTIFICATION AND METRICS

5.1. SOCIAL ENTERPRISE MARK

Many see in the CIC not just a tailored legal form to support UK social enterprises, but also a sector-specific brand that is distinctive in describing a company that works for the benefit of the community.[50] The impact of the CIC legislation and its Regulator works in this sense much like a certification tool that helps social enterprise to stand out as a distinct organisational form and to achieve a higher profile for the sector.[51] For those not operating as a CIC, or wishing to further mark out their identity as a social enterprise, a number of routes are available. For example, they may become a member of SEUK, the largest network and advocacy organisation for the sector in the UK. In addition, they have the option of gaining an independent accreditation through the Social Enterprise Mark (SEM).[52]

SEM accreditation is administered by Social Enterprise Mark CIC, itself a social enterprise set up as a CIC dedicated to providing standards that define and accredit what it means to be a genuine social enterprise. Social Enterprise Mark CIC publishes an online directory of all accredited organisations and their social impact statements,[53] and charges an annual licence fee based on turnover for administering its accreditation procedure. SEM accreditation offers a grading scheme whereby organisations are assessed (by what are described as 'independent' and 'voluntary' accreditation panels) to the benchmark of either 'aspiring SEM', 'SEM' or 'Gold SEM' status. For aspiring SEM status, the social enterprise must demonstrate it is an independent business, primarily dedicated to social objectives, putting a principal proportion of profits towards these objectives, and the operation of an asset lock once the business ceases trading.

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[50] Office of the Regulator of Community Interest Companies, *Introducing the new Regulator of Community Interest Companies*, 2020, https://communityinterestcompanies.blog.gov.uk/2020/10/15/introducing-the-new-regulator-of-community-interest-companies/.

[51] J. Korchak, above n. 37.

[52] Social Enterprise Mark, *Our Accreditation Framework*, https://www.socialenterprisemark.org.uk/social-enterprise-mark-cic-accreditation-portfolio/.

[53] Social Enterprise Mark, *Directory of Certified Social Enterprises*, https://www.socialenterprisemark.org.uk/directory-certified-social-enterprises/.

For full SEM, it must demonstrate earnings of at least 50% of income through trading and that social objectives are in fact being achieved. For Gold SEM, additional criteria include evidence of effective governance and stakeholder engagement, ethical and good business practice, financial transparency and monitoring and reporting on social impact.

5.2. B CORP

The option for UK companies to gain B Corp certification was introduced in 2015, and it is enjoying growing popularity. Overseen by B Lab UK, which is set up as a registered charity, the process replicates the B Corp certification procedure available in other jurisdictions, with elements of the required 'legal test' tailored to the existing UK corporate legal framework. The UK test requires that companies incorporate an adjustment to the wording of section 172 of the Companies Act 2006 into their articles, which enables directors to place greater emphasis on the interests of society and the environment in their decision-making. The requirement introduces a 'corporate purpose' clause that defines the object 'to promote the success of the Company (i) for the benefit of its members as a whole; and (ii) through its business and operations, to have a material positive impact on (a) society and (b) the environment, taken as a whole.'[54] By accrediting these adjustments, the B Corp label certifies a 'mission-led' format rather than the operation of a social enterprise, for two main reasons: first, the adjusted corporate purpose is worded to confer discretion on directors regarding social and environmental matters, but it does not constitute a commitment to a primary social mission over and above financial interests. Secondly, B Corps can remain fully profit-distributing and without asset lock, in clear distinction from social enterprises (see above). Nevertheless, social enterprises including CICs do appear to be attracted to its growing popularity and profile, and there are now CICs that seek B Corp certification while operating as a social enterprise.[55]

5.3. MEASURING IMPACT

Beyond brands and certification procedures, there is an active history in the UK of developing methodologies to help socially invested organisations, including social enterprises, to measure their social impact, often linked to

[54] B Lab UK, *Meeting the Legal Requirement*, https://bcorporation.uk/b-corp-certification/how-to-certify-as-a-b-corp/legal-requirement/.

[55] B Lab UK, *Find a B Corp: Bubble Chamber CIC*, https://www.bcorporation.net/en-us/find-a-b-corp/company/bubble-chamber-cic/.

initiatives that support social and impact investment. In 2011, Inspiring Impact set up a key initiative to improve impact measures across social organisations based on a 'plan – do – assess – review' cycle that it derived from project management in the private and public sector and 'tailored to the issue of social impact'.[56] In 2014, the Social Impact Investment Taskforce followed up with impact measurement guides. They set out ideas that could also be widely seen in European and international impact initiatives, emphasising an organisational approach that was 'proportional' to the scale and character of each enterprise.[57] At the same time, the UK government has provided support for the development of impact measures, for example through the Impact Readiness Fund to build measurement capacity and consultancy.[58]

The social return on investment (SROI) methodology, which applies economic cost–benefit principles or to a wider analysis of social value, was developed in the UK in the 2000s–2010s.[59] Social Value UK, originally named SROI Network, was created to develop resources and guidance but, over time, the organisation has moved its focus beyond the SROI methodology. It now applies a framework for accounting for, measuring and valuing social value based on seven Principles of Social Value that were introduced in 2009 and updated in 2015.[60] At the same time, work is ongoing to link impact measurement methodologies with international efforts to develop non-financial reporting standards and guidance.[61]

6. SUBSIDIES AND BENEFITS

6.1. GRANTS

Unlike commercial businesses, social enterprises in the UK enjoy the benefit of available grant funding from the public and private sectors. Indeed, according

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56 T. Lumley, B. Rickey and M. Pike, *Inspiring Impact: Working Together for a Bigger Impact in the UK Social Sector*, 2011, https://inspiringimpact.files.wordpress.com/2012/06/inspiring_impact.pdf.

57 Social Impact Investment Taskforce, Working Group on Impact Measurement, *Measuring Impact*, 2014, https://gsgii.org/reports/measuring-impact/.

58 A. Hornsby, *That's My Hat! A Review of the Impact Readiness Fund (IRF)*, 2017, https://access-socialinvestment.org.uk/wp-content/uploads/2017/07/irf_review_2017-Final.pdf.

59 SROI Network, *A Guide to Social Return on Investment*, 2012, http://www.socialvaluelab.org.uk/wp-content/uploads/2016/09/SROI-a-guide-to-social-return-on-investment.pdf (update to 2009 Guide).

60 Social Value UK, *What Are the Principles of Social Value?*, https://socialvalueuk.org/what-is-social-value/the-principles-of-social-value/.

61 Impact Management Project, *Mainstreaming the practice of impact management*, https://impactmanagementproject.com/.

to SEUK, grant finance remains the most popular source of finance for UK social enterprises, and three-quarters of social enterprises that applied for funding or finance in 2021 applied for a grant (77%). By comparison, 39% of organisations applied for a loan, and a much lower proportion of 8% applied for equity finance.[62]

The UK features a variety of large and smaller independent grant funders, including organisations that specialise in supporting social enterprises through targeted grants.[63] In addition, public grant funding is available and supported by local and central government. The National Lottery Community Fund (NLCF), established by Act of Parliament in 1993, distributes National Lottery funding that is available to social enterprises as grant finance.[64] Eligible organisations must be registered as either a charity, CIC or CBS, or, in the case of an unregulated organisation, they must satisfy a list of criteria to identify themselves as a 'voluntary, community and social enterprise' (VCSE).[65] The NLCF currently finances a Social Enterprise Support Fund two-year partnership project to provide grants of over £16 million as financial support for social enterprises to address the impact of COVID-19.[66] It also administers the UK government's £200 million Coronavirus Community Support Fund introduced in 2020.[67]

Sizeable grant funding and social investment (see below) is available under a government-backed dormant assets scheme set up by the Dormant Bank and Building Society Accounts Act 2008. The scheme enables participating financial institutions and firms to transfer dormant account funds to an intermediary and allows for surpluses to be distributed to social and environmental initiatives, including social enterprises, across the UK. NLCF oversees a major share of these distributions, which so far amount to almost £800 million. In 2022, the government approved legislation to expand the current scheme to include assets from the insurance and pensions, investment, wealth management and securities sectors.

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62 SEUK, above n. 2.

63 School for Social Entrepreneurs, *What funding is available for social entrepreneurs?*, https://www.the-sse.org/resources/starting/what-funding-is-available-for-social-entrepreneurs/.

64 National Lottery Community Fund, *Corporate Plan 2020–23*, https://www.tnlcommunityfund.org.uk/media/documents/corporate-documents/TNLCF_Corporate_Plan_2020_2023.pdf?mtime=20200724093554&focal=none.

65 Criteria set out by the National Lottery Community Fund at https://www.tnlcommunityfund.org.uk/funding/thinking-of-applying-for-funding/who-can-apply/voluntary-community-and-social-enterprise-vcse-definition.

66 Social Enterprise Support Fund, *About Us*, https://socialenterprisesupportfund.org.uk/about-us.

67 National Lottery Community Fund, *Statement about the Coronavirus Community Support Fund*, 2020, https://www.tnlcommunityfund.org.uk/news/press-releases/2020-05-20/statement-about-the-coronavirus-community-support-fund.

6.2. SOCIAL INVESTMENT

Distinct from grant funding, the UK government defines social investment as 'the use of repayable finance invested into a social organisation to help it achieve its purpose and increase its impact on society.'[68] As investment capital tailored to social organisations, and often government-backed, social investment is distinct from other socially responsible forms of investment, including impact investing or investment focused on environmental, social and governance (ESG) risks.[69] Social enterprises, but not fully profit-distributing businesses, may currently benefit from social investment.[70] A key role in this is played by Big Society Capital (BSC), an organisation set up in 2012 as wholesaler of social investment capital in 2012 under the Dormant Accounts Act 2008. BSC distributes funding, which it receives from NLCF under the existing dormant asset scheme, to social investment intermediaries that will then pass it on to social organisations, including social enterprises.

According to BSC,[71] there has been an eight-fold rise in the UK social investment market over the past 10 years, with an estimated £6.4 billion outstanding at the end of 2020 and over 5,000 existing investments. However, notwithstanding its overall growth, the market has a mixed recent history. In reality, social property funds and social lending, partially boosted by recently introduced government-backed business loan schemes linked to COVID-19, account for the vast majority of its rise. Despite a range of new initiatives, there is continued need among UK social enterprises for more 'patient risk-bearing capital' to satisfy their financial needs, which the investment market continuously fails to meet.[72] In 2015, concern over these unmet needs led to the establishment of a second wholesale institution, the Access Foundation, to operate alongside BSC and distribute social investment capital to those organisations that BSC had been unable to reach.[73] Among other things, the Access Foundation has supported blended finance structures for social enterprises which, by combining grants and loans, enables funders to offer

[68] Department for Digital, Culture, Media & Sport et al., *Inclusive Economy*, 2013, https://www.gov.uk/government/collections/social-investment.

[69] J. Daggers, D. Floyd and D. Gregory, *A Snapshot of the UK Social Investment Market: 2000 to 2021*, 2021, http://flipfinance.org.uk/wp-content/uploads/2021/09/210906-UK-Social-Investment-Snapshot_Flip-Finance.pdf.

[70] HM Government, *Growing the Social Investment Market: A Vision and Strategy*, 2011, p. 31, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/61185/404970_SocialInvestmentMarket_acc.pdf.

[71] Big Society Capital, *Market Data – Size of the UK social impact investment market*, https://bigsocietycapital.com/our-approach/market-data/.

[72] Shift Design, *Beyond Demand: The social sector's need for patient, risk-bearing capital*, 2020, https://shiftdesign.org/content/uploads/2020/05/Beyond-Demand-Report_Shift_Esmee Fairbairn.pdf.

[73] Access: The Foundation for Social Investment, https://access-socialinvestment.org.uk/us/.

more advantageous terms than conventional finance.[74] Despite their popularity, so far it has only partially been able to alleviate existing gaps in the market as mismatches between demand and supply in social investment products continue.

6.3. TAXATION

The rules on direct taxation of social enterprises are determined by the legal format and status of the individual organisation. Those that become a charity may enjoy certain charitable tax exemptions, but according to SEUK only roughly one out of 10 UK social enterprises seek charitable status (either by choice or because, as is the case for CICs, the legal rules prevent them).[75] The vast majority of UK social enterprises, in other words, are subject to direct corporate taxation and to other taxes such as land tax charges (e.g. stamp duty).[76] General exemptions, for example group relief rules, may be available to them. Additional exemptions from corporation tax may be available where a social enterprise is wholly owned by, and mainly providing services to, a local government authority. Charitable social enterprises may apply for an exemption from corporation tax on charitable activities in their tax return filings. But commercial activities are still subject to corporation tax on any profits they generate. Certain land tax relief may be available to charities for real estate transactions, subject to potential clawbacks where applicable.

Since 2014, the UK government has supported investment in social enterprises by creating targeted tax incentives for social investors. Social investment, in debt or equity, provided to a social enterprise operating as a UK registered charity, CIC, asset-locked CBS or accredited social impact contractor may attract an income tax break of 30% for investors under the Social Investment Tax Relief (SITR) scheme.[77] SITR is not available, on the other hand, for investment in social enterprises set up as a cooperative society or simple limited company, even if they have a voluntary asset lock in place. In addition, a range of commercial activities are exempted from SITR, including taking on property or leasing and energy generation. For this and other reasons (including, on the investor side, poor awareness of SITR among investors and the need for more time to integrate SITR into the social investment market),[78]

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[74] J. Daggers et al., above n. 69, p. 2.
[75] SEUK, above n. 2.
[76] Grant Thornton, above n. 32.
[77] Get SITR, *Eligibility criteria for who can use SITR*, https://www.getsitr.org.uk/can-i-use-sitr.
[78] HM Treasury, *Social Investment Tax Relief: summary of responses to the call for evidence*, March 2021, p. 17, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/971811/210211_SITR_SoR.pdf.

the uptake of SITR has been relatively disappointing, falling below initial expectations.[79] A government review of SITR in 2019–2020 identified this, but the scheme itself was retained. It has now been extended to 2023.[80]

6.4. PUBLIC CONTRACTS

UK social enterprises have benefited from initiatives that encourage central government and local authorities to approach the award of public contracts from a holistic perspective that focuses on 'social value'. The Public Services (Social Value) Act 2012 requires authorities to consider how the services they seek to procure can improve social, environmental and economic well-being of the relevant area, how this improvement might be secured, and whether they might need to consult on the issue. The legislation applies only to public services contracts and framework agreements of a certain size. Its underlying policy encourages contracting with social enterprises and charities as organisations that are designed to deliver social value.[81] A 2015 review of the legislation however revealed that only a small number of authorities actively used social value provisions in their procurement, while generally awareness and application of the legislation remained relatively low, well below expectations.[82] Research in 2018 identified that, despite the law on social value, the proportion of public contracts awarded to CICs had in fact regressed over the preceding years.[83] In an effort to boost the social value agenda, from 2021 a new law has come into force requiring all major central government procurements to explicitly evaluate social value as appropriate, rather than (as was previously required) just consider it.[84]

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[79] Sapphire, *Guide to SITR*, https://info.sapphirecapitalpartners.co.uk/blog/sustainability-and-social-benefit-through-the-social-investment-tax-relief-sitr.

[80] HM Revenues and Customs, *Extension of the Social Investment Tax Relief for Venture Capital Schemes*, 2021, https://www.gov.uk/government/publications/extension-of-the-social-investment-tax-relief/extension-of-the-social-investment-tax-relief-for-venture-capital-schemes.

[81] Social Enterprise UK, *The Social Value Guide: Implementing the Public Services (Social Value) Act 2012*, https://www.socialenterprise.org.uk/wp-content/uploads/2019/05/Social_Value_Guide_Nov12.pdf; N. Boeger, 'Reappraising the UK Social Value Legislation' (2017) 37(2) *Public Money and Management* 113.

[82] Cabinet Office, *Social Value Act Review*, 2015, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/403748/Social_Value_Act_review_report_150212.pdf.

[83] Tussell – Social Enterprise UK Index, *Community Interest Companies (CICs) in Public Procurement*, 2018, https://www.socialenterprise.org.uk/policy-and-research-reports/tussell-social-enterprise-uk-index-community-interest-companies-cics-in-public-procurement/.

[84] Cabinet Office, *Social Value Act: information and resources*, 2021, https://www.gov.uk/government/publications/social-value-act-information-and-resources/social-value-act-information-and-resources.

Social Impact Bonds (SIBs), first introduced in the UK in 2010, provide a potential benefit to social enterprises by enabling their involvement in delivering public services. SIBs are in fact not bonds as the name would suggest, but outcomes-based contracts for the delivery of public services that enable the private, public and voluntary sectors to work together.[85] Under a SIB, a social enterprise or charity (or group of social enterprises or charities) is engaged to provide the service in question. Social investors pay the initial cost upfront in full, but are repaid, usually by a local or federal government authority, when the provider has successfully delivered the social outcomes under the contract. There are currently over 30 SIBs in the UK and their innovation has attracted international attention, but some see this as an 'exaggerated impression of their importance'.[86] For social enterprises, they can be complicated to access and tend to involve large charitable organisations.[87]

7. PRIVATE CAPITAL

UK policy has for some time addressed the question of how private capital through mainstream investment may support social enterprises. In one sense, it already widely does. High-street banks provide a major source of loan income for social enterprises. According to one report, in 2016 their loans to charities and social enterprises far exceeded the volume of other private investment.[88] However, other aspects of private investment have proven less accessible to social enterprises, despite progressive policy efforts. The UK's social investment strategy devised in 2011, which led to the creation of BSC, was primarily designed to attract private capital into the social sector. Targets included mainstream institutional investors such as pension and insurance funds,[89] but also high-net-worth individual and angel investors who may wish to generate social impact alongside financial returns. The strategy also encouraged the use of charitable endowments for social investment,[90] with government guidance

85 Department for Digital, Culture, Media and Sport, Cabinet Office, and Office for Civil Society, *A Guide to Social Impact Bonds*, 2012 (last updated 2017), https://www.gov.uk/guidance/social-impact-bonds.

86 J. Daggers et al., above n. 69, p. 1.

87 Ibid., p. 18.

88 D. Floyd and D. Gregory, *The Forest for the Trees: UK Banks' Investment in a Social Purpose*, 2016, http://flipfinance.org.uk/wp-content/uploads/2016/09/Forest-for-the-Trees-RBS-Social-Spider-July-2016.pdf.

89 HM Government, *Growing the Social Investment Market: A Vision and Strategy*, 2011, p. 31, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/61185/404970_SocialInvestmentMarket_acc.pdf.

90 Review of the Charities Act 2006, *Trusted and Independent: Giving charity back to charities*, 2012, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/79275/Charities-Act-Review-2006-report-Hodgson.pdf.

in 2016 adding clarification on the issue of how trustees may use endowment funds for social investment.[91]

However, with the partial exception of property-related investment, uptake among institutional and individual investors has been slower than expected, despite the introduction of SITR tax incentives. Among the more successful initiatives, the Big Venture Challenge scheme, funded by the NLCF (then Big Lottery Fund), was set up to attract private capital to support social enterprises in scaling up their business, leading to £4.7 million of new investment into the market by 2016. On the institutional side, BSC in 2020 partnered with Schroders to create a new vehicle, the Schroders Impact Trust plc, to provide investment to social organisations.[92]

In recent years, and in parallel with the rising interest in 'mission-led' business, UK policy closely follows the globally developing impact investment market.[93] This ongoing policy work considers how mainstream impact investment products may in future play a more important role in providing debt and equity capital of both social enterprise and profit-distributing 'mission-led' businesses. To that effect, the UK has recently set up an Impact Taskforce charged with developing solutions beyond traditional social investment that have a wider remit to 'harness private capital at scale for public good',[94] aligned in scope with the Global Network for Impact Investment.

For social enterprises, these developments encompass a shift in perspective that may prove significant. The government's original policy on social investment has been linked to a position that sees social investment funding as earmarked for social organisations, including social enterprises, that accept profit restrictions. The Dormant Accounts Act 2008, for example, makes this clear. More recent initiatives on impact investment, on the other hand, accept and indeed emphasise that social impact can be achieved effectively by

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[91] Charities (Protection and Social Investment) Act 2016; Charities Commission, *Social Investment by charities – the new power introduced by the Charities (Protection and Social Investment) Act 2016*, 2016, https://www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14/charities-and-investment-matters-interim-guidance.

[92] Schroder BSC Social Impact Trust plc, https://www.schroders.com/en/uk/private-investor/fund-centre/funds-in-focus/investment-trusts/schroders-investment-trusts/schroder-bsc-social-impact-trust/?gclid=EAIaIQobChMI2NCQ8--n9gIVDOrtCh3FqALZEAAYAiAAEgKwiPD_BwE&gclsrc=aw.ds.

[93] Implementation Taskforce, *Growing a culture of social impact investing in the UK*, Final Report, 2019, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/811914/Final_report_by_the_Implementation_Taskforce_Growing_a_culture_of_social_impact_investing_in_the_UK_2019.pdf.

[94] A. Patton, *UK government funds new taskforce to rocket boost global impact investing during G7 presidency*, Pioneers' Post, 12 July 2021, https://www.pioneerspost.com/news-views/20210712/nick-hurd-leads-impact-taskforce-boost-impact-investing-during-uk-g7-presidency.

'mission-led' profit-distributing businesses that promise return on investment. The focus has shifted, in other words, away from the question of organisational form and lock-in guarantees provided by the investee organisation. It has instead moved towards the wider question of what social impact the investment, generally, generates. The initiatives in question target any 'investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.'[95] This explicit shift in the positioning of UK government policy is a political choice, designed to produce leadership in the development of standards for impact investing and investment focused on ESG risks.

8. STAKEHOLDERS

As businesses dedicated to a social purpose, the benefit and importance for social enterprises of engaging with stakeholders beyond their members (including their employees and clients or consumers, the community, environmental stakeholders, etc.) is widely acknowledged in the UK. To 'involve stakeholders' is, for example, the first of seven principles developed by Social Value UK as part of their framework for measuring and according for social value or impact. Stakeholder involvement, the organisation points out, helps 'inform what gets measured and how this is measured'.[96] Similarly, in the context of public procurement under the Public Services (Social Value) Act 2012, what often marks out social enterprises as organisations suited to deliver social value for public services is their ability to engage with and establish a long-term relationship with service users and community stakeholders.[97] Survey data, too, links UK social enterprises to inclusive governance. According to SEUK, they have more diverse leadership teams than traditional businesses, with 83% including a woman and almost one-third including an ethnic minority member in their leadership team.[98] And most social enterprises involve staff in decision-making regarding the operating and future of the organisation (84%), though fewer (64%) say the same for involving external stakeholders and their beneficiaries in governance.[99]

Yet the law itself is widely silent on the issue of engaging with stakeholders other than members in social enterprises, leaving the development of adequate

[95] Impact Investing Institute, *Estimating and describing the UK impact investing market*, 2022, https://www.impactinvest.org.uk/wp-content/uploads/2022/03/Estimating-and-describing-the-UK-impact-investing-market.pdf.

[96] Social Value UK, *What Are the Principles of Social Value?*, https://socialvalueuk.org/what-is-social-value/the-principles-of-social-value/.

[97] SEUK, above n. 81.

[98] SEUK, above n. 2, p. 34.

[99] Ibid., p. 37.

practice and strategy instead to individual organisations or their networks in the sector, often without any significant enforcement mechanism. In part, this reliance on self-regulation and soft law in the area of corporate governance is culturally engrained in Britain. It is evident foremost in the existence of a UK corporate governance code for commercial companies, which applies subject only to a soft 'comply or explain' framework overseen by the Financial Reporting Council. For social enterprises, no general corporate governance code exists.

Under the CIC legal framework, every CIC must account in its annual community interest report for adequate engagement with its stakeholders. However, the obligation is subject to a light-touch review only, and in practice a short paragraph in the report suffices to satisfy this legal requirement. In its guidance notes on corporate governance, the CIC Regulator dedicates one mere page to stakeholder engagement, compared to eight pages on the issue of directors' remuneration alone.[100] Non-binding guidance on Governance for Community Interest Companies was developed in 2015, and it prefaces the importance of stakeholder involvement as 'essential for the company to learn and understand how it is meeting community need and how it can improve and develop'.[101] However, the guidance itself focuses primarily on methods of effective leadership and internal board procedures rather than for engaging with community stakeholders.

The situation is different for social enterprises of a cooperative type that grant democratic membership to their stakeholders directly. Such membership may extend to a single stakeholder group (e.g. employees, consumers, community members) or it may be multi-stakeholder.[102] In these organisations, decision-making rests with stakeholder members. They are often set up as a CBS or cooperative society, but alternatively the membership structure of a limited company can be adjusted.[103] For those which are community-based and set up as a registered society (CBS or cooperative society), issuing 'community shares' has become a relatively popular and effective way of financing, often drawing on the technology of online platforms in support.[104] Community shares constitute a withdrawable equity investment that is non-transferable. The community investor can take her money out of the organisation if she chooses

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[100] Office of the Regulator of Community Interest Companies, *Information and guidance notes, Chapter 9: Corporate governance*, 2016, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/605421/13-712-community-interest-companies-guidance-chapter-9-corporate-governance.pdf.

[101] *Governance for Community Interest Companies: a practical framework*, 2015, https://www.voscur.org/sites/default/files/Governance%20for%20Community%20Interest%20Companies.pdf.

[102] R. Ridley-Duff, 'Communitarian Perspectives on Social Enterprise' (2007) 15(2) *Corporate Governance: An International Review* 382.

[103] See *Fair Shares* company model articles, http://shura.shu.ac.uk/6636/1/V1-2_-_FairShares_Social_Enterprise_-_Model_Articles.pdf.

[104] Cooperatives UK, *Community Shares*, https://www.uk.coop/start-new-co-op/support/community-shares/about.

to, after an agreed period. But, unlike conventional shares, she cannot transfer them to another person. Community shares confer on their holders the right to a vote on how the organisation is run, on a one-member-one-vote basis.[105] They have been described as 'a source of patient capital for social enterprises' and 'a way of democratising social investment' because the investment is often raised from large numbers of individuals who are part of a community, each putting in a relatively small amount of money to support, manage and own a local business.[106]

9. CONCLUSION

The UK's social enterprise sector is strong but under constant pressure to reassert the principles and practice of social enterprise. A growing movement of 'mission-led' businesses is clearly distinct from social enterprise in Britain. These businesses are committed to social impact but without committing unequivocally to prioritising their social mission over their financial commitments to investors, and they remain fully profit-distributing. The impact of this movement on the social enterprise sector is hard to predict. Currently, national government policy targets businesses and investors seeking to achieve wider impact while support for traditional social enterprises is often developed at local level. This is a political choice, and particularly visible in the policy work focused on developing investment products that may in the future provide debt and equity capital to a variety of business organisations committed to generating measurable social impact. These policies may shift again in the future, and meanwhile the sector itself is actively involved in new initiatives that refocus on a social investment agenda tailored to social enterprises.[107] As more start-ups enter the sector, access to finance and the ability to scale have become key factors for many social entrepreneurs in their choice of organisational form. At the same time, 'mission-led' businesses and their networks play into the hands of social enterprises too. For example, B Lab UK, the organisation behind the B Corp movement, is currently putting forward proposals for a

105 Good Finance, *Community Shares*, https://www.goodfinance.org.uk/community-shares-0#:~:text=A%20withdrawable%2C%20non%2Dtransferrable%20equity,organisation%20if%20they%20choose%20to.

106 J. Daggers et al., above n. 69, p. 20.

107 Social Enterprise UK, *Adebowale Commission on Social Investment*, https://www.socialenterprise.org.uk/adebowalecommission/; Commission on Social Investment, *Reclaiming the Future: Reforming Social Investment for the Next Decade*, 2022, https://www.socialenterprise.org.uk/wp-content/uploads/2022/01/Reclaiming-the-Future-Commission-on-Social-Investment-Report.pdf.

'Better Business Act' (BBA).[108] This involves a legislative proposal to reform UK company law by incorporating an adjustment that would give directors more flexibility to take account of social and environmental concerns in their decisions. The aim is effectively to make the 'mission-led' format compulsory for all companies under the Act. Achieving such a major legal shift is ambitious and, strictly speaking, it does not directly advance the interests of social enterprises that wish to go further. But by forcing the conversation of what an alternative 'mission-led' company legal framework might look like, the BBA initiative draws attention both to the importance of corporate purpose and the availability of alternative business forms in the UK. Both are points that social enterprises have been advocating for years.

108 See Better Business Act, https://betterbusinessact.org/.

SOCIAL ENTERPRISES IN THE UNITED STATES

Lécia Vicente*

[C]orporations can do good, and that they do. But they cannot, and do not, do good at the expense of doing well. 'Doing well by doing good' is the guiding principle. Doing good for its own sake is out of bounds. Which limits profoundly how much and what kind of good corporations can do, while licensing them to do bad if that, rather than doing good, is the best way to do well.[1]

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[1] J. Bakan, 'The New Corporation: How "Good" Corporations Are Bad For Democracy', Harvard Law School Forum on Corporate Governance (9 September 2021) https://corpgov.law.harvard.edu/2021/09/09/the-new-corporation-how-good-corporations-are-bad-for-democracy/.

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1. INTRODUCTION

In a statement issued by the Business Roundtable in 2019, 181 CEOs of major corporations committed to 'lead their companies for the benefit of all stakeholders – customers, employees, suppliers, communities and shareholders.'[2]

The discussion about corporate purpose is not recent. However, since the Business Roundtable Statement, there has been a renewed debate about the corporations' purpose and the political roles they can perform in developed and developing countries, as well as emerging economies.[3] A vital question is: do

[2] 'Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy that Serves all Americans"', *Business Roundtable* (19 August 2019) https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

[3] E. Pollman and R.B. Thompson (eds), *Research Handbook on Corporate Purpose and Personhood*, Edward Elgar, Cheltenham/Northampton 2021; O.K. Osuji, F.N. Ngwu and D. Jamali (eds), *Corporate Social Responsibility in Developing and Emerging Markets: Institutions, Actors and Sustainable Development*, Cambridge University Press, Cambridge/New York 2020; A. Handley, *Business and Social Crisis in Africa*, Cambridge University Press, Cambridge/New York 2020. For a review of the latter two books and a discussion of the political role of the corporation in developing countries and emerging economies, see L. Vicente, 'Corporate Social Responsibility in Developing and Emerging Markets: Institutions, Actors and Sustainable Development (O.K. Osuji, F.N. Ngwu and D. Jamali eds., 2020) and A. Handley, Business and Social Crisis in Africa (2020)' (2021) *International Journal of Law in Context* 1.

corporations have a comparative advantage over individuals and the state when it comes to changing the status quo to benefit corporate constituencies, such as employees and social welfare?[4]

In the last decade, social enterprise emerged as a part of this debate.[5] Social enterprise grew out of the idea that businesses can 'do well by doing good'. Supporters of this vision of 'stakeholder governance'[6] believe that enterprises can mind the bottom line without disregarding social issues and the environment.[7] However, as commercial undertakings whose sustainability depends on their profitability, businesses' detachment, solidarity and welfare-driven agenda are heavily undermined by market pressure to mind shareholders' wealth maximisation. Still, due to their capacity to anticipate a change of status quo ahead of the state during scenarios of crisis or systemic risk, businesses can adapt and even join individuals to fight for social, political and economic change.[8]

How honest are businesses' efforts to change? Are their efforts solely motivated by self-interest? Can it be any other way? Actions attributed to corporations with a social focus have been debated, as corporate social responsibility strategies are

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4 O. Hart, 'Shareholders Don't Always Want to Maximize Shareholder Value', *ProMarket* (14 September 2020) https://promarket.org/2020/09/14/shareholders-dont-always-want-to-maximize-shareholder-value/.

5 Despite the increasing popularity of social enterprise in the last decade, see H.R. Bowen, *Social Responsibilities of the Businessman*, Harper & Brothers, New York 1953. See also the long-standing debate concerning non-shareholder constituency statutes in S.M. Bainbridge, 'Interpreting Nonshareholder Constituency Statutes' (1992) 19 *Pepperdine Law Review* 971; and J.R. Macey, 'Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective' (1999) 84 *Cornell Law Review* 1266.

6 R. Edward Freeman, *Strategic Management: A Stakeholder Approach*, Cambridge University Press, Cambridge/New York 2010 (1984). Also see 'Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy that Serves all Americans"', *Business Roundtable* (19 August 2019) https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans; and 'Stakeholder Capitalism: A Manifesto for a Cohesive and Sustainable World', World Economic Forum (14 January 2020) https://www.weforum.org/press/2020/01/stakeholder-capitalism-a-manifesto-for-a-cohesive-and-sustainable-world/?utm_source=ECGI+General+Mailing+List&utm_campaign=7b7cbc131b-EMAIL_CLS_STEWARDSHIP_2_COPY_02&utm_medium=email&utm_term=0_892f3cc861-7b7cbc131b-202068525&mc_cid=7b7cbc131b&mc_eid=2daf1ab709.

7 A.S. Ball, 'Social Enterprise Governance' (2016) 18 *University of Pennsylvania Journal of Business Law* 919; J.H. Murray, 'Beneficial Benefit LLCs' (2017) 85 *University of Cincinnati Law Review* 437; E. Schmidt, 'New Legal Structures for Social Enterprises: Designed for One Role but Playing Another' (2019) 43 *Vermont Law Review* 675; J. MacLeod Heminway, 'Lawyering for Social Enterprise' (2019) 20 *Transactions: The Tennessee Journal of Business Law* 797; A.E. Plerhoples, 'Social Enterprise As Commitment: A Roadmap' (2015) 48 *Washington University Journal of Law & Policy* 89; M. Yunus and K. Weber, *Building Social Business: The New Kind of Capitalism that Serves Humanity's Most Pressing Needs*, Public Affairs, New York 2010.

8 A. Handley, *Business and Social Crisis in Africa*, Cambridge University Press, Cambridge/New York 2020.

often deemed to enhance profit maximisation. Given the scepticism corporations face when they refrain from maximising shareholder value to engage in socially charged activities, one must ask: is social enterprise a new form of business enterprise or is it merely a measure to address unavoidable problems like climate change, economic inequality, social injustice and employee mass exodus in the 'Great Resignation' following the COVID-19 pandemic?[9] It is not surprising that publicly held companies like Veeva value employee success to the extent that they convert to a Delaware public benefit corporation to live by that value.[10]

This report examines the status and evolution of social enterprise in the US. It is part of a broader comparative endeavour. The last legal form for traditional business enterprises, the limited liability partnership, was created in 1991.[11] The Delaware legislature created the newest legal form for social enterprise, the statutory public benefit limited partnership, in 2019.

On the one hand, this report sheds light on the role of legal forms that house traditional businesses – the corporation, the limited liability company and the partnership – in the context of a global political-economic order in flux.[12] On the other hand, this report discloses the roles of traditional business forms and social enterprise in addressing social justice, economic inclusion and sustainability during the devastating COVID-19 pandemic and beyond.[13]

Where appropriate, I zoom into technical aspects of corporate law and corporate governance and report how changes in these fields mirror a renewed market dynamic. At times, the focus is on the public benefit corporation in Delaware. Currently, benefit corporations and variations on it are the most used specialised legal forms for social enterprise in the US. Delaware has successfully led other states in competition for companies' incorporation due to its statutory innovation, knowledgeable judiciary, tax incentives and overall reputation.[14]

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[9] J. Kaplan, 'The psychologist who coined the phrase "Great Resignation" reveals how he saw it coming and where he sees it going. "Who we are as an employee and as a worker is very central to who we are"', *Insider* (2 October 2021) https://www.businessinsider.com/why-everyone-is-quitting-great-resignation-psychologist-pandemic-rethink-life-2021-10.

[10] A. Sterling, A. Miazad and D.L. Louie, 'Veeva Systems: The Journey to Converting to a Public Benefit Corporation', *Berkeley Law Executive Education Case Series* (20 January 2022) https://executive.law.berkeley.edu/veeva-systems-case-study/.

[11] R.R. Keatinge, A.G. Donn, G.W. Coleman and E.G. Hester, 'Limited Liability Partnerships: The Next Step in the Evolution of the Unincorporated Business Organization' (1995) 51 *The Business Lawyer* 147.

[12] N. Bosma, S. Hill, A. Ionescu-Somers, D. Kelley, M. Guerrero and T. Schott, 'Global Entrepreneurship Monitor 2020/2021 Global Report' (2021) https://www.gemconsortium.org/report/gem-20202021-global-report.

[13] L. Feiner, 'Tech Companies Made Big Pledges To Fight Racism Last Year – Here's How They're Doing So Far', *CNBC* (6 June 2021) https://www.cnbc.com/2021/06/06/tech-industry-2020-anti-racism-commitments-progress-check.html.

[14] M.J. Roe, 'Regulatory Competition in Making Corporate Law in the United States – and its Limits' (2005) 21 *Oxford Review of Economic Policy* 232; A. Greif, 'Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders' (1989) 49 *Journal of Economic History* 857.

This report is structured as follows. Section 2 focuses on defining social enterprise. Section 3 describes elements of traditional legal forms for business enterprises and social enterprises. Section 4 is devoted to a social enterprise's lifecycle. Section 5 explains certifications and metrics for social enterprise. Section 6 concerns subsidies and benefits. Section 7 illuminates issues regarding private capital. Section 8 addresses prospective changes in the law. Section 9 concludes.

2. WHAT IS A SOCIAL ENTERPRISE?

2.1. THE CONCEPT OF SOCIAL ENTERPRISE

The concept of social enterprise is not clearly defined in the United States.[15] It has been used to signify 'the use of nongovernmental, market-based approaches to address social issues.'[16] The Social Enterprise Alliance (SEA) has defined social enterprises as '[o]rganizations that address a basic unmet need or solve a social or environmental problem through a market-driven approach.'[17]

For this reason, some authors refer to social enterprises as hybrids. This report focuses on differences and similarities among different types of business undertakings. To distinguish social enterprises from traditional business forms, such as limited liability companies (LLCs) that are also commonly referred to as hybrids, social enterprises are better defined as dual-purpose organisations.[18]

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15 F. Petrella and N. Richez-Battesti, 'Social Entrepreneur, Social Entrepreneurship and Social Enterprise: Semantics and Controversies' (2014) 14 *Journal of Innovation Economics & Management* 143; N. Choi and S. Majumdar, 'Social Entrepreneurship as an Essentially Contested Concept: Opening a New Avenue for Systemic Future Research' (2014) 29 *Journal of Business Venturing* 363; W.L. Tan, J. Williams and T.M. Tan, 'Defining the "Social" in "Social Entrepreneurship": Altruism and Entrepreneurship' (2005) 1 *The International Entrepreneurship and Management Journal* 353; J.G. Dees, 'The Meaning of "Social Entrepreneurship"' (2001) *CASE* 1, https://centers.fuqua.duke.edu/case/wp-content/uploads/sites/7/2015/03/Article_Dees_MeaningofSocialEntrepreneurship_2001.pdf.

16 J.A. Kerlin, 'A Comparative Analysis of the Global Emergence of Social Enterprise' (2010) 21 *Voluntas: International Journal of Voluntary and Nonprofit Organizations* 162, 164; see also D.B. Reiser, 'Theorizing Forms for Social Enterprise' (2014) 62 *Emory Law Journal* 681, 684; A.S. Ball, 'Social Enterprise Governance' (2016) 18 *University of Pennsylvania Journal of Business Law* 919, 926–30; T. Saebi, N.J. Foss and S. Linder, 'Social Entrepreneurship Research: Past Achievements and Future Promises' (2019) 45 *Journal of Management* 70, 71–76.

17 'A Working Definition of Social Enterprise', *Finca* (2019) https://finca.org/blogs/a-working-definition-of-social-enterprise/.

18 E. Schmidt, 'New Legal Structures for Social Enterprises: Designed for One Role but Playing Another' (2019) 43 *Vermont Law Review* 675; J. Battilana, A.C. Pache, M. Sengul and M. Kimsey, 'The Dual-Purpose Playbook: What It Takes to Do Well and Do Good at the Same Time' (2019) 97 *Harvard Business Review* 124; T. Saebi, N.J. Foss and S. Linder, 'Social Entrepreneurship Research: Past Achievements and Future Promises' (2019) 73 *Journal of Management* 70, 71–76.

Further, social enterprises overlap with the non-profit industry, particularly non-profits that generate revenue and are registered as §501(c)(3) tax-exempt entities with the Internal Revenue Service (IRS).[19] Several states have enacted legislation to introduce legal forms for social enterprise.[20]

In the past decade, economic inequality, lost faith in the public sector and deeper awareness of climate change has shifted consumers' needs and demands. Such issues cannot be resolved with philanthropy only and impact the bottom line. Social enterprise emerged from societal, economic, climate and technological changes.

2.2. INDUSTRY AND DISTINCTIVE FEATURES OF SOCIAL ENTERPRISE

Social enterprises develop their businesses in multiple industries such as professional services (e.g. scientific research, technical services, consultancy and others), information, communication, technology, agriculture, wholesale or retail sales (e.g. clothes, food, personal care and others), health, life sciences, energy, natural resources, water and sanitation, education, skills development, administrative and support services, finance, insurance, real estate, transportation, construction, leisure, and restauration.[21,22] In their book, Young, Searing and Brewer use a zoo metaphor to point out the many 'species' of social enterprise as an illustration of how difficult it is to restrain social enterprise to one type of industry.[23]

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19 J.A. Kerlin, 'A Comparative Analysis of the Global Emergence of Social Enterprise' (2010) 21 *Voluntas: International Journal of Voluntary and Nonprofit Organizations* 162.

20 For a description of forms of social enterprise in US, see section 3.1.

21 M. Barnes, 'Innovation with Crawfish Sauce: What A New Orleans Nonprofit Can Teach the Rest of the Country', The White House President Barack Obama (30 October 2009) https://obamawhitehouse.archives.gov/blog/2009/10/30/innovation-with-crawfish-sauce-what-a-new-orleans-nonprofit-can-teach-rest-country (Café Reconcile, in New Orleans, a city with significant levels of poverty and devastated by multiple natural disasters, works with youth in the area of skills development. This non-profit was part of the Community Solutions Tour – a governmental initiative to promote information and network in the social enterprise and non-profit sector).

22 E. Berrey, 'Social Enterprise Law in Action: Organizational Characteristics of U.S. Benefit Corporations' (2018) 20 *Transactions: The Tennessee Journal of Business Law* 21.

23 D.R. Young, E.A.M. Searing and C.V. Brewer (eds), *The Social Enterprise Zoo: A Guide for Perplexed Scholars, Entrepreneurs, Philanthropists, Leaders, Investors, and Policymakers*, Edward Elgar, Cheltenham /Northampton, MA 2016. See also W.L. Tan, J. Williams and T.M. Tan, 'Defining the "Social" in "Social Entrepreneurship": Altruism and Entrepreneurship' (2005) 1 *International Entrepreneurship and Management Journal* 353, 361 (dividing social enterprise into several categories – community-based enterprises, socially responsible enterprises, social service industry professionals, and socio-economic or dualistic enterprises); J. Defourny and M. Nyssens, 'Fundamentals for an International Typology of Social Enterprise Models' (2017) 28 *Voluntas: International Journal of Voluntary and Nonprofit Organizations* 2469, 2475–76 (categorising three major 'matrices' of the economy that shape social enterprise).

Additionally, distinctive features of social enterprise vary geographically. Social enterprise fuses social and environmental missions with a revenue-generating activity.[24] In the US, social enterprise mirrors private and business-oriented views. In Western Europe, social enterprises are embedded into society and align with the model of the post-World War II welfare state.[25]

Considering their constant evolution, it has been challenging to identify and quantify social enterprises. Some statistical treatment of these business entities can be found at the state level. For example, as of 23 February 2022, 2,314 low-profit limited liability companies (L3Cs) were counted in the US in Vermont, Michigan, Wyoming, Utah, Illinois, North Carolina (which repealed its L3C law effective 1 January 2014), Louisiana, Maine, Rhode Island, the Oglala Sioux Tribe, and the Navajo Tribe.[26] That figure increased from 2,015 L3Cs back on 20 July 2021. However, the number is volatile.

Oregon provides data regarding corporations and LLCs designated as 'benefit companies' in the state.[27] Other states provide similar data.[28] However, such data is difficult to navigate. Ellen Berrey's 2018 empirical study disclosed that at least 7,704 benefit corporations had been formed between 1 October 2010 and 31 December 2017, and that most benefit corporations had been incorporated in Oregon, New York, Nevada, Delaware, Colorado, California and Maryland.[29]

B Lab, a non-profit corporation at the forefront of social enterprise development, has tracked the number of benefit corporations, such as Kickstarter, King Arthur Flour and Patagonia.[30] However, there are very few empirical studies that scrutinise the data B Lab provides against the databases Secretaries of States hold in different states.[31] Secretaries of States play an active role in

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24 J. Defourny and M. Nyssens, 'Fundamentals for an International Typology of Social Enterprise Models' (2017) 28 *Voluntas: International Journal of Voluntary and Nonprofit Organizations* 2469.

25 J.A. Kerlin, 'A Comparative Analysis of the Global Emergence of Social Enterprise' (2010) 21 *Voluntas: International Journal of Voluntary and Nonprofit Organizations* 162; M. Nyssens (ed.), *Social Enterprise: At The Crossroads of Market, Public Policies, And Civil Society*, Routledge, Oxon/New York 2006; H.W. Micklitz (ed.), *The Many Concepts of Social Justice in European Private Law*, Edward Elgar, Cheltenham/Northampton, MA 2011; M. Weir, 'Welfare State' (2001) *International Encyclopedia of the Social & Behavioral Sciences* 16432, https://www.sciencedirect.com/science/article/pii/B0080430767010949.

26 'What is an L3C?', *Intersector*, https://www.intersectorl3c.com/l3c; K. Cooney, J. Koushyar, M. Lee and H. Murray, 'Benefit Corporation and L3C Adoption: A Survey', *Stanford Social Innovation Review* (5 December 2014) https://doi.org/10.48558/4XEZ-4964.

27 'Active Benefit Companies', *Oregon.Gov Open Data Portal*, https://data.oregon.gov/Business/Active-Benefit-Companies/baig-8b9x/data.

28 'Status Tool', *Social Enterprise Law Tracker*, https://socentlawtracker.org/#/map.

29 E. Berrey, 'Social Enterprise Law in Action: Organizational Characteristics of U.S. Benefit Corporations' (2018) 20 *Transactions: The Tennessee Journal of Business Law* 21, 26, 44–51.

30 'Find a Benefit Corp', *Benefit Corp*, https://benefitcorp.net/businesses/find-a-benefit-corp.

31 E. Berrey, 'Social Enterprise Law in Action: Organizational Characteristics of U.S. Benefit Corporations' (2018) 20 *Transactions: The Tennessee Journal of Business Law* 21, 42.

the formation of traditional corporations, benefit corporations and variations thereof, as further explained below.

2.3. DOES SIZE MATTER?

It is unclear whether the metric to define the largest or most prominent social enterprise should lie in profitability, number of investors or level of social impact. To assess a company's commitment to social causes and the environment, B Lab uses the company's ownership structure, size and profitability to determine broader impact.

Companies like Bi-Rite Market, Bridgetown Natural Foods, Cooperative Home Care Associates (CHCA), Dr. Bronner's, Home Care Associates of Philadelphia, Inc., TOMS, Patagonia and Sunrise Banks have more than 250 employees and have been ranked in B Lab's Best for the World list for their positive impact and best business practices regarding community, environment, customers, workers and governance.[32]

In 2015, Laureate Education Inc. became the first Delaware public benefit corporation (PBC) through an initial public offering (IPO).[33] Lemonade Inc. filed for its IPO to become a Delaware PBC in 2020.[34] Coursera[35] and Vital Farms[36] are two other Delaware PBCs. Patagonia is a California benefit corporation.[37] Laureate, Lemonade and Vital Farms were all privately held corporations before

32 'Best For The World 2021 Lists', *B Lab Global*, https://www.bcorporation.net/en-us/best-for-the-world/?_ga=2.139506675.1951213295.1640508221-1407490944.1639765892&_gac=1.54564569.1640337393.Cj0KCQiA_JWOBhDRARIsANymNOYDiEW7CQZfUF98A-xdVsF5UcBzHSkL_id4nkQdjjIdZh66lBlGbokaAjSKEALw_wcB.

33 C. Posner, 'A "Public Benefit Corporation" Takes the IPO Plunge (Updated)', *Cooley PubCo* (13 October 2015) https://cooleypubco.com/2015/10/13/a-public-benefit-corporation-takes-the-ipo-plunge/. See also Laureate Education, Inc., United States Securities and Exchange Commission Form S-1, *EDGAR* (2 October 2015) https://www.sec.gov/Archives/edgar/data/912766/000104746915007679/a2209311zs-1.htm#ez43501_legal_matters.

34 Lemonade, Inc., United States Securities and Exchange Commission Form S-1, *EDGAR* (8 June 2020) https://www.sec.gov/Archives/edgar/data/1691421/000104746920003416/a2241721zs-1.htm.

35 Coursera, Inc., United States Securities and Exchange Commission Form S-1, *EDGAR* (5 March 2021) https://www.sec.gov/Archives/edgar/data/1651562/000119312521071525/d65490ds1.htm.

36 Vital Farms, Inc., United States Securities and Exchange Commission Form S-1, *EDGAR* (9 July 2020) https://www.sec.gov/Archives/edgar/data/1579733/000119312520190455/d841617ds1.htm.

37 E. Loughman, 'Benefit Corporation Update: Patagonia Passes B Impact Assessment, Improves Score to 116', *Patagonia* (24 October 2014) https://www.patagonia.com/stories/benefit-corporation-update-patagonia-passes-b-impact-assessment-improves-score-to-116/story-17871.html.

becoming PBCs. In January 2021, Veeva Systems' shareholders voted for it to become the first publicly held corporation ever in the US to convert to a PBC.[38]

A growing number of publicly held corporations, which are not benefit corporations or PBCs, have achieved the status of Certified B Corporation provided by B Lab. Charlotte's Web Holdings, Inc., based in Colorado and operating in the US and Canada,[39] and Amalgamated Bank[40] are examples.[41]

2.4. CONTROVERSIAL ASPECTS OF SOCIAL ENTERPRISE

US law applies the legal regime of traditional business organisations to different forms of social enterprise. The corporation is the legal form of business organisation most used for social enterprise. In a nutshell, legal personality, limited liability (i.e. shareholders are not personally liable for the company's debts), transferability of ownership and centralised management through a board of directors characterise the corporation.

Managers of the traditional corporation must abide by fiduciary duties of care, loyalty and good faith.[42] Benefit corporations' managers' duties are characterised by finding a balance between shareholders' interest in maximising profit and stakeholders' interests in pursuing public benefit.

Delaware General Corporation Law (DGCL) §362(a) provides that 'a public benefit corporation shall be managed in a manner that balances the stockholders' pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit or public benefits identified in its certificate of incorporation.'[43]

DGCL §362(b) defines 'public benefit' as 'a positive effect (or reduction of negative effects) on 1 or more categories of persons, entities, communities or interests (other than stockholders in their capacities as stockholders) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature.'

DGCL §362 is unclear about how managers will be liable for failure to satisfy the balancing requirement outlined in §362(a). Directors fulfil their fiduciary

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38 A. Sterling, A. Miazad and D.L. Louie, 'Veeva Systems: The Journey to Converting to a Public Benefit Corporation', *Berkeley Law Executive Education Case Series* (20 January 2022) https://executive.law.berkeley.edu/veeva-systems-case-study/.

39 'Charlotte's Web Holdings, Inc.', *B Corp*, https://www.bcorporation.net/en-us/find-a-b-corp/company/charlottes-web-holdings-inc.

40 'Amalgamated Bank', *B Corp*, https://www.bcorporation.net/en-us/find-a-b-corp/company/amalgamated-bank.

41 'Are Any B Corps Publicly Traded?', *B Corp* (14 November 2021) https://bcorporation.net/faq-item/are-any-b-corps-publicly-traded.

42 Model Business Corporation Act §8.30.

43 See also DGCL §365(a).

duties to stockholders and the corporation 'if such director[s'] decision is both informed and disinterested and not such that no person of ordinary, sound judgment would approve.'[44]

DGCL §362(a) does not extend directors' duties of care, loyalty and good faith to 'those materially affected by the corporation's conduct.' Furthermore, corporations can eliminate or limit director or officer personal liability to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director or officer by opting into DGCL §102(b)(7). Failure to satisfy the §362(a) balancing requirement does not constitute a breach of duties of good faith or loyalty unless the certificate of incorporation provides or if there is a self-dealing conflict of interest that would be considered a breach even if the corporation was not a PBC.[45]

Regarding these rules' enforcement, §367 maintains that only stockholders can file individual, derivative or other actions to enforce the balancing requirement set forth in §§362 and 365. In the context of benefit corporations, managers' fiduciary duties are frequently defined as 'dual fiduciary duties', for managers have obligations to both the company (and its stockholders) and other stakeholders.[46] However, lodging exclusive enforcement rights with stockholders inevitably means managers will care primarily about stockholders' interests in benefit corporations and PBCs.

This fact demonstrates the social enterprise's underlying business and profit-oriented configuration over its public interest orientation. This feature of the social enterprise's legal framework constitutes a self-defeating paradox. This paradox exposes the social enterprise to market uncertainty and investor scepticism.

2.5. FUNDING SOCIAL ENTERPRISE

A year before Maryland passed its benefit corporation legislation, in 2009, Congress enacted the Edward M. Kennedy Serve America Act, an Act to reauthorise and reform the national service laws.[47] It considerably increased funding for AmeriCorps, a governmental agency that supports service and volunteering, and created the Social Innovation Fund (SIF).

In 2015, Congress amended the Jumpstart Our Business Startups Act (JOBS Act) to allow use of crowdfunding by social enterprises.[48] While such legislative

44 See DGCL §365(b).
45 See DGCL §365(c).
46 J.R. Macey, 'An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties' (1991) 21 *Stetson Law Review* 23, 24.
47 Serve America Act, Pub. L. No. 111-13 (2009), CONGRESS.GOV (21 April 2009) https://www.congress.gov/bill/111th-congress/house-bill/1388/text.
48 Jumpstart Our Business Startups Act, Pub. L. No. 112-106 (2012), CONGRESS.GOV (5 April 2012) https://www.congress.gov/bill/112th-congress/house-bill/3606.

output could trigger a wave of financial support, the reality is that social enterprises still struggle to obtain funding. Customers' and funders' lack of understanding of and trust in social enterprise poses a clear challenge in accessing capital.[49] Additionally, investors feel ambivalent regarding the commercialisation of the non-profit sector. This ambivalence leads some investors and critics to ask hard questions, such as who gets to decide what issues have social significance.[50]

Despite the challenges, social enterprise attracts funding from 'social investors', such as individuals, philanthropists, for-profit organisations and governmental grants.[51] Depending on their size, social enterprises may be eligible for microfinance services, climate 'finance' funds, social investment competitions and social impact bonds introduced or supported by governments.[52] When it became listed on the Bonds Market of the Singapore Exchange in 2017,[53] Impact Investment Exchange (IIX)'s Women's Livelihood BondTM 1 (WLB1) was the world's first gender lens and impact investing instrument to be listed on a stock exchange.[54] The USAID's Development Credit Authority provided a loan guarantee for WLB1.[55]

Dana Brakman Reiser and Steve A. Dean suggest that the standardisation of hybrid financial instruments may overcome the mistrust and fear of commitment stemming from the 'unique assurance game' between social entrepreneurs

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49 A.J. Abramson and K.C. Billings, 'Challenges Facing Social Enterprises in the United States' (2019) 10 *Nonprofit Policy Forum* 20180046.

50 N. Whoriskey, 'Milbank Discusses SEC Guidance on Shareholder Proposals and the Way to Regulate Climate Change', *The CLS Blue Sky Blog* (24 November 2021) https://clsbluesky.law.columbia.edu/2021/11/24/milbank-discusses-sec-guidance-on-shareholder-proposals-and-the-way-to-regulate-climate-change/.

51 United Nations Department of Economic and Social Affairs, 'World Youth Report: Youth, Social Entrepreneurship and the 2030 Agenda', United Nations, New York 2020, pp. 16–18, https://www.un.org/development/desa/youth/world-youth-report/wyr2020.html.

52 United Nations Department of Economic and Social Affairs, 'World Youth Report: Youth, Social Entrepreneurship and the 2030 Agenda', United Nations, New York 2020, p. 17, https://www.un.org/development/desa/youth/world-youth-report/wyr2020.html. See also D.B. Reiser and S. Dean, 'Financing the Benefit Corporation' (2017) 40 *Seattle University Law Review* 793; O. Mazur, 'Taxing Social Impact Bonds' (2017) 20 *Florida Tax Review* 431; L. Sommer, 'This Kenyan Family Got Solar Power. High-Level Climate Talks Determine Who Else Will', *NPR* (10 November 2021) https://www.npr.org/sections/goatsandsoda/2021/11/10/1052926511/this-kenyan-family-got-solar-power-high-level-climate-talks-determine-who-else-w?utm_campaign=storyshare&utm_source=twitter.com&utm_medium=social&t=1638182550144.

53 'IIX's Women's Livelihood Bond™ Officially Listed on the Singapore Exchange', *IIX* (16 August 2017) https://iixglobal.com/iixs-womens-livelihood-bond-officially-listed-singapore-exchange/.

54 'World's First Listed Gender Lens Impact Investing Security, IIX Women's Livelihood Bond 1, Matures', *The Rockefeller Foundation* (26 July 2021) https://www.rockefellerfoundation.org/news/worlds-first-listed-gender-lens-impact-investing-security-iix-womens-livelihood-bond-1-matures/.

55 'USAID's US$8-M livelihood bond to aid 385,000 women in Southeast Asia', *The Jakarta Post* (11 August 2017) https://www.thejakartapost.com/seasia/2017/08/11/usaids-us8-m-livelihood-bond-to-aid-385000-women-in-southeast-asia.html.

and investors. The suggested financial instruments would combine debt and equity, such as convertible bonds, which combine debt with equity attributes, or preferred shares, which combine equity with debt attributes. Other financial constructions derive from the negotiation of individually tailored contractual provisions to meet the specific needs of social entrepreneurs and investors.[56]

3. FORMS OF ORGANISATION FOR SOCIAL ENTERPRISES

3.1. FORMS OF SOCIAL ENTERPRISE AND PURSUIT OF A SOCIAL MISSION

The first legal form for social enterprise provided by legislation in the US was the L3C in Vermont in 2008.[57] Since then, several state legislatures have authorised alternatives to the traditional corporate legal forms that expressly permit the consideration of a broader set of stakeholders in corporate decision-making.[58]

Besides the L3C, the current forms of social enterprise legislatively contemplated across states in the US include: the benefit corporation;[59] the public benefit corporation (PBC), enacted in Delaware in 2013 and amended in 2015 and 2020;[60] the social purpose corporation (SPC), enacted for the first time in Washington in 2012;[61] the benefit limited liability company (BLLC), first enacted by Maryland legislature in 2010;[62] and the statutory public benefit

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56 D.B. Reiser and S.A. Dean, 'Financing the Benefit Corporation' (2017) 40 *Seattle University Law Review* 793.

57 Low-Profit Limited Liability Companies Act, Vt. Stat. Ann. tit. 11, §§3001(27), 3005(a), 3023(a) (2013).

58 'Status Tool', *Social Enterprise Law Tracker*, https://socentlawtracker.org/#/map.

59 'Model Benefit Corporation Legislation', *Benefit Corp* (17 April 2017) https://benefitcorp.net/sites/default/files/Model%20benefit%20corp%20legislation%20_4_17_17.pdf.

60 See current enterprise legal status of public benefit corporation in Delaware at: https://socentlawtracker.org/#/bcorps: 'Del. Code Ann. tit. 8, §§361–368 (2013). Delaware's Public Benefit Corporation Act deviates from the Model Benefit Corporation Legislation. On June 24, 2015, Gov. Jack Markell signed S.B. 75 into law, which amended 362 and 363 relating to the use of the "P.B.C." designation, voting thresholds, and appraisal rights. On July 16, 2020, the Governor signed H.B. 341 into law, which amended 363, 365 and 367 relating to the voting thresholds and appraisal rights, changing the voting threshold from a two thirds to a majority requirement. Effective date was August 1, 2013.'

61 California Social Purpose Corporations Act, Cal. Corp. Code §§2500–3503 (2014); Washington, An Act Relating to Social Purpose Corporations, Rev. Code Wash. 23B.25.005 to .150 (2013).

62 Maryland Benefit LLC Act, Md. Code Ann., Corps. & Ass'ns §§11-4A-1201 to 11-4A-1208, 11-1-502, 5-6C-03 (2013). See also Oregon, An Act Relating to Benefit Companies, Ore. Rev. Stat. §§60.750 to .770 (2014). Oregon uses the expression 'benefit companies' and allows traditional for-profit business forms, such as corporations and limited liability companies to adopt the benefit company form.

limited partnership (SPBLP), created in Delaware in 2019.[63] Benefit corporations have become the most popular form of social enterprise, while L3Cs have fallen short of attracting investment.[64]

3.2. PRIORITISING STAKEHOLDERS' INTERESTS: WHICH STAKEHOLDERS?

In the 1980s, the US experienced a wave of corporate takeovers which did not impact other types of traditional for-profit entities as much as it affected the corporation. Since the 1980s, the market for corporate control took off and shareholder wealth maximisation has dominated corporate law and governance.[65] This understanding led managers to pursue profits to the detriment of other stakeholders' interests.

This occurred despite the fact that managers even of traditional business corporations have no statutory obligation to consider only the interests of shareholders,[66] but rather are allowed to consider the interests of other stakeholders provided managers follow their fiduciary duties of care, loyalty and good faith,[67] and do not usurp the company's business opportunities.[68]

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63 Delaware Revised Uniform Limited Partnership Act Subchapter XII of Chapter 17, Title 6 Commerce and Trade of the Delaware Code, Section 17 1202.

64 E. Schmidt, 'New Legal Structures for Social Enterprises: Designed for One Role but Playing Another' (2019) 43 *Vermont Law Review* 675, 700–10.

65 H. Baum, 'The Rise of the Independent Director in the West: Understanding the Origins of Asia's Legal Transplants' in D.W. Puchniak, H. Baum and L. Nottage (eds), *Independent Directors in Asia: A Historical, Contextual and Comparative Approach*, Cambridge University Press, Cambridge/New York/Melbourne/Delhi/Singapore 2017, pp. 21–57; M. Gelter, 'The Pension System and the Rise of Shareholder Primacy' (2013) 43 *Seton Hall Law Review* 909. For a different approach, see M.M. Blair and L.A. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247.

66 V.H. Ho, '"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder Stakeholder Divide' (2010) 36 *Journal of Corporation Law* 59; L. Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public*, Berrett-Koehler Publishers, San Francisco 2012. See also Principles of Corporate Governance §2.01 (1994).

67 J. MacLeod Heminway, 'Shareholder Wealth Maximization as a Function of Statutes, Decisional Law, and Organic Documents' (2017) 74 *Washington and Lee Law Review* 939, 950–56; K.E. Scott, 'Agency Costs and Corporate Governance' in P. Newman (ed.), *The New Palgrave Dictionary of Economics and the Law*, Palgrave Macmillan, London 2002, pp. 26–30; J.R. Macey, 'Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective' (1999) 84 *Cornell Law Review* 1266. In the jurisprudence, see *Kamin v. American Express Company* 86 Misc.2d 809, 383 N.Y.S.2d 807, affirmed, 54 A.D.2d 654, 387 N.Y.S.2d 993 (1st Dept. 1976); *Smith v. Van Gorkom* 488 A.2d 858 (Del.Sup.Ct. 1985); *Broz v. Cellular Information Systems, Inc.* 673 A.2d 148 (Del. 1996).

68 *Guth v. Loft, Inc.* 5 A.2d 503, 510–11 (Del. 1939).

Litigation challenging the actions of directors who do not prioritise shareholder value at the expense of customers, creditors, employees, the environment or society in general has occurred for more than a century.[69] When they face liability, directors are protected by the business judgment rule, which maintains that they are not liable for an honest mistake due to their business judgment. The business judgment rule provides discretion for directors to balance shareholder and other stakeholder interests in all but the most extreme circumstances.[70]

3.3. ELEMENTS OF TRADITIONAL LEGAL FORMS FOR BUSINESS ENTERPRISES

Traditional business enterprises are like a foil onto which social enterprise legal forms have developed. The following aspects of traditional business enterprises are relevant for establishing differences and similarities, and understanding the most distinctive features of social enterprises and the reasons for their emergence.

For the most part, traditional business enterprises are standardised. Forming a corporation, an LLC, a limited partnership (LP) or a limited liability partnership (LLP) requires documents to be filed with a state authority, such as the Secretary of State. General partners, in contrast, can inadvertently form a partnership by merely acting like one.[71]

Additionally, incorporators or a company's legal representatives must acquire an Employer Identification Number (EIN) or a Federal Tax Identification Number (FTIN) to identify the company. They must identify the appropriate federal tax classification and pay any applicable fees.

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69 J. MacLeod Heminway, 'Lawyering for Social Enterprise' (2019) 20 *Transactions: The Tennessee Journal of Business Law* 797, 808; M. Gelter, 'Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?' (2012) 37 *Brooklyn Journal of International Law* 843. See also *Revlon, Inc. v. Macandrews & Forbes Holdings, Inc.* 506 A.2d 173 (Del. 1986).

70 L.P.Q. Lyman Johnson, 'Corporate Officers and the Business Judgement Rule' (2005) 60 *The Business Lawyer* 439; S.M. Bainbridge, 'The Business Judgment Rule as Abstention Doctrine' (2004) 57 *Vanderbilt Law Review* 83; F.A. Gevurtz, 'The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?' (1994) 67 *Southern California Law Review* 287. See also Principles of Corporate Governance §4.01 (1994): '(c) A director or officer who makes a business judgment in good faith fulfills the duty under this Section if the director or officer: (1) is not interested [§1.23] in the subject of the business judgment; (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and (3) rationally believes that the business judgment is in the best interests of the corporation.'

71 W.T. Allen, R. Kraakman and V.S. Khanna, *Commentaries and Cases on the Law of Business Organization*, 6th ed., Aspen Publishing, Frederick, MD 2021; D.S. Kleinberger, *Examples & Explanations: Agency, Partnerships, and LLCs*, 5th ed., Aspen Publishing, Frederick, MD

From the moment they are created, business organisations acquire specific features in areas such as legal personality, investors' ownership and liability, transferable ownership, and delegated management. These features assume different nuances depending on the business enterprise's legal form.[72]

3.3.1. Organisation under National Law and Model Legislation

Business organisation law is fundamentally state law, which is greatly shaped by case law.[73] However, model legislation is often available, and it is implemented or followed differently by individual states.[74]

The most common business entities are the sole proprietorship, the partnership (including the general partnership, the LP and the LLP), the corporation,[75] and the LLC.[76] Although there is a core understanding of each of these forms, their nuances vary across states. Social enterprises commonly use the legal form of the corporation and, less often, the LLC and the partnership as alternative legal forms.

2017; L.E. Ribstein, J.M. Lipshaw, E.S. Miller and J.P. Fershee, *Unincorporated Business Entities*, 5th ed., Carolina Academic Press, Durham, NC 2013; S.M. Bainbridge, *Business Associations: Cases and Materials on Agency, Partnerships, LLCs, and Corporations*, 11th ed., West Academic/Foundation Press, St. Paul, MN 2021.

[72] R. Kraakman, J. Armour, P. Davies, L. Enriques, H. Hansmann, G. Hertig, K. Hopt, H. Kanda, M. Pargendler, W. Ringe and E. Rock, *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 3rd ed., Oxford University Press, Oxford 2017, pp. 5–13.

[73] *Rosenfeld v. Fairchild Engine & Airplane Corp.* 309 N.Y. 168, 128 N.E.2d 291 (1955); *Cheff v. Mathes* 41 Del.Ch. 494, 199 A.2d 548 (1964); *Smith v. Van Gorkom* 488 A.2d 858 (Del. Sup.Ct. 1985); *Unocal Corporation v. Mesa Petroleum Co.* 493 A.2d 946 (Del. 1985); *Moran v. Household Int'l, Inc.* 490 A.2d 1059 (Del. Ch. 1985); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* 506 A.2d 173 (Del. 1985); *Paramount Communications, Inc. v. Time Incorporated* 571 A.2d 1140 (Del. 1989); *Unitrin, Inc. v. American General Corp.* 651 A.2d 1361 (Del. 1995); *Lyondell Chemical Co. v. Ryan* 970 A.2d 235 (Del. 2009); and *Corwin v. KKR Financial Holdings LLC* 125 A.3d 304 (Del. 2015).

[74] Model legislation includes the following: the Uniform Partnership Act created in 1914 and revised in 1997 by the National Conference of Commissioners on Uniform State Laws (NCCUSL), 'Partnership Act', Uniform Law Commission (1997) https://www.uniformlaws.org/committees/community-home?CommunityKey=52456941-7883-47a5-91b6-d2f086d0bb44; the Model Business Corporation Act (MBCA) drafted by the Committee on Corporate Laws of the Section of Business Law of the American Bar Association, 'Model Business Corporation Act', American Bar Association Corporate Laws Committee (2023) https://www.americanbar.org/groups/business_law/committees/corplaws/; the Uniform Limited Liability Company Act (ULLCA) and the Revised Uniform Limited Liability Company Act (RULLCA), 'Limited Liability Company Act, Revised', Uniform Law Commission (2006) https://www.uniformlaws.org/committees/community-home?CommunityKey=bbea059c-6853-4f45-b69b-7ca2e49cf740.

[75] Regarding the corporation, often a distinction is made between the C Corporation or S Corporation. This is an income tax election that does not create different business forms.

[76] W.T. Allen, R. Kraakman and V.S. Khanna, *Commentaries and Cases on the Law of Business Organization*, 6th ed., Aspen Publishing, Frederick, MD 2021; D.S. Kleinberger, *Examples & Explanations: Agency, Partnerships, and LLCs*, 5th ed., Aspen Publishing, Frederick, MD

3.3.2. Permissible Objects of Adopting Entities

The company's object refers to the nature and purpose of the business. Discussion around corporate purpose is long-standing in US corporate law history. From *Dodge v. Ford* in 1919,[77] to Milton Friedman's popular 1970 *New York Times* op-ed,[78] the American Law Institute's Principles of Corporate Governance drafted in the 1980s through early 1990s,[79] to the Business Roundtable Statement in 2019,[80] the corporation's purpose has been highly debated. Currently, climate change has reignited the conversation about the company's object, nature or business purpose.

Generally, the object should not be illegal, go against public interests or undermine the country's rule of law. However, the company's object may or may not be in line with broader societal interests.

3.3.3. Stakeholders' Rights to Participation in Management

Except for sole proprietorship, traditional business enterprises contemplate the separation of management from ownership to varying degrees.[81] For example, corporations (from which benefit corporations derive their legal framework) are managed by the board of directors, which must approve any major business decision. Directors may be shareholders or officers, although neither status is required.[82]

Shareholders elect directors, which gives shareholders some power to shape management and control the boardroom. Shareholders' control of management

2017; L.E. Ribstein, J.M. Lipshaw, E.S. Miller and J.P. Fershee, *Unincorporated Business Entities*, 5th ed., Carolina Academic Press, Durham, NC 2013; S.M. Bainbridge, *Business Associations: Cases and Materials on Agency, Partnerships, LLCs, and Corporations*, 11th ed., West Academic/Foundation Press, St. Paul, MN 2021. See also IRS, 'IRS Business Structures' (11 October 2023) https://www.irs.gov/businesses/small-businesses-self-employed/business-structures.

77 *Dodge v. Ford Motor Co.* 204 Mich. 459, 170 N.W. 668 (1919).

78 M. Friedman, 'A Friedman Doctrine – The Social Responsibility of Business is to Increase its Profits', *The New York Times* (13 September 1970) https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html.

79 Principles of Corporate Governance §2.01 (1994).

80 'Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy that Serves all Americans"', *Business Roundtable* (19 August 2019) https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

81 A.A. Berle, Jr. and G.C. Means, *The Modern Corporation and Private Property*, Macmillan, New York 1933 (1932).

82 H. Baum, 'The Rise of the Independent Director in the West: Understanding the Origins of Asia's Legal Transplants' in D.W. Puchniak, H. Baum and L. Nottage (eds), *Independent Directors in Asia: A Historical, Contextual and Comparative Approach*, Cambridge University Press, Cambridge/New York/Melbourne/Delhi 2017, pp. 21–57; T. Spiegel, 'Independent

is limited as they need access to inside market information, which is not always readily available. Thus, investors tend to vote on actions that are initiated by the corporation, such as mergers and acquisitions or conversion into a social enterprise.[83]

Other stakeholders typically do not hold rights to management in the US, though creditors may negotiate for an active role in governance or become empowered in the context of insolvency.[84]

3.3.4. Disclosure/Reporting

The 1933 Securities Act and the 1934 Securities Exchange Act define the field of securities law.[85] The 1933 Act requires companies issuing stock to disclose business and capital structure information. Companies must make disclosures through Form S-1 and a prospectus.[86] The 1934 Act requires certain publicly held companies to annually disclose information through Form 10-K and Form 10-Q. The 1934 Act also regulates tender offers and proxy fights.

Certain public companies are subject to periodic disclosure requirements.[87] There are new frontiers of regulation on the horizon. As of fall 2022, the

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Directors in Japan: Changing Corporate Governance?' (2018) 23 *Journal of Japanese Law (ZJapanR)* 85; S. Cools, 'Shareholder Proposals Shaking Up Shareholder Say: A Critical Comparison of the United States and Europe' in A. Afsharipour and M. Gelter, *Comparative Corporate Governance*, Edward Elgar, Cheltenham/Northampton, MA 2021, pp. 302–23.

[83] See section 4.1.2 below on the conversion of traditional business enterprises to social enterprises.

[84] G. Nini, D.C. Smith and A. Sufi, 'Creditor Control Rights, Corporate Governance, and Firm Value' (2012) 25 *The Review of Financial Studies* 1713. See also M. Gatti and C. Ondersma, 'Stakeholder Syndrome: Does Stakeholderism Derail Effective Protections for Weaker Constituencies?' (2021) 100 *North Carolina Law Review* 167; M. Gelter, 'The Pension System and the Rise of Shareholder Primacy' (2013) 43 *Seton Hall Law Review* 909; H. Hansmann and R. Kraakman, 'The End of History for Corporate Law' (2000) 89 *Georgetown Law Journal* 439; M. Naniwadekar and U. Varottil, 'The Stakeholder Approach Towards Directors' Duties Under Indian Company Law: A Comparative Analysis' in M.P. Singh (ed.), *The Indian Yearbook of Comparative Law 2016*, Oxford University Press, New Delhi 2017, pp. 95–120; K. Pistor, 'Codetermination: A Socio-Political Model with Governance Externalities' in M.M. Blair and M.J. Roe (eds), *Employees and Corporate Governance*, Brookings Institution Press, Washington, D.C. 1999, pp. 163–93; S.A. Shimoda, 'Time to Retire: Is Lifetime Employment in Japan Still Viable?' (2016) 39 *Fordham International Law Journal* 753; W.R. Dill, 'Public Participation in Corporate Planning – Strategic Management in a Kibitzer's World' (1975) 8 *Long Range Planning* 57.

[85] Securities Act of 1933 (48 Stat. 74, 15 U.S.C. 77a–77mm) and Securities Exchange Act of 1934 (48 Stat. 881, 15 U.S.C. 78a–78kk). See also F.H. Easterbrook and D.R. Fischel, 'Mandatory Disclosure and the Protection of Investors' (1984) 70 *Virginia Law Review* 669.

[86] EDGAR Filer Manual Volume II: Index to Forms, *SEC* (December 2020) https://www.sec.gov/info/edgar/forms/edgform.pdf; 'Electronic Data Gathering, Analysis, and Retrieval system (EDGAR) filing and forms', *SEC* (9 January 2017) https://www.sec.gov/edgar.shtml.

[87] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204 (2002), CONGRESS.GOV (30 July 2002) https://www.congress.gov/bill/107th-congress/house-bill/3763/text; Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010), CONGRESS.

Securities and Exchange Commission's (SEC) agenda includes an extensive list of topics related to corporate board diversity, climate change disclosure, human capital management disclosure, cybersecurity risk governance, rules related to investment companies and investment advisers to address matters relating to environmental, social and governance (ESG) factors, and the redefinition of record holder for the purpose of the number of shareholders.[88]

Disclosures under securities laws should include social impact, especially if social purpose is described in the company's charter.[89] However, social impact is difficult to measure. This challenge raises questions as to the type of disclosure that should be implemented – voluntary disclosure imposed by a private-sector institution or mandatory disclosure dictated by a state regulatory body. Should there be social impact disclosure rules, it is unclear whether they would cause a change of paradigm in traditional corporations regarding directors' approach to share value.

3.4. ELEMENTS OF SOCIAL ENTERPRISE AND NON-PROFIT LEGAL FORMS: ORGANISATION UNDER NATIONAL AND STATE LAW

Reportedly, more than half a million non-profits or Internal Revenue Code (IRC) §501(c)(3) tax-exempt organisations have been created in the US alone since the 2000s.[90] Non-profits qualified under §501(c)(3) include public charities (or

GOV (21 July 2010) https://www.congress.gov/bill/111th-congress/house-bill/4173. See also R. Romano, 'The Sarbanes-Oxley Act and the Making of Quack Corporate Governance' (2005) 114 *The Yale Law Journal* 1521; S. Bhagat and R. Romano, 'Reforming Executive Compensation: Focusing and Committing to the Long-Term' (2009) 26 *Yale Journal on Regulation* 359; V.V Acharya, T.F. Cooley, M. Richardson and I. Walter (eds), *Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance*, John Wiley & Sons, Inc., Hoboken, New Jersey 2010; Y. Guseva, 'Destructive Collectivism: Dodd-Frank Coordination and Clearinghouses' (2016) 37 *Cardozo Law Review* 1693.

88 'Agency Rule List', Office of Information and Regulatory Affairs, https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=F93DDA75B0D952E153B7019FC53F68D720E4F59FC01A0970832F3257162E20C7F1A9A0711058A0E670BDD754797D30C59BC4. See also L. Vicente, L. Ruggeri and K. Kashiwazaki, 'Beyond Lipstick and High Heels: Three Tell-Tale Narratives of Female Leadership in the United States, Italy and Japan' (2021) 32 *Hastings Women's Law Journal* 3; D. Rosenblum and Y. Nili, 'Board Diversity by Term Limits?' (2019) 71 *Alabama Law Review* 211; E. Demers, J. Hendrikse, P. Joos and B. Lev, 'ESG Didn't Immunize Stocks During the COVID-19 Crisis, But Investments in Intangible Assets Did' (2021) 48 *Journal of Business Finance & Accounting* 433; J. Armour, L. Enriques and T. Wetzer, 'Mandatory Corporate Climate Disclosures: Now, But How?' (2022) 2021 *Columbia Law Review* 1085; G.S. Georgiev, 'The Human Capital Management Movement in U.S. Corporate Law' (2021) 95 *Tulane Law Review* 639.

89 See section 4.1.3 on social enterprise regulatory framework.

90 National Council of Nonprofits, 'Nonprofit Impact Matters: How America's Charitable Nonprofits Strengthen Communities and Improve Lives' (2019), p. 16, https://www.nonprofitimpactmatters.org/site/assets/files/1/nonprofit-impact-matters-sept-2019-1.pdf.

charitable non-profits), which are exempt from paying federal income tax.[91] Although they are also charitable non-profits, private foundations pay a nominal tax on their investment incomes.

Non-profits also include other organisations that meet specified requirements for exemption under other subsections than §501(c)(3), such as social welfare organisations,[92] agricultural or horticultural organisations,[93] civic leagues, social clubs, labour organisations,[94] and business leagues.[95]

Non-profits, especially charitable, tax-exempt non-profits, can make profits but cannot distribute profits to investors as dividends. Moreover, they cannot distribute profits to anyone who exerts control over them.[96]

The use of non-profit forms for a social enterprise may be challenging due to the 'commerciality doctrine'. That doctrine maintains that non-profits will hinder their tax-exempt status under IRC §501(c)(3) if they develop a commercial activity. Even if that commercial activity may be consistent with a tax-exempt status, the activity itself may be subject to the unrelated business income tax (UBIT).[97]

Non-profits' social entrepreneurship features may raise significant challenges for these organisations, namely when non-profits operate in complex environments and are linked to or held by for-profit entities, such as traditional corporations, benefit corporations and PBCs.

Benefit corporations and their variants, such as PBCs, were created to produce a public benefit or public benefits and to operate in a responsible and sustainable manner.[98] The legislative impetus that originated these legal forms for social enterprise was a response to previous attempts to conciliate different models of the corporation, namely the shareholder and stakeholder models.[99]

Federal law, namely tax law, and state laws define social enterprise and non-profits' elements. State laws are based on model legislation, such as the Model Business Corporation Act (MBCA), which the majority of the states have adopted. However, considering its model purpose, the MBCA has been

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[91] IRS, 'Life Cycle of a Public Charity/Private Foundation' (27 February 2023) https://www.irs.gov/charities-non-profits/charitable-organizations/life-cycle-of-a-public-charity-private-foundation.

[92] §501(c)(4).

[93] §501(c)(5).

[94] §501(c)(5).

[95] §501(c)(6).

[96] H. Hansmann, *The Ownership of Enterprise*, The Belknap Press of Harvard University Press, Cambridge, MA/London 1996.

[97] J.D. Colombo, 'Commercial Activity and Charitable Tax Exemption' (2002) 44 *William & Mary Law Review* 487.

[98] DGCL §362.

[99] M. Gelter, 'The Pension System and the Rise of Shareholder Primacy' (2013) 43 *Seton Hall Law Review* 909; M.M. Blair and L.A. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247.

differently implemented by the states.[100] Notably, Delaware has not adopted the MBCA. The Delaware General Corporation Law applies to corporations, and it has been adopted by other states and territories such as Kansas, Nevada, Puerto Rico and Oklahoma.[101]

Contrary to non-profits, benefit corporations and PBCs are for-profit corporations organised under and subject to the statutory requirements applicable to traditional corporations. After the 2019 proposal by the Corporate Laws Committee of the American Bar Association (ABA) to amend the MBCA, the 2020 version of the MBCA formally maintained the benefit corporation in the menu of legal forms for businesses.[102] In 2020, Delaware also amended its PBC statute. Incorporated in the MBCA, the 2020 ABA Model Legislation is based on the 2017 B Lab Model Legislation and the 2020 Amended Delaware PBC Statute.

A comparison of selected features of the 2020 ABA model legislation, the 2017 B Lab model legislation, and the 2020 Amended Delaware PBC Statute shows variations regarding multiple aspects. Those aspects include voting, the existence of a benefit director, the statutory definition of stakeholders and public benefit, reporting frequency, third-party standards, filing requirements, the public availability of benefit reports, limitations on shareholders' rights of action, and liability. None of the three legislation models available in 2020 contemplated appraisal rights.[103]

Alabama,[104] Georgia,[105] New Mexico[106] and Ohio[107] constituted the latest group of states to enact benefit corporations in 2020. This group of states is geographically and culturally heterogeneous, reaching into the Southwest, Midwest and 'Deep South' of the US.[108] States have not uniformly adopted social

[100] Corporate Laws Committee, American Bar Association Business Law Section, 'Model Business Corporation Act (2016 Revision)' (2017) 72 *The Business Lawyer* 421.

[101] M.P. Dooley and M.D. Goldman, 'Some Comparisons Between the Model Business Corporation Act and the Delaware General Corporation Law' (2001) 56 *The Business Lawyer* 737.

[102] Grunin Center for Law and Social Entrepreneurship, 'The State of Social Enterprise and the Law: 2020–2021 Report', Grunin Center at NYU Law, p. 9, https://www.law.nyu.edu/sites/default/files/Tepper%20Report%20-%20State%20of%20Social%20Enterprise%20and%20the%20Law%20-%202020-2021.pdf. Corporate Laws Committee, ABA Business Law Section, 'Benefit Corporation White Paper' (2013) 68 *The Business Lawyer* 1083.

[103] Grunin Center for Law and Social Entrepreneurship, 'The State of Social Enterprise and the Law: 2020-2021 Report', Grunin Center at NYU Law, p. 10, https://www.law.nyu.edu/sites/default/files/Tepper%20Report%20-%20State%20of%20Social%20Enterprise%20and%20the%20Law%20-%202020-2021.pdf.

[104] H.B. 202, 2020 Reg. Sess. (Ala. 2019).

[105] H.B. 230, 2019–2020 Reg. Sess. (Ga. 2018).

[106] H.B. 118, Regular Session (N.M. 2020).

[107] S.B. 21, 134th Legis, 1st Sess. (Oh. 2020).

[108] B. Tshidzu, 'Social Enterprise Lessons from the American South', *Guardian* (10 May 2012) https://www.theguardian.com/social-enterprise-network/2012/may/10/lessons-america-social-enterprise.

enterprise statutory laws. Our analysis shows variations in terms of voting, stakeholder and public benefit definitions, reporting frequency, third-party standards, public availability of benefit reports, limitations on shareholders' rights of action, and liability. There is no variation regarding the existence of benefit directors and filing requirements.

Different legal forms for social enterprise are sub-categories of pre-existing legal forms for traditional business organisations. Characteristics of limited liability, delegated management, continuity of existence, transmissibility of ownership, protections of members and shareholders' rights in the L3C, the BLLC, the SPC and the benefit corporation are the same as their equivalent traditional forms of business organisation. Additionally, there are no significant differences in taxation. There are noteworthy exceptions. For example, the City of Philadelphia adopted a Sustainable Business Tax Credit (SBTC) for companies that are a 'sustainable business' and certified by B Lab.[109]

A few elements unique to social enterprise and non-profits must be highlighted regarding formation, management duties, compliance, performance assessment, regulation, certification, filing, disclosure and reporting.

4. LIFECYCLE

4.1. FORMATION

4.1.1. Legal Steps to Form a Social Enterprise

The first step to form a social enterprise is to create an organisation under state law.[110] The object of the business must be identified in the articles of incorporation or the corporation's charter in a way that clearly spells out the social purpose or specific public benefit or benefits of the business. This requirement demands board members to think about purpose seriously.

Non-profits or charitable organisations applying for exemption from federal income taxation must submit additional application forms. Requirements for the formation of non-profits and social enterprises including filing timelines and other ancillary steps vary between states.

Once social enterprises are formed, they are not subject to auditing on a regular basis. Corporations certified by B Lab (B Corporations or B Corps) can be selected to be audited by B Lab. However, even those audits are not regular.

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[109] City of Philadelphia, 'Sustainable Business Tax Credit' (19 January 2023) https://www.phila.gov/services/payments-assistance-taxes/taxes/tax-credits/business-tax-credits/sustainable-business-tax-credit/.

[110] Please refer to section 3.3 above.

4.1.2. Managers and the Decision to Convert into a Social Enterprise

Benefit corporations can deviate from the shareholder-centric model that prioritises shareholder wealth maximisation. Defenders of shareholder primacy posit that social enterprise forms were created precisely to overcome for-profit organisations' obvious purpose.[111] Benefit directors can legitimately favour the realisation of *positive profit* through relative efficiency over profit maximisation.[112] They are independent and free to judge their business beyond economics.[113]

If they feel attracted to this model, existing companies can elect to become social enterprises by amending their organic documents and altering the company's name to indicate the change of status.[114] Shareholders must vote for the amendment. For example, states like California require a two-thirds supermajority vote of all shareholders.[115]

The procedure for filing amendments with the state is identical to any other corporate structure. Additionally, there must be a statement that the company has adopted one of the legal forms available for social enterprise.

The conversion of §501(c)(3) non-profits to social enterprise forms may be problematic. Most social enterprises are for-profit despite the social goals they would want to achieve. Depending on the state's law, the conversion of a non-profit into a for-profit company may be possible. However, the conversion will often be challenging, as a non-profit entity's assets must be exclusively applied for the purposes for which it was created.

It is important to note that converting traditional business organisations into social enterprise forms is unusual in the US. Veeva's case has been exceptional

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111 W.H. Clark, Jr, Drinker Biddle & Reath LLP; L. Vranka, and Canonchet Group LLC, 'The Need and Rationale for the Benefit Corporation: Why is it the Legal Form that Best Addresses the Needs of Social Entrepreneurs, Investors, and, Ultimately, the Public', White Paper (18 January 2013) https://growthorientedsustainableentrepreneurship.files.wordpress.com/2016/07/gv-white-paper-need-and-rationale-for-benefit-corporations.pdf. See also S. Ansari, K. Munir and T. Gregg, 'Impact at the "Bottom of the Pyramid": The Role of Social Capital in Capability Development and Community Empowerment' (2012) 49 *Journal of Management Studies* 813.

112 A. Alchian, 'Uncertainty, Evolution and Economic Theory' in D.K. Benjamin (ed.), *The Collected Works of Armen A. Alchian Vol. 1: Choice and Cost Under Uncertainty*, Liberty Fund, Indianapolis 2006, p. 6.

113 Model Benefit Corporation Legislation §102 (2017) (setting forth that '[s]erving as a benefit director or benefit officer does not make an individual not independent').

114 DGCL §362(c).

115 See Cal. Corp. Code §14600–14631 (2012). The California Benefit Corporation Act §14603(a) provides that '[a] corporation may become a benefit corporation under this part by amending the corporation's articles so that the articles contain a statement that the corporation is a benefit corporation. The amendment shall not be effective unless it is adopted by at least the minimum status vote.' §14601(d)(1)(A) defines 'minimum status vote' in the following way: '[t]he shareholders of every class or series shall be entitled to vote

thus far. The conversion's *leitmotif* and the investors' decision to vote for a conversion may be based on the idea that social enterprise forms act as better proxies for the board of directors' oversight because those social enterprise forms are more stakeholder-oriented.

4.1.3. Compliance, Third-Party Standards and the Regulation of Social Enterprise

In addition to an annual or biennial report,[116] statutes may require that corporations apply a third-party standard to assess compliance and their social and environmental performance.[117] The statutory requirements relating to the third-party standard vary between states, but none requires certification by the third-party standard setter or other outside reviewer.

Besides statutory requirements outlined in model business legislation and state law, such as periodic statements or reports and third-party standards, there is no specific regulatory agency or regulatory framework for social enterprise. Whether regulatory agencies can effectively enforce social and environmental goals set up by corporations remains open and contentious.[118]

4.1.4. Steps to Cease Operations

A clear statement must indicate a willingness to cease operations under a social enterprise form. A benefit corporation is subject to the corporation's legal regime, including dissolution and liquidation. Rather than dissolving, the benefit corporation may only terminate its status as a benefit corporation and cease to be subject to relevant rules by amending its articles of incorporation to eliminate the statement that maintains that such business is a benefit corporation.[119]

California requires that the amendment to change the benefit corporation status must be approved by at least two-thirds of shareholders' votes, which is a rule adopted from the Model Benefit Corporation Legislation.[120] Delaware's

on the corporate action regardless of any limitation stated in the articles or bylaws on the voting rights of any class or series.' Additionally, §14601(d)(1)(B) sets forth that 'minimum status vote' means that '[t]he corporate action shall be approved by the outstanding shares of each class or series by at least two-thirds of the votes, or greater vote if required in the articles of incorporation'.

116 DGCL §366.

117 Model Benefit Corporation Legislation §401(a) and DGCL §366.

118 R.T. Esposito, 'Charitable Solicitation Acts: Maslow's Hammer for Regulating Social Enterprise' (2015) 11 *New York University Journal of Law & Business* 463; A.S. Ball, 'Social Enterprise Governance' (2016) 18 *University of Pennsylvania Journal of Business Law* 919; D.B. Reiser, 'Regulating Social Enterprise' (2014) 14 *UC Davis Business Law Journal* 231.

119 Model Benefit Corporation Legislation §§105, 104 and 103 for the termination of the benefit corporation. Also see §102 for the definition of 'minimum status vote'.

120 Cal. Corp. Code §14604(a).

Public Benefit Corporation Act deviates from the model legislation and is more flexible. The PBC's board of directors shall adopt a resolution to amend the certificate of incorporation to change the nature of the corporation's business. Additionally, managers should declare the advisability of the amendment and call a meeting of the stockholders entitled to vote in respect thereof for the consideration of such amendment. The amendment is approved by a majority of the votes of the shareholders entitled to vote.[121]

Non-profits' boards of directors are responsible for dissolving and liquidating the non-profit, and provide for its assets to transfer to another non-profit entity. When most business organisations terminate, board members may have to file a certificate or articles of dissolution within relevant state institutions and notify agencies such as the IRS about the termination.[122]

5. STATE AND PRIVATE CERTIFICATIONS FOR SOCIAL ENTERPRISES

States may offer certifications for social enterprises, although this is not a generalised practice.[123] B Lab offers the B Corp Certification,[124] which is a stamp that signals a business is meeting standards of verified performance, accountability and transparency to achieve the goals embraced by the B Lab community and its object. The certification path depends on several factors, such as the company's industry, profit and ownership structure. To achieve certification, companies must demonstrate several aspects, such as high social and environmental performance and governance commitments, and achieve a B Impact Assessment score of 80 or above and pass the B Lab's risk review.

Benefit corporations are frequently named Certified B Corporations. Both types of companies are sometimes called 'B corps', and both are for-profit companies. However, benefit corporations shall be distinguished from Certified B Corporations, which have been independently certified by B Lab. Statutes of the benefit corporation are often based on B Lab's Model Benefit Corporation Legislation. Nevertheless, the benefit corporation's features vary across jurisdictions.[125]

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121 DGCL §242(a)(2) and (b).

122 Internal Revenue Code §6043(b) and Treasury Regulations §1.6043-3.

123 For example, the Los Angeles County offers a certification that it develops through a Social Enterprise Preference Program. See 'Small Business: Social Enterprise', Los Angeles County Consumer and Business Affairs, https://dcba.lacounty.gov/social-enterprise/. The City of Los Angeles and the City of Santa Monica also offer a green business certification programme.

124 'About B Corp Certification: Measuring a Company's Entire Social and Environmental Impact', *B Lab*, https://www.bcorporation.net/en-us/certification.

125 M. Gunther, 'Will Wall Street Embrace B Corps?', *B the Change* (31 March 2017) https://bthechange.com/will-wall-street-embrace-b-corps-5df5c91c4f4a.

6. SUBSIDIES, TAX PREFERENCES AND OTHER BENEFITS FOR SOCIAL ENTERPRISES AND INVESTORS

Currently, entities using social enterprise forms do not benefit from any special federal tax benefits or tax-exempt status. The specialised legal forms for social enterprise described above are taxed like traditional forms for business enterprise, depending on the legal form they adopt.

Internal Revenue Code §501(c)(3) determines when non-profits are tax-exempt. Contributors who donate to non-profits benefit from tax deductions on their personal income taxes as well as estate and gift taxes. The same tax advantage is not afforded to social enterprise investors. In addition to a tax-exempt status, non-profits often qualify for specific government or privately sponsored grants and loans that are not taxable.

There are multiple legislative instances in which the government 'delegates' the provision of social services to non-governmental entities, such as non-profits, through procurement of services via contracts. These contracts are an avenue for social enterprises to provide human services like homeless assistance, child care, skills development and job placement, housing and urban development, and transportation. However, such contracts do not provide preferences for entities adopting specialised forms for social enterprise.

7. PRIVATE CAPITAL, SECURITIES REGULATION AND THE PROTECTION OF SOCIAL-MINDED INVESTORS

Perhaps the most enticing aspect of social enterprises is the ability to create social and environmental benefits. The status that legal forms for social enterprise provide may render enterprises more attractive to long-term investors due to their triple bottom line – social, environment and profits – and perceived accountability and transparency regarding their social purpose.

Social enterprise investors may include retail investors, institutional investors (such as investment firms, banks and funds), and non-profits when their charitable purpose is not at risk. Non-profits' charitable capital is less likely to be at risk if the social enterprise they invest in treats capital as a social return rather than a financial return.[126]

Securities laws do not treat social enterprises, particularly the benefit corporation, differently when the enterprise issues financial instruments, such

[126] A. Bugg-Levine, B. Kogut and N. Kulatilaka, 'A New Approach to Funding Social Enterprise' *Harvard Business Review* (January–February 2012) https://hbr.org/2012/01/a-new-approach-to-funding-social-enterprises.

as stocks and bonds, which constitute 'securities'. This means that general reporting obligations and enforcement provisions under securities law can be applicable to social enterprises. However, given that most social enterprises are privately held, they are not subject to the disclosure obligations faced by publicly traded companies. Still, they are subject to the anti-fraud rules governing all securities.

8. PROSPECTIVE CHANGES IN LAW, THE COVID-19 PUBLIC HEALTH CRISIS, THE AMERICAN RESCUE PLAN AND THE INFRASTRUCTURE INVESTMENT AND JOBS ACT

The COVID-19 public health crisis created additional hurdles for social enterprises, many of which are underfunded or struggle to obtain funding. Recent federal legislation might help mitigate these hurdles.

Enacted in March 2021, the American Rescue Plan Act of 2021 (Rescue Plan) maintained the eligibility of certain non-profits for covered loans, payments and awards.[127] The Rescue Plan also afforded beneficial tax treatments to commercial undertakings, including partnerships and S Corporations. It provided COVID-19 state and local fiscal recovery funds to allow states, territories and Tribal governments to mitigate the fiscal effects from the COVID-19 public health crisis.

These funds were meant to be utilised by city, county and state governments to help households, small businesses and non-profits respond to the negative economic effects of the public health emergency, particularly in the tourism, travel and hospitality industries.

The Infrastructure Investment and Jobs Act was effective on 15 November 2021.[128] This Act oversaw funding and tax incentives for non-profits in the education, energy, environmental and construction sectors. Particularly, §100401 sets forth grants to non-profit organisations that support minority business enterprises through education, grants or loans, and other similar activities.

Furthermore, this Act incentivised entities using taxpayer-financed federal assistance to give a common-sense procurement preference for materials and products produced by companies and workers in the US in line with environmental and other regulatory requirements.

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[127] American Rescue Plan Act of 2021, Pub. L. No. 117-2 (2021), CONGRESS.GOV (11 March 2021) https://www.congress.gov/bill/117th-congress/house-bill/1319/text.

[128] Infrastructure Investment and Jobs Act, Pub. L. No. 117-58 (2021), CONGRESS.GOV (15 November 2021) https://www.congress.gov/bill/117th-congress/house-bill/3684.

This legislative framework provided a new space to discuss the purpose and political role of business entities and the promise of social enterprise in a polarised, sensitive and fragile socio-economic and political environment.

9. CONCLUSIONS

Amartya Sen developed the idea of human capabilities as:

> 'basic capabilities': a person being able to do certain things. The ability to move about is the relevant one here, but one can consider others, e.g., the ability to meet one's nutritional requirements, the wherewithal to be clothed and sheltered, the power to participate in the social life of the community.[129]

The idea of development of human capabilities gains different nuances based on different approaches. The most common approaches mirror the divide between public and private law, which in common law countries like the US is less prominent. Still, such divide affects our representations of market and government.

The divide triggers conflicting understandings of what the nature and purpose of business enterprises should be in the development of human capabilities, the society and the environment. In this context, Bakan's remark as the epigraph to this report fundamentally challenges how much good a corporation – a private entity – can do.

Social enterprises are business undertakings that aim to generate profit while also benefiting society and the environment. The excursion through their legal regime showed how weak enforcement of certain rules is, particularly those that require managers to balance shareholders and other stakeholders' interests. The weakness of enforcement rules constitutes a paradox that defeats the purpose of social enterprise. The Delaware PBC illustrates how directors have legal incentives to primarily care about stockholders' interests even in the setting of a social enterprise.

Furthermore, a cohesive system of governance and regulation is missing. The literature has advanced possibilities, some of which are based on instruments already foreseen for traditional business enterprises. These include the annual report provided by the managers.

Those mechanisms may be useful. However, they transform legal forms for social enterprises into byproducts, artefacts created out of existing legal forms

[129] A. Sen, 'Equality of What?' in S.M. McMurrin (ed.), *The Tanner Lectures on Human Values*, vol. I, University of Utah Press, Salt Lake City; Cambridge University Press, Cambridge/London/Melbourne/Sydney 2011, pp. 195, 218 (first published by the Tanner Lectures on Human Values in 1980).

for traditional business organisations and undermine the social purpose for which these business enterprises were envisioned. The current legal regime does not award managers of social enterprises with enough incentives to prioritise the interests of other stakeholders to the detriment of shareholders' interests.

An interdisciplinary approach to social enterprise is needed to appeal to a dialogue among fields such as law, economics, management, political economy, political science or psychology. Such an approach will allow us to understand the motivations at the individual level that drive social entrepreneurs to explore business opportunities in a certain fashion. The way social entrepreneurs position themselves toward their businesses has effects at the organisational level and the societal level.

To develop a strong system of governance for social enterprise, interdisciplinarity helps design allocative mechanisms for the attribution of decision rights, distribution of resources and provision of incentives to managers, shareholders, employees and creditors.[130]

Incentive policies such as certifications do not seem to exponentially increase the self-sufficiency of social enterprise. Large-scale empirical data documenting the social impact of social enterprise is scarce. Furthermore, public–private partnerships and the collaboration of different institutions is essential for social enterprises and the non-profit sector to flourish.

Social enterprises face a lack of tax incentives, difficulties in obtaining funding and social impact measuring hurdles. This scenario calls for a cultural shift that puts human capabilities at the centre. It presses legislatures to create legal frameworks to effectively develop an institutional ecosystem for the advancement of social enterprises as something more than mere byproducts. Current legislative approaches have yet to solve this challenge.

[130] A. Okoye, 'CSR and a Capabilities Approach to Development: CSR Laws as an Allocative Device?' in O.K. Osuji, F.N. Ngwu and D. Jamali (eds), *Corporate Social Responsibility in Developing and Emerging Markets: Institutions, Actors and Sustainable Development*, Cambridge University Press, Cambridge/New York 2020, pp. 31–48.

PART II

SPECIAL NON-NATIONAL REPORTS

SOCIAL ENTERPRISE: A LEGAL DEFINITION OF THE TERM

Benedict Sheehy and Juan Diaz-Granados

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1. INTRODUCTION

This report addresses a conceptual issue in the law and legal scholarship, namely the ambiguity in the concept of 'social enterprise' and particularly whether it is possible to develop it so as to identify it as a distinct legal category differentiating it from existing, related legal categories. Currently, 'social enterprise' is not a category of positive law in many jurisdictions and so the ability of the concept to harness social and market potential is limited. The situation is problematic as it hinders law's power to regulate both positively and negatively the phenomenon.

Using the established legal categories for organisations generally, and the social/non-social and profit/non-profit divides, our normatively and categorically developed definition differentiates 'social enterprises' from other legal categories such as charities, non-profits and cooperatives. By providing conceptual clarity, the report argues for a distinct category of organisation for social enterprises and, as a result, a useful category for legal analysis. The report advances by reviewing extant literature and approaches to the definition of 'social enterprise' and related legal concepts, arguing for the development of a distinct category 'social enterprise'.

Arguing for the establishment of a distinct legal category for social enterprises, we note that doing so improves the ability to allocate rights and

duties. As Victoria D. Alexander explains: 'Legal definitions sort organizations into different sectors. These sectors have important influences on organizational behavior, especially in defining goals and setting the yardsticks for determining organizational success.'[1] Further, it does so more efficiently – an important measure as it facilitates meeting social policy objectives. Creating and allocating more or fewer rights and duties to organisations that are social enterprises allows policymakers greater power to promote socially oriented organisations.

2. PRIOR APPROACHES

The term 'social enterprise'[2] currently is a vague one, lacking 'a clear and concise definition.'[3] Numerous scholars have attempted to define the term as can be distilled from their works. Reflecting the highly diverse types of businesses and organisations claiming to be 'social enterprises', these definitions include a wide range of activities and organisational forms, from not-for-profit organisations to market-based for-profit entities, and adopt conceptual approaches to social purpose 'as diverse as human ingenuity.'[4] For example, Aurelien Loric explains that 'social enterprises have three characteristics that distinguish them from other types of businesses, nonprofits and government agencies: they directly address social needs, the common good is their primary purpose, and their commercial activity is a strong revenue driver.'[5] While we adopt Loric's business, non-profit and government agency categories, such definitions leave many legal issues undetermined.

Further complicating matters, a large number of scholars conflate the concept of 'social enterprise' with the notions of 'social entrepreneur' and 'social entrepreneurship'.[6] Illustrating the problem, Dacin et al. provide a summary of 37 definitions of 'social enterprise', 'social entrepreneurship' and 'social entrepreneur', without a convincing argument for accepting any particular one.[7] The challenge, as

1 V.D. Alexander, 'Environmental Constraints and Organizational Strategies: Complexity, Conflict, and Coping in the Nonprofit Sector' in W.W. Powell and E.S. Clemens (eds), *Private Action and the Public Good*, Yale University Press 1998, p. 273.

2 A. Loric, 'Designing a Legal Vehicle for Social Enterprises: An Issue Spotting Exercise' (2013) 5 *Columbia Journal of Tax Law* 100, 103.

3 R.J. Gaffney, 'Hype and Hostility for Hybrid Companies: A Fourth Sector Case Study' (2011) 5 *Journal of Business, Entrepreneurship & the Law* 329, 332.

4 A. Loric, 'Designing a Legal Vehicle for Social Enterprises: An Issue Spotting Exercise' (2013) 5 *Columbia Journal of Tax Law* 100, 103.

5 Ibid., pp. 103–04.

6 See P.A. Dacin, M.T. Dacin and M. Matear, 'Social Entrepreneurship: Why We Don't Need a New Theory and How we Move Forward from Here' (2010) 24 *Academy of Management Perspectives* 37, 39; A.M. Peredo and M. McLean, 'Social Entrepreneurship: A Critical Review of the Concept' (2006) 41 *Journal of World Business* 56, 57.

7 P.A. Dacin, M.T. Dacin and M. Matear, 'Social Entrepreneurship: Why We Don't Need a New Theory and How we Move Forward from Here' (2010) 24 *Academy of Management Perspectives* 37, 39.

Carol Liao acknowledges, is that although '[t]here is a desire to clarify its meaning, … it remains difficult given the dynamics of this evolving and ever-changing movement.'[8] This statement is not only correct on its face, but provides a sharp insight into the underlying problem. The issue is not merely a linguistic problem, but socio-political issue, an expression of a socio-political movement with multiple aims.

Outside of the academy, others have developed definitions – or more accurately, descriptive characteristics – for the term 'social enterprise'. The European Commission's characteristics of social enterprise are as follows: '[A]n organization must (i) engage in economic activity; (ii) pursue an explicit and primary social aim; (iii) have limits on distribution of profits and/or assets; (iv) be independent; and (v) have an inclusive corporate governance of a participatory nature'.[9] This list has been turned into positive law in various jurisdictions – albeit raising as many problems as it solves.

Other parties have contributed definitions. For example, the Social Enterprise Alliance defines 'social enterprises' as '[o]rganizations that address a basic unmet need or solve a social or environmental problem through a market-driven approach.'[10] Very loosely, many approaches including the foregoing, include the following five common characteristics of the concepts of 'social enterprise', 'social entrepreneur' and 'social entrepreneurship': (i) innovation in the execution of a social purpose;[11] (ii) reinvestment of earned income to pursue the societal objectives;[12] (iii) use of business-led solutions within the enterprise – namely, the reproduction of the outlook and methods of market-driven enterprises;[13] (iv) the

[8] C. Liao, 'Social Enterprise Law: Friend or Foe to Corporate Sustainability?' in B. Sjåfjell and C.M. Bruner (eds), *Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, Cambridge University Press 2019, p. 656.

[9] T. Lambooy, A. Argyrou, A. Colenbrander and R. Blomme, 'Stakeholder Participation in Social Enterprises in the Netherlands – A Case Study: An Assessment of the Organizational and Governance Structure of the Dutch Social Enterprise AutiTalent in Light of Social Enterprise Governance Theory and the Facilities in Dutch Corporate Law', International OFEL Conference on Governance, Management and Entrepreneurship (2016).

[10] https://socialenterprise.us/.

[11] According to Alvord, Brown and Letts, 'most definitions of social entrepreneurship emphasize the innovative character of the initiative'. S.H. Alvord, L.D. Brown and C.W. Letts, 'Social Entrepreneurship and Societal Transformation' (2016) 40 *The Journal of Applied Behavioral Science* 260, 263. Dees and Anderson focus on the 'enterprising social innovation' upon which the Social Innovation School of Thought is developed. J.G. Dees and B.B. Anderson, 'Framing a Theory of Social Entrepreneurship: Building on Two Schools of Practice and Thought' (2006) *Research and Social Entrepreneurship* 39. See also W.L. Tan, J. Williams and T.M. Tan, 'Defining the "Social" in "Social Entrepreneurship": Altruism and Entrepreneurship' (2005) 1 *The International Entrepreneurship and Management Journal* 353, 356.

[12] See e.g. J. Boschee and J. McClurg, 'Toward a Better Understanding of Social Entrepreneurship: Some Important Distinctions' (2003) https://www.law.berkeley.edu/php-programs/courses/fileDL.php?fID=7289; R. Harding, 'Social Enterprise: The New Economic Engine?' (2004) 15 *Business Strategy Review* 39, 41; H. Haugh, 'Social Enterprise: Beyond Economic Outcomes and Individual Returns' in J. Mair, J. Robinson and K. Hockerts (eds), *Social Entrepreneurship*, Palgrave Macmillan 2006, p. 183.

[13] A.M. Peredo and M. McLean, 'Social Entrepreneurship: A Critical Review of the Concept' (2006) 41 *Journal of World Business* 56, 58. See also H. Haugh, 'Social Enterprise: Beyond

existence of a double bottom line – namely, achievement of both social and financial returns;[14] and (v) a social purpose.[15]

As demonstrated, the conceptual approaches to social enterprises are, therefore, numerous and vary in terms of scope, characteristics and underlying assumptions. None of these definitions provides a clear basis for legal rights or duties, nor for including or excluding any particular organisation(s). Placing social enterprises within the legal system and differentiating them from other related legal categories is a taxonomic task,[16] a classification task,[17] a basic task of legal scholarship. A taxonomic approach to social enterprise promotes understanding, analytical order, and consistency within the study, development and application of law,[18] and it is to that which we turn next.

3. CONCEPTUAL APPROACH

We argue that there are three complementary approaches to this problem, beginning with the analysis of two existing legal categories – corporations and charities. First, to understand the use of the legal corporation, we investigate the drivers underlying demand for social enterprises. For that analysis we turn to economics. Then, we turn to the second area of law, namely charities. Finally, we turn to business ethics, which provides a useful lens to steer the discussion.

3.1. THE BUSINESS CORPORATION AND MARKET FAILURE

The social enterprise is a type of organisation driven not by market demand, but by market failure. Interestingly, most social enterprises operate through a market actor – the business corporation, or a corporation limited by shares. Business corporations, like all corporations, are distinct actors within the legal system. Turning to examine this type of corporation in greater detail, we focus

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Economic Outcomes and Individual Returns' in J. Mair, J. Robinson and K. Hockerts (eds), *Social Entrepreneurship*, Palgrave Macmillan 2006, p. 183; G.A. Lasprogata and M.N. Cotten, 'Contemplating "Enterprise": The Business and Legal Challenges of Social Entrepreneurship' (2003) 41 *American Business Law Journal* 67, 69.

14 A.J. Germak and J.A. Robinson, 'Exploring the Motivation of Nascent Social Entrepreneurs' (2014) 5 *Journal of Social Entrepreneurship* 5, 7. See also J. Robinson, 'Navigating Social and Institutional Barriers to Markets: How Social Entrepreneurs Identify and Evaluate Opportunities' in J. Mair, J. Robinson and K. Hockerts (eds), *Social Entrepreneurship*, Palgrave Macmillan 2006, p. 95.

15 Also termed social value, social change, social wealth, social end or social benefit.

16 See E. Sherwin, 'Legal Taxonomy' (2009) 15 *Legal Theory* 25.

17 P. Birks, 'Equity in the Modern Law: An Exercise in Taxonomy' (1996) 26 *Western Australian Law Review* 1, 3.

18 Ibid., pp. 3–5.

on economics' market failure and how the legal characteristics and subcategories respond to these failures through the social enterprise.

Given that the social enterprise is a response to market failures, it is best analysed using an economic lens. In this regard, the conceptual foundation – the economic idea of market failure[19] – is an organising problem.[20] That is, people establishing and operating social enterprises are organising themselves and their resources in a particular way as a consequence of their beliefs that markets are not producing sufficient quantities of something desirable – in this case, a particular state of affairs. In this perspective, social enterprises are set up by social entrepreneurs to achieve non-market outcomes. This initial analytical step, however, does not settle the matter. The diversity in social enterprise activities makes it difficult to determine which non-market activities ought to be sufficient for being included in the category of 'social enterprise'.

Continuing our survey of the field, we see many organisations deemed social enterprises that look like any other business organisation. They operate in ordinary markets producing goods and services identical to those of any other enterprise. Further, they may return up to 100% of their profits to members, just like any other company limited by shares. Yet these enterprises may be categorised as social enterprises because, for example, they may focus on addressing perceived labour market failures. Such organisations may emphasise promoting specifically identified people to certain positions or roles such as managers – people who might otherwise be excluded from them, such as women, immigrants or BIPOC (Black, Indigenous and People of Colour).[21] Thus, a social enterprise may address a failure of labour markets in terms of failure to correctly apportion opportunities or choices to the talent pool.

Further, we note that there are some social enterprises that produce certain goods and services that are underrepresented in markets. For example, there may be a perceived shortage of a certain type of ecologically friendly product or a market too small to support a critical niche medical device. To address this market failure – incomplete markets – a social enterprise may be established to produce such goods or services, and likely generate a below-market return.[22] Again, this activity might be similar to the heads of charity, discussed further below, as a defining characteristic of a new legal category; however, given the diversity in the sector, it is inappropriate as the sole criterion.

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[19] See B. Sheehy, 'Corporations and Social Costs: The Walmart Case Study' (2004) 24 *Journal of Law and Commerce* 1. See also F.M. Bator, 'The Anatomy of Market Failure' (1958) 72 *The Quarterly Journal of Economics* 351, 351.

[20] See discussion of 'organising problem' in B. Sheehy and D. Feaver, 'Designing Effective Regulation: A Normative Theory' (2015) 38 *University of New South Wales Law Journal* 392.

[21] See e.g. https://www.birmingham.ac.uk/documents/college-social-sciences/social-policy/tsrc/working-papers/working-paper-107.pdf.

[22] See e.g. https://www.tsuno.com.au/pages/what-is-tsuno; https://www.ecocitex.cl/pages/equipo_.

In considering the types of activities that social enterprises might pursue, we may see additional forms of screening or selectivity might be applied. Drawing from the discipline of business ethics, we see a means to distinguish the activities of social enterprises from other similar organisations. Ethical investment theories aim to improve social outcomes by supporting socially positive goods and services while discouraging the production of what may be described as 'anti-social goods and services'.[23] These theories rest on the assumption that by reducing funding available for undesirable goods and services, a reduced quantity produced will result. To achieve this goal, investment firms utilise either 'positive' or 'negative' screens – i.e. avoiding companies that are investing in undesirable goods or services, or investing in companies that are producing desirable goods or services, or doing so in a socially desirable way, using socially responsible processes.[24] Enterprises that engage in this type of ethical product or investment selection may denominate themselves as 'social enterprises'.

Finally, we note that some social enterprises divert some of their profits from shareholders to other parties. That is, despite potentially being identical to their non-social enterprise peers in terms of returning profits to investors, many social enterprises give a portion of their profits to charitable causes. This donative activity is an effort to achieve a non-market outcome; however, it is insufficient to create a new legal category distinct from legal charities. The objective of returning any profit to members precludes them from being categorised as a 'charity'. Charitable donations, however, create an interesting challenge for investors as, from an economic perspective, such social enterprises are providing less than full market returns.

In sum, it is clear that organisations claiming social enterprise status include businesses aimed at ecological sustainability, social inclusiveness agendas and charitable causes. Beyond these non-financial objectives, all of the businesses aim to make a profit.

Taking this economic analysis into law, we are able to apply it to the common business organisation, the corporate form. Corporate law categories useful in this analysis are (1) shareholders, (2) directors and officers, and (3) assets in the form of contracts and property. This understanding of the corporation can be displayed graphically in a way that facilitates the analysis (see Figure 1).[25]

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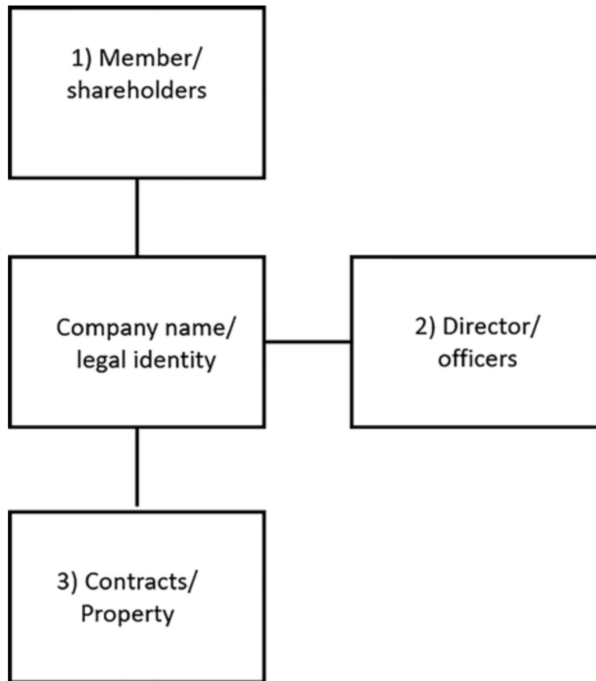
23 See R.T. DeGeorge, *Business Ethics*, Macmillan 1997.

24 B. Sheehy, 'Defining CSR: Problems and Solutions' (2015) 131 *Journal of Business Ethics* 625.

25 B. Sheehy, 'Explaining the Corporation to Non-Specialists: A Graphic Approach' (2016) 40 *University of Western Australia* 69.

Figure 1. Corporate person



Source: Produced by Benedict Sheehy.

Applying the economic analysis above to the legal person of the corporation as modelled in the diagram, we can see that corporations that donate certain part of their profits can be classified as social enterprises on the basis of their dealings with member's rights in category 1. That is, a company which donates some or all of its profits rather than distributing to members may be eligible for categorisation as a social enterprise. Similarly, a company which provides offices of director or senior officer to certain types of people usually excluded from such roles, category 2, may be eligible for categorisation as a social enterprise. Finally, a company that deals with contracts or property in specific ways – whether distribution, procurement or sale at non-market prices – or provides employment for certain groups that are discriminated against may be eligible for categorisation as a social enterprise (category 3).

3.2. THE CHARITY AND ELEEMOSYNARY CORPORATIONS

One of the earliest forms of collective financial organisations comes from the classic civilisation of Hellenic Greece. Such organisations have a long history,

dating back to the Ancient Greek grave cults which maintained graves out of personal property. Indeed, the terms charity and eleemosynary come from the Hellenistic Greek words *xaris/charis* meaning 'gift' and *eleeo* meaning 'mercy'.[26] Eleemosynary organisations exist for the purpose of charitable giving.[27] As Hellenism was integrated into Roman ways, so too were certain charitable practices, and organisations *etairia* and Roman law developed to enable and protect those charitable purposes.

Charities have long been organised in the corporate form. Indeed, with the corporation being a collegium of three or more people,[28] the grave cults of the Roman era would have been corporations. Thus, it is fair to observe that the early charitable corporation was a body of people organised for normative purposes and recognised at law in the Justinian Code. This non-market, social purpose is evident in social enterprises.

Further, although a legal identity as a body corporate, an eleemosynary corporation from early on was structured in a manner which at law today would identify as a trust.[29] That is, a wealthy benefactor would bestow assets upon an individual or a group and the disposition of the granted assets would be for purposes beneficial only to non-parties to the transaction. This category allocation was continued in subsequent legal developments as charitable corporations continued to hold their assets in trust.[30] Social enterprises, in a parallel manner, hold an investment for purposes which include social objectives and which may diverge from maximising financial returns.

Accordingly, we can add to our definition of social enterprises by drawing from the category of charitable corporations. There are two defining legal characteristics of the charity, both of which are applicable to the taxonomy. The first is its use of assets for social purposes – that is, some form of public good. The law of charities provides a listing or 'heads of charity' for inclusion in the category. In the UK, for example, section 3(1) of the Charities Act 2011 establishes 13 descriptions of purpose to categorise an organisation as a charity, including preventing poverty, helping the needy, and advancing fundamental matters such as education, health and human rights.[31] Similarly, in the USA, §501(c)(3) of the Internal Revenue Code provides that to qualify as tax-exempt,

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26 S. Wexler, 'Some Further Reflections on Poor People and Law' (2007) 40 *UBC Law Review* 859, 864.

27 S. Kyd, *A Treatise on the Law of Corporations*, J. Butterworth 1793, p. 22; L. Bristowe, C. Hunt and H. Burdett, *The Law of Charities and Mortmain: Being the Fourth Edition of Tudor's Charitable Trusts*, Sweet and Maxwell Limited 1904, p. 68.

28 W. Blackstone, *Commentaries on the Laws of England*, vol. 1, University of Chicago Press 1765, p. 469.

29 L. Bristowe, C. Hunt and H. Burdett, *The Law of Charities and Mortmain: Being the Fourth Edition of Tudor's Charitable Trusts*, Sweet and Maxwell Limited 1904, p. 64.

30 Ibid.

31 Charities Act 2011 (UK) s. 3(1).

a non-profit must exist for one or more exclusively charitable purposes: religious, charitable, scientific, testing for public safety, literary, educational, fostering of national or international amateur sports, and prevention of cruelty to animals and children.[32] Secondly, the charitable corporation has a prohibition on the disposition of corporate assets or corporate earnings for the benefit of the corporators.

Social enterprises have similarities. They are aimed fundamentally at providing some type of public good, whether equitable employment opportunities (corporate categories 2 and 3), underprovided socially desirable goods and services (corporate category 3), or contributions of resources to other bodies providing the public good (corporate category 1).

Additionally, to preserve the peculiar category of charitable corporation, the organisation's objectives are safeguarded in three ways. Suitable objectives are carefully set out and circumscribed. For example, early law prohibited even the corporator who created the corporation from changing the objectives.[33] Further, compliance with the corporate objectives was ensured in past times by an external accountability structure, the Visitor. In applying these to social enterprises today, there are some jurisdictions in both hard and soft law that provide a constitutional restriction on corporate objects or corporate purpose. For example, benefit corporations have a constitutional provision imposing limitations on corporate objectives.[34]

As to restricting the right to change objects, law has a limited set of established organisational forms available to socially oriented organisations. Accordingly, social enterprises may be limited to those business activities that fall within those forms available for limited objects. For example, if a social enterprise's object is limited to providing undersupplied social goods and it were to change such that its object is to compete with other businesses, it would lose its status as a social enterprise.

Finally, and often troubling in social enterprises and corporations generally, is the method used for ensuring social enterprises are complying with their obligations. For example, while auditors may test the financial statements of companies, in the case of social enterprises, there is no widely accepted external assurance system. Individual social enterprise schemes, such as benefit corporations and certified B Corporations, may require reporting, but ultimately these are reliant on the integrity of the leadership in the first place.

As to the making of a profit by charities, historically they were permitted to charge for their services, profit and still be a charity. The restriction was that

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32 26 U.S. Code §501.

33 L. Bristowe, C. Hunt and H. Burdett, *The Law of Charities and Mortmain: Being the Fourth Edition of Tudor's Charitable Trusts*, Sweet and Maxwell Limited 1904, p. 67.

34 See e.g. 805 ILCS 40 §3.01.

profits were not to be converted to private use.[35] As a corporation established by private individuals, the eleemosynary corporation is a private corporation, at least to the extent that such a distinction makes sense in the medieval context.

Structurally, many eleemosynary corporations in different jurisdictions are not limited by shares, but are corporations limited by guarantee. They are classified in tax law as having a tax-exempt status.[36] This charitable status of the corporation is not, as noted, a matter of structure, but dependent upon a grant of charitable status by taxation authorities determined in terms of its activities – some type of public good as identified above. The charitable corporation must apply its profits to social projects and, in doing so, it justifies its exemption from the taxation regime.

3.3. STATE-OWNED ENTERPRISE

The umbrella term 'state-owned enterprise' (SOE) includes a variety of enterprises at different levels of government,[37] in different models of revenue generation – from money losing units or organisations aimed at distributing social welfare reliant on government treasure, to highly profitable telecommunications business monopolies. These non-market entities can be used to achieve social objectives broadly aimed at improving justice. Such issues start from a reimagined society where the whole of society is in better circumstances, and places the state, rather than private individuals in markets, at the centre of the specific economic activity necessary to achieve those improved circumstances.[38]

From a jurisprudential perspective, the objective of the SOE can often be described as increasing positive liberties. That is, SOEs are a public provision of opportunities in the form of goods and services that the market fails to produce in adequate quantities, at affordable prices or in accessible locations, in order to allow citizens to achieve the necessary capacities to make meaningful choices in life. Similar to SOEs, social enterprises increase access to specific goods and services, improving the options for specific groups underserved by the market.

SOEs may be organised in any variety of ways.[39] Where they are delivering goods or services for a fee, they are usually organised as some type of corporation

[35] Ibid., pp. 63–64.

[36] See S. Woodward, 'Not-For-Profit Motivation in a For-Profit Company Law Regime – Baseline Data' (2003) 21 *Companies & Securities Law Journal* 102.

[37] P.A. Toninelli and P.M. Toninelli, *The Rise and Fall of State-Owned Enterprise in the Western World*, vol. I, Cambridge University Press 2000, p. 10; D. Feaver and B. Sheehy. 'The Political Division of Regulatory Labour: A Legal Theory of Agency Selection' (2015) 35 *Oxford Journal of Legal Studies* 153.

[38] E.S. Reinert, 'The Role of the State in Economic Growth' (1999) 26 *Journal of Economic Studies* 268.

[39] D. Feaver and B. Sheehy. 'The Political Division of Regulatory Labour: A Legal Theory of Agency Selection' (2015) 35 *Oxford Journal of Legal Studies* 153.

in which the government or its representative holds some or all of its shares.[40] As share limited corporations, they may return a profit to the shareholders. The SOEs are not under the same constraints as charities and so do not have the non-distribution constraints.

Like SOEs, social enterprises may aim to distribute the goods and services necessary to enhance the capacity of different categories of people such as might be necessary for them to make meaningful choices. The activities of the social enterprise might include increasing production of certain goods or services, making them more affordable through subsidies to certain customers, or distributing them where they are in lesser supply.

3.4. LEGISLATED SOCIAL ENTERPRISES

A number of jurisdictions have enacted 'social enterprise' legislation. This legislation ranges from US B Corporations to specific EU members' social enterprise entities. This legislation as positive law defines social enterprise for their specific jurisdictions; however, we believe that oftentimes the legislation befuddles the issues. Social enterprise legislation may conflate charities with non-distribution constraints, or other ventures already inhabiting distinct, well-defined categories of law.[41] Accordingly, although positive law in these instances provides definitions or categories, we believe these are misconstrued theoretically and will cause problems with the normative coherence of the legal system.

4. DEFINITION

Social enterprises, we argue, have three different but complementary characteristics that inform our definition. Drawing from the foregoing, we summarise as follows: the characteristics of the social enterprise can be explained using the lens of economics and then applying three existing legal categories. First, social enterprises provide non-market goods and services (economic perspective). Second, social enterprises are for-profit organisations usually organised as a legal corporation. When organised as a corporation, the social purpose of the social enterprise can be achieved through the different corporate law categories explained above, that

[40] S. Bottomley, 'Regulating Government-Owned Corporations: A Review of the Issues' (1994) 53 *Australian Journal of Public Administration* 521.

[41] See European Commission, *A map of social enterprises and their eco-systems in Europe. Country report: Italy* (31 October 2014) https://ec.europa.eu/social/BlobServlet?docId=13026&langId=en.

is, shareholders and members (category 1), directors and officers (category 3), and assets – contracts and property (category 4). Finally, social enterprises have a clear social purpose which can be determined by their contribution to social objectives – products, people and ethics – which find parallels in the legal categories of charities and SOEs.

Consequently, we define the social enterprise as a *for-profit organisation* that provides some *non-market* distribution with a defined *social purpose*.

Taking this definition further, we note that although there are different views of what the *for-profit/not-for-profit* divide means,[42] Henry Hansmann describes the 'nondistribution constraint' that is useful for our purpose.[43] According to Hansmann, a 'nonprofit organization is, in essence, an organization that is barred from distributing its net earnings, if any, to individuals who exercise control over it'.[44] He continues:

> It should be noted that a nonprofit organization is not barred from earning a profit. Many nonprofits in fact consistently show an annual accounting surplus. It is only the distribution of the profits that is prohibited. Net earnings, if any, must be retained and devoted in their entirety to financing further production of the services that the organization was formed to provide. Since a good deal of the discussion that follows will focus upon this prohibition on the distribution of profits, it will be helpful to have a term for it; I shall call it the 'nondistribution constraint.'[45]

Consequently, *not-for-profit* organisations are formal groups[46] created to achieve an organisational purpose, social or otherwise,[47] through the reinvestment of the organisation's net earnings[48] ('nondistribution constraint').[49] *Not-for-profit*

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42 See e.g. P.F. Drucker, 'The Age of Social Transformation' (1994) 274 *The Atlantic Monthly* 53, 75; M. Auteri and R.E. Wagner, 'The Organizational Architecture of Nonprofit Governance: Economic Calculation Within an Ecology of Enterprises' (2007) 7 *Public Organization Review* 57, 59; R. Dart, 'The Legitimacy of Social Enterprise' (2004) 14 *Nonprofit Management & Leadership* 411, 414.

43 See V.D. Alexander, 'Environmental Constraints and Organizational Strategies: Complexity, Conflict, and Coping in the Nonprofit Sector' in W.W. Powell and E.S. Clemens (eds), *Private Action and the Public Good*, Yale University Press 1998, p. 273 (explaining that 'the primary legal consideration for managing nonprofits is the "nondistribution" constraint').

44 H.B. Hansmann, 'The Role of Nonprofit Enterprise' (1980) 89 *The Yale Law Journal* 835, 838.

45 Ibid.

46 D.H. Smith, R.A. Stebbins and M.A. Dover, *A Dictionary of Nonprofit Terms and Concepts*, Indiana University Press 2006, p. 87 (defining this concept as a 'group (usually an organization) having a proper and unique name, clear boundaries (updated, complete list of analytic members), and clear leadership structure (widely accepted means of making binding group decisions)').

47 See H.B. Hansmann, 'The Role of Nonprofit Enterprise' (1980) 89 *The Yale Law Journal* 835, 839.

48 Ibid., p. 838.

49 See D.H. Smith, R.A. Stebbins and M.A. Dover, *A Dictionary of Nonprofit Terms and Concepts*, Indiana University Press 2006, pp. 156–58.

organisations are not created to generate profits for those who exercise control over the organisation, such as shareholders, members, officers, directors or trustees.[50] In the case of social enterprises, however, we note that distributions – i.e. profits – are a clear part of the category.[51] Thus, we propose that while a less-than-market return, a negative impact (actual or potential) on share profit, may often be a characteristic of the category of social enterprise, it is not necessarily so.

Further, social enterprises must have an explicit *social purpose*.[52] The organisation's objectives and its social goal are the same.[53] In terms of identifying a qualifying social purpose, we draw from the law of charities. The recognised heads of charity, as noted, are: religious, relief of the poor, scientific, testing for public safety, literary, educational, fostering of national or international amateur sports, and prevention of cruelty to animals and children. Taking the examples of charities[54] and SOEs developed above, this social purpose is the provision of some type of public good or service undersupplied by the market or, like SOEs, redistributions of power, inclusiveness of specific groups, and access to specific goods and services.

Social enterprises, therefore, can be defined as having the dual purpose of profit-making *and* providing some public good.

5. SOCIAL ENTERPRISE AND RELATED CONCEPTS

We differentiate social enterprises from other related concepts: 'social entrepreneur' and 'social entrepreneurship'. Although social enterprise, social entrepreneur and social entrepreneurship all have a market-driven social purpose, the social agent in each one of these concepts is different.[55] Social enterprise, as explained above, is 'a

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50 H.B. Hansmann, 'The Role of Nonprofit Enterprise' (1980) 89 *The Yale Law Journal* 835, 838.

51 R. Bohinc and J. Schwartz, 'Social Enterprise Law: A Theoretical And Comparative Perspective' (2020) 15 *Ohio State Business Law Journal* 1, 5–6.

52 See e.g. C. Seelos and J. Mair, 'Social Entrepreneurship: Creating New Business Models to Serve the Poor' (2004) 48 *Business Horizons* 241, 243. From an institutional theory perspective, the social purpose gives organisations legitimacy. Alexander conceptualises the aim of meeting public needs and providing social goods as 'rationalized myths', institutionalised rules that give organisations legitimacy. V.D. Alexander, 'Environmental Constraints and Organizational Strategies: Complexity, Conflict, and Coping in the Nonprofit Sector' in W.W. Powell and E.S. Clemens (eds), *Private Action and the Public Good*, Yale University Press 1998, p. 275.

53 See M. Renko and M.J. Freeman, 'Entrepreneurship by and for Disadvantaged Populations' in A. McWilliams, D.E. Rupp, D.S. Siegel, G.K. Stahl and D.A. Waldman (eds), *The Oxford Handbook of Corporate Social Responsibility*, Oxford University Press 2019, p. 413.

54 Helping disadvantaged populations is a salient example of social purpose. See ibid., pp. 420–21.

55 J. Mair and N. Rathert, 'Social Entrepreneurship: Prospects for the Study of Market-Based Activity and Social Change' in A. McWilliams, D.E. Rupp, D.S. Siegel, G.K. Stahl and

specific type of organization'.[56] Instead, social entrepreneur refers to an individual and social entrepreneurship refers to an activity or process.

The term 'entrepreneur' was initially introduced as an economic concept in France 'to identify the venturesome individuals who stimulated economic progress by finding new and better ways of doing things'.[57] This definition is consistent with the general[58] and the legal[59] definitions of the word. Scholarship also defines 'entrepreneur' as a 'person',[60] 'individual',[61] 'persons'[62] or 'people'.[63] Consequently, individuals or natural persons[64] are the social agents in the 'social entrepreneur' category.

Unlike the 'entrepreneur' and the 'enterprise' categories, 'entrepreneurship' does not refer to an agent but an activity or process.[65] This category, which has its origins in Richard Cantillon's work around 1730,[66] refers to the process[67] or

D.A. Waldman (eds), *The Oxford Handbook of Corporate Social Responsibility*, Oxford University Press 2019, p. 359.

56 Ibid., p. 360. See also *Black's Law Dictionary* (10th ed., 2014) 'enterprise' (n, def 1) (defining 'enterprise' as an organisation for business purposes).

57 J.G. Dees, 'The Meaning of "Social Entrepreneurship"', Duke University (1998) https://centers.fuqua.duke.edu/case/wp-content/uploads/sites/7/2015/03/Article_Dees_MeaningofSocialEntrepreneurship_2001.pdf. Drucker has pointed out that Jean Baptiste Say coined the term 'entrepreneur' close to 1800 to describe those who shift 'economic resources out of an area of lower and into an area of higher productivity and greater yield'. P.F. Drucker, *Innovation and Entrepreneurship*, revised ed., Routledge 2015, p. 25.

58 The Concise English Oxford Dictionary defines 'entrepreneur' as 'a person who sets up a business or businesses, taking on financial risks in the hope of profit.' *Concise Oxford English Dictionary*, 12th ed., Oxford University Press 2011.

59 The Black's Law Dictionary defines 'entrepreneur' as '[s]omeone who initiates and assumes the financial risks and accepts the rewards of a new enterprise and who usu. undertakes its management.' *Black's Law Dictionary* (10th ed., 2014) 'entrepreneur' (n, def 1).

60 See e.g. J. Boschee and J. McClurg, 'Toward a Better Understanding of Social Entrepreneurship: Some Important Distinctions' (2003) https://www.law.berkeley.edu/php-programs/courses/fileDL.php?fID=7289.

61 See e.g. J.S. McMullen and D.A. Shepherd, 'Entrepreneurial Action and the Role of Uncertainty in the Theory of the Entrepreneur' (2006) 31 *Academy of Management Review* 132, 134.

62 See e.g. G.N. Prabhu, 'Social Entrepreneurial Leadership' (1999) 4 *Career Development International* 140, 140.

63 See e.g. D. Bornstein, *How to Change the World: Social Entrepreneurs and the Power of New Ideas*, revised ed., Oxford University Press 2007, p. 1.

64 See *Black's Law Dictionary* (10th ed., 2014) 'person' (def 1) (defining 'person' or 'natural person' as a human being).

65 S.A. Zahra, E. Gedajlovic, D.O. Neubaum and J.M. Shulman, 'A Typology of Social Entrepreneurs: Motives, Search Processes and Ethical Challenges' (2009) 24 *Journal of Business Venturing* 519, 522. See also J. Mair and N. Rathert, 'Social Entrepreneurship: Prospects for the Study of Market-Based Activity and Social Change' in A. McWilliams, D.E. Rupp, D.S. Siegel, G.K. Stahl and D.A. Waldman (eds), *The Oxford Handbook of Corporate Social Responsibility*, Oxford University Press 2019, p. 360.

66 W. Long, 'The Meaning of Entrepreneurship' (1983) 8 *American Journal of Small Business* 42, 42.

67 See J. Mair and N. Rathert, 'Social Entrepreneurship: Prospects for the Study of Market-Based Activity and Social Change' in A. McWilliams, D.E. Rupp, D.S. Siegel, G.K. Stahl

activity[68] that entrepreneurs and enterprises, as its agents, undertake. In other words, 'entrepreneurship' is the action, while 'entrepreneur' and 'enterprise' are the subjects.

Consequently, despite these concepts being used interchangeably,[69] they are not the same. Social enterprises, social entrepreneurs, and social entrepreneurship all have a market-based social purpose; however, they refer to different social agents. The social agent in social enterprises is a legal organisation, in social entrepreneurs it is an individual, and in social entrepreneurship there is no social agent: this is a process, a model of organisation.

Based on the categories previously explained, we propose the following taxonomic framework of legal organisations based on their *profit distribution* and *social purpose* (see Table 1).

Table 1. Taxonomy of organisations

	For-profit	Not-for-profit
Social purpose	– B Corp – Benefit Corporation (USA) – Community Contribution Company (Canada) – *Società Benefit* (Italy) – For-Profit Public Benefit Corporation – Special Purpose Corporation – Low Profit LLC (USA) – Public Benefit LLC – Corporation, LLC and Partnership with social purpose	– Eleemosynary Corporations/Charities – Private Foundations – Private Operating Foundations – Trust – Non-Profit Corporation – Companies Limited by Guarantee – Public Utility
Non-social purpose	– Corporation – LLC – Partnership	

Source: Compiled by the rapporteurs.

and D.A. Waldman (eds), *The Oxford Handbook of Corporate Social Responsibility*, Oxford University Press 2019, p. 360; J. Robinson, 'Navigating Social and Institutional Barriers to Markets: How Social Entrepreneurs Identify and Evaluate Opportunities' in J. Mair, J. Robinson and K. Hockerts (eds), *Social Entrepreneurship*, Palgrave Macmillan 2006, p. 78; A. Rahdari, S. Sepasi and M. Moradi, 'Achieving Sustainability through Schumpeterian Social Entrepreneurship: The Role of Social Enterprises' (2016) 137 *Journal of Cleaner Production* 347, 350.

68 See J. Austin, H. Stevenson and J. Wei-Skillern, 'Social and Commercial Entrepreneurship: Same, Different, or Both?' (2006) 30 *Entrepreneurship Theory and Practice* 1, 2.

69 See T. Lambooy, A. Argyrou, A. Colenbrander and R. Blomme, 'Stakeholder Participation in Social Enterprises in the Netherlands – A Case Study: An Assessment of the Organizational and Governance Structure of the Dutch Social Enterprise AutiTalent in Light of Social Enterprise Governance Theory and the Facilities in Dutch Corporate Law', International OFEL Conference on Governance, Management and Entrepreneurship (2016) (explaining that 'the concepts "social entrepreneurship", "social enterprise" and "social entrepreneur" are often used interchangeably in academic literature, although they actually have different meanings').

Thus, a social enterprise is a business that uses markets to have a positive social impact. It is a business entity, a for-profit organisation – usually in a corporate form – with a social objective. As a result, social enterprises have a dual purpose: profit generation and provision of some type of non-market public good – guided, for instance, by the heads of charity – which includes cultural and environmental matters.[70]

6. CONCLUSION

This report has provided a conceptual definition of 'social enterprises'. It has explained, delimited and clarified the traditionally ambiguous concept of 'social enterprise'. The definition proposed in this report drew on market failure theory, established legal categories for organisations, and social/non-social and profit/non-profit legal divides. It differentiated 'social enterprises' from other legal categories, creating a more useful classification for the legal system. This differentiation and conceptual clarification allow precise identification and regulation of potential 'social enterprises', which, in turn, enables policymakers, legislators and regulators to promote socially oriented organisations through the creation and allocation of more or lesser rights and duties to organisations that adopt the 'social enterprise' form.

The sharp delineation between social enterprises and other organisations such as charities with their non-distribution constraint is clearly important. While policymakers may be interested in fostering the innovation and social causes supported by social enterprises, they find themselves less able to provide the support in terms of rights and duties, such as access to finance or tax incentives, when they confound these different forms. Understanding that difference gives legislators the precision to target their work. For example, legislators and policymakers make far greater efforts to provide rights and benefits for social benefits when they limit profit/asset distribution – the proper domain of charities – rather than expecting profit-motivated bodies to deliver too much.

[70] See J. Diaz-Granados, 'Sustainable Business Solutions' in S. Idowu, R. Schmidpeter, N. Capaldi, L. Zu, M. Del Baldo and R. Abreu (eds), *Encyclopedia of Sustainable Management*, Springer 2023.

SOCIAL ENTERPRISE IN EU LAW AND POLICIES

Antonio Fici

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1. INTRODUCTION: SOCIAL ENTERPRISES IN THE FRAMEWORK OF EUROPEAN UNION ORGANISATIONAL LAW

Social enterprises are well known in Europe, both at the national and at the European Union (EU) level. Today, more than two-thirds of the Member States (MSs) of the EU have specific laws on this subject, as a result of a legislative process that started in the 1990s and that remains in progress. In contrast, at the EU level, there is no specific regulation on social enterprises, although a specific request for its introduction was made by the European Parliament (EP) in 2018.[1] The contribution of social enterprises to the Union objectives has however turned them into a specific policy area of the EU.

Broadly speaking, as will be detailed later,[2] the concept of social enterprise emerging from the most relevant EU texts and documents embraces various types of legal entities with a democratic or participatory governance that carry

[1] For more details, see below section 3.
[2] See below section 4.

out commercial activities of general interest, without a profit aim, and in the interest of disadvantaged people, the community or the society as a whole. This general concept is in line with the idea of social enterprise that has inspired the existing national legal frameworks.

In order to better frame and understand the topic of social enterprise in this particular supranational context, it is convenient to begin with an analysis of the patterns and objectives of EU law's approach to private entities and organisational forms.

In the Treaty on the European Union (TEU),[3] the only reference to private organisational forms is in Article 11, which obliges the institutions of the EU to give citizens and their 'representative associations' the possibility to express their opinions in all areas of Union action, as well as to maintain an open, transparent and regular dialogue with these associations and civil society. Whilst it is significant that the TEU refers to 'associations' in close relationship to 'citizens' and 'civil society', it does not seem that the TEU intends here to refer to a precise legal form, that of the association, and in any event the provision is not relevant for our specific purposes, because Article 11 does not regulate associations (nor does it confer enforceable rights upon them) but rather the activity of the EU institutions (which are obligated to establish a dialogue with civil society).

As regards EU primary legislation, of utmost importance in this area of law is Article 54 of the Treaty on the Functioning of the European Union (TFEU),[4] where specific types of private organisations are mentioned, namely companies, cooperative societies and 'non-profit-making' private legal persons. The function of this provision is to specify the scope of freedom of establishment within the EU, with particular regard to the freedom 'to set up and manage undertakings'.

More precisely:

- Article 49(1) TFEU prohibits restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State;
- prohibited restrictions – according to Article 49(2) – are also those relative to the establishment and management of 'companies or firms';
- Article 54(1) specifies that 'companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall … be treated in the same way as natural persons who are nationals of Member States', and therefore enjoy the same freedom of establishment as the citizens of the EU; and

[3] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12016M/TXT&from=EN.
[4] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12016E/TXT&from=EN.

- Article 54(2) clarifies what 'companies' are for the said purposes, namely 'companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making'.

With the aim of safeguarding and ensuring the effectiveness of this particular aspect of the freedom of establishment, these provisions of the TFEU have stimulated the development of EU organisational law.

More exactly, what happened is that – having freedom of establishment as its main objective and favoured by the EU institutions' focus on the internal market and its inherent virtues – a set of EU rules on companies (and cooperatives) was produced over several decades, starting from the 1960s.[5] This corpus of law comprises both EU regulations and directives[6] with different objects and purposes, including harmonisation and uniformisation of certain aspects of national company laws,[7] which have been considered necessary to ensure and promote freedom of establishment, as well as the creation of supranational legal forms, which have been provided to EU citizens and organisations as optional and additional types of entities,[8] which are pan-European (albeit not fully so)[9] and equipped with full mobility across the EU.[10] These European legal forms are the European Economic Interest Grouping,[11] the European Company

5 Following the 'General Programme for the abolition of restrictions on freedom of establishment', adopted by the Council of the European Economic Community (as the European Union, comprising only six MSs, was named at the time) on 18 December 1961; in 1968 the First Council Directive 68/151/EEC on company law was approved.

6 Among the legal acts of the EU, a regulation has general application, is binding in its entirety and is directly applicable in all MSs, whereas a directive is binding, as to the result to be achieved, upon each MS to which it is addressed, but leaves to the national authorities the choice of form and methods (Art. 288 TFEU).

7 More precisely, (public and private) limited liability company laws.

8 'Optional' and 'additional' in relation to the national law equivalents. This is why the European Company (as well as the European Cooperative Society) is also understood as the '28th type' of (public limited liability) company available in the EU. In fact, equivalence is not full, because the European Company (as well as the European Cooperative Society) requires a supranational element to be established (indeed, easy to be met). See Art. 2 Reg. 2157/2001, and Art. 2 Reg. 1435/2003.

9 'Not fully' because European Companies (and European Cooperative Societies, to an even greater extent) are also regulated by the national law of the MS in which the European Company (or the European Cooperative Society) has its registered office. See Art. 9 Reg. 2157/2001, and Art. 8 Reg. 1435/2003.

10 European Companies and European Cooperative Societies are required to establish their registered offices in the same MS as their head offices (see Art. 7 Reg. 2157/2001, and Art. 6 Reg. 1435/2003), but their registered office may freely be transferred to another MS (see Art. 8(1) Reg. 2157/2001, and Art. 7(1) Reg. 1435/2003). This means that the legal entity continues in the MS of arrival, no winding up takes place and there is no need to reincorporate the legal entity in the country of destination.

11 Council Regulation No. 2137/1985 of 25 July 1985, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31985R2137&from=EN.

(*Societas Europaea*)[12] and the European Cooperative Society (*Societas Cooperativa Europaea*).[13]

European company law[14] does not comprise only statutory law but also includes the case law of the Court of Justice of the European Union (CJEU), which has significantly contributed to its formation, notably by clarifying the contents and limits of a company's freedom of establishment.[15]

EU company (and cooperative) law is relevant for social enterprises for two main reasons. Firstly, at the national level (as will be explained in more detail below) social enterprises may be established as companies or cooperatives. Secondly, social enterprises might in principle also be incorporated as European companies or cooperatives according to the pertinent EU regulations.[16]

In contrast, non-profit organisations (NPOs), such as associations, foundations and mutual societies, have not received the same degree of consideration from the EU legislator. No harmonisation or uniformisation measures have addressed NPO law.[17] No European legal forms for NPOs exist. As regards harmonisation and uniformisation of national laws, this is mainly due to insufficient knowledge of NPOs[18] and the misleading reference to 'non-profit-making' legal entities in Article 54(2) TFEU.[19] The different cultural and historical roots of national NPO laws, and their resulting variety, have also contributed to this result.

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12 Council Regulation No. 2157/2001 of 8 October 2001, supplemented by Council Directive 2001/86/EC of 8 October 2001 with regard to the involvement of employees, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02001R2157-20130701&from=EN.

13 Council Regulation No. 1435/2003 of 22 July 2003, supplemented by Council Directive 2003/72/EC of 22 July 2003 with regard to the involvement of employees, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02003R1435-20030821&from=EN.

14 A very useful introduction to this matter is provided by N. De Luca, *European Company Law*, 2nd ed., Cambridge University Press, Cambridge 2021.

15 This long list of judgments includes, at least, *Daily Mail* (C-81/87), *Centros* (C-212/97), *Überseering* (C-208/00), *Inspire Art* (C-167/01), *Sevic* (C-411/03), *Cartesio* (C-210/06), *Vale* (C-378/10), and *Polbud* (C-106/16).

16 This option, of course, requires verification of the concrete possibility to adapt the European Company and the European Cooperative Society to the specific needs of a social enterprise. This analysis goes beyond the limits of this report.

17 A recommendation, which is however a non-binding legal instrument of the EU (see Art. 288 TFEU), was issued in 2007 with regard to non-governmental organisations (NGOs). A European Convention on the Recognition of the Legal Personality of International NGOs was introduced in 1986, although it was ratified by only eight MSs of the EU.

18 It is still not always clear, for example, that the non-profit character refers to the purpose of the entity, moreover in a purely negative way (as a profit non-distribution constraint), and not to the activity of the entity. Therefore, NPOs may, in principle, conduct commercial activities that generate profits (provided profits are not distributed but are reinvested in the activity).

19 A global and systematic interpretation of EU law does not allow for the conclusion that Art. 54(2) TFEU refers to NPOs, because it is a principle of EU law that undertakings which carry out economic activities must be treated equally whatever their legal form, including a non-profit form (cf. *Höfner and Elser* (C-41/90), para. 21; *Poucet and Pistre* (C-159/91 and 160/91), para. 17; *Fédération Française des Sociétés d'Assurance and others* (C-244/94), para. 22; *Albany*

As regards supranational legal forms, the absence of EU non-profit legal forms is mainly due to a lack of political consensus. Indeed, the creation of supranational legal forms of NPOs by means of EU regulations equivalent to those establishing the European Company and the European Cooperative Society has been under discussion for several years. The first official proposal on the European Association dates back to 1991;[20] a proposal for a European Foundation was formulated in 2012;[21] the first proposal on mutual societies was made in 1992; and a subsequent draft proposal on the same subject was discussed later.[22] However, despite the considerable efforts of the EU institutions and the pressure applied by stakeholders, all these proposals have been unsuccessful.

Following a resolution of the EP in February 2022,[23] the debate about the introduction of a European statute for associations and NPOs has now restarted. Indeed, in September 2023, the European Commission adopted a proposal for a directive on European Cross-Border Associations, with the aim of facilitating the effective exercise of freedom of movement of non-profit associations operating in the internal market. The new political climate, of which the 'Action Plan on the Social Economy' is a clear manifestation,[24] might on this occasion yield a different

(C-67/96), para. 85, and a number of following decisions). Therefore, Art. 54(2) should properly refer to gratuitous, non-economic activities and to entities that exclusively perform these kinds of activities. NPOs are not per se organisations that may only conduct non-economic activities. This is clear not only under national laws but also under EU law, as shown by the fact that NPOs are potential VAT payers (although Art. 132(1)(l)(m) Directive 112/2006 provides for some exceptions). Under EU public procurement law, NPOs are explicitly considered 'undertakings that carry out economic activities' (see, among many others, *Pavlov* (C-180/98 to 184/98), *Ambulanz Glöckner* (C-475/99), *Conisma* (C-305/08) and *Parsec* (C-219/19)).

20 An EU statute on associations was first recommended in Nicole Fontaine's 'Report on Non-Profit Making Associations in the European Community' of 8 January 1997, followed in the same year by a Resolution of the EP. The first official proposal was presented by the European Commission on 18 December 1991. A second amended proposal was put forward in 1993. It attracted criticism by some MSs, notably Germany, Denmark and the United Kingdom. The proposal was officially withdrawn by the European Commission in 2005. After public protest against this decision, both the EESC in 2006 and the EP in 2011 pushed for the adoption of a European statute for associations. The withdrawal in 2015 of the proposed European Foundation statute led the EC to maintain that the endorsement of such an initiative by the Council seemed unlikely at that time. The EESC has revisited this point, once again calling upon the Commission to take actions in this regard.

21 The European Commission officially withdrew the proposal for a European Foundation statute in 2015 after eight MSs (Austria, Denmark, Estonia, Germany, the Netherlands, Portugal, Slovakia and the UK) rejected it.

22 The first proposal was officially withdrawn in 2006. Activities on the subject resumed in 2010. Two studies on mutuals were then commissioned. The European Commission launched a public consultation in 2013. Since then, there has been no news on the EC website. AMICE – the association of mutual insurers and insurance cooperatives in Europe – refers on its website to a draft regulation sent to inter-services consultation in April 2014.

23 Cf. European Parliament resolution of 17 February 2022 with recommendations to the Commission on a statute for European cross-border associations and non-profit organisations (2020/2026(INL)) https://www.europarl.europa.eu/doceo/document/TA-9-2022-0044_EN.pdf.

24 See below section 5.

result. This would put NPOs on an equal footing with companies (and cooperatives) and finally terminate an unreasonable disparity of treatment which has lasted for several years, to the benefit of both the European internal market (also because NPOs undertaking commercial activities, due to their non-profit orientation, may solve several market failures)[25] and European civil society at large (which may find in NPOs the legal forms suitable for carrying out activities of general interest).

In the absence of EU secondary legislation on NPOs, the CJEU has played a significant role in their favour. The CJEU has elaborated a non-discrimination principle under tax law, which may be usefully employed when equal treatment of NPOs relative to companies and cooperatives is more generally under discussion. More precisely, the CJEU has ruled that foreign public-benefit organisations (which are a particular type of NPOs, characterised by a specific social purpose and other distinguishing features related to the use of profits, permissible activities and governance requirements)[26] may not be discriminated against in favour of national public-benefit organisations to which the former are 'comparable'.[27] Therefore, for example, donations to foreign public-benefit

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25 Reference must be made here to the work of Prof. Henry Hansmann, beginning with 'The Role of Nonprofit Enterprise' (1980) *Yale Law Journal* 835.

26 Cf. A. Fici, *A statute for European cross-border associations and nonprofit organizations. Potential benefits in the current situation,* Study for the Policy Department for Citizens' Rights and Constitutional Affairs of the European Parliament, European Union, Brussels 2021.

27 The list of relevant judgments includes at least the following:

- *Laboratoires Fournier* (C-39/04): Article 49 TEC precludes legislation of a Member State which restricts the benefit of a tax credit for research only to research carried out in that Member State.
- *Centro di musicologia Walter Stauffer* (C-386/04): Article 73b of the EC Treaty, in conjunction with Article 73d of the EC Treaty, must be interpreted as precluding a Member State which exempts from corporation tax rental income received in its territory by charitable foundations which, in principle, have unlimited tax liability if they are established in that Member State, from refusing to grant the same exemption in respect of similar income to a charitable foundation established under private law solely on the ground that, as it is established in another Member State, that foundation has only limited tax liability in its territory.
- *Hein Persche* (C-318/07): Where a taxpayer claims, in a Member State, the deduction for tax purposes of gifts to bodies established and recognised as charitable in another Member State, such gifts come within the compass of the provisions of the EC Treaty relating to the free movement of capital, even if they are made in kind in the form of everyday consumer goods. Article 56 TEC precludes legislation of a Member State by virtue of which, as regards gifts made to bodies recognised as having charitable status, the benefit of a deduction for tax purposes is allowed only in respect of gifts made to bodies established in that Member State, without any possibility for the taxpayer to show that a gift made to a body established in another Member State satisfies the requirements imposed by that legislation for the grant of such a benefit.
- *Missionswerk* (C-25/10) Article 63 TFEU precludes legislation of a Member State which reserves application of succession duties at the reduced rate to non-profit-making bodies which have their centre of operations in that Member State or in the Member State in which, at the time of death, the deceased actually resided or had his place of work, or in which he had previously actually resided or had his place of work.

organisations must be granted, in a given jurisdiction, the same tax privileges as donations to national public-benefit organisations to the extent that foreign organisations are 'comparable' to national ones.

The current situation of NPO law at the EU level is certainly not favourable to social enterprises, which may be, and in some countries indeed are, mainly incorporated as associations and more generally belong to the non-profit sector or rather to the third sector or the social economy sector, of which the non-profit nature of the organisation is a distinguishing trait (albeit not the only one).

Due to the limited attention initially paid by EU institutions to NPOs and unconventional forms of business organisations, social enterprise law began to develop at the country level. Only later, as we will see, was the process reversed, so that European policies started influencing national legislation.

2. EMERGENCE AND DEVELOPMENT OF SOCIAL ENTERPRISE LAW IN EUROPE (1991–2011): THE SOCIAL COOPERATIVE MODEL

Italian Law of 8 November 1991, no. 381, on social cooperatives, is widely recognised as the cornerstone of the legislation on social enterprise in Europe.[28] Indeed, it has given rise to a wave of similar laws throughout Europe (and not only in Europe). In the EU alone, there are nine MSs that have specific laws on social cooperatives. Besides Italy, this group of MSs comprises Croatia,[29]

- *European Commission v Austria* (C-10/10): By authorising the deduction from tax of gifts to research and teaching institutions exclusively where those institutions are established in Austria, the Republic of Austria has failed to fulfil its obligations under Article 56 TEC.

The principle of non-discrimination of public-benefit organisations has been the focus of a staff working document accompanying the proposal for a recommendation on developing social economy framework conditions.

[28] In this sense, cf., among others, G. Galera and C. Borzaga, 'Social Enterprise. An International Overview of Its Conceptual Evolution and Legal Implementation' (2009) 5 *Social Enterprise Journal* 210; J. Defourny and M. Nyssens, 'The EMES Approach of Social Enterprise in a Comparative Perspective', EMES Working Papers Series no. 12/03 (2012), p. 3, https://emes.net/content/uploads/publications/EMES-WP-12-03_Defourny-Nyssens.pdf; M. Crama, 'Entreprises sociales. Comparaison des formes juridiques européennes, asiatiques et américaines', Think Tank européen Pour la Solidarité – PLS (2014), p. 17, https://www.pourlasolidarite.eu/sites/default/files/publications/files/2014_06_entreprises_sociales_comparaisons_juridiques.pdf. However, although it cannot be denied that Italian Law no. 381/1991 initiated a process that involved several EU MSs and, therefore, had a strong cultural impact even outside the borders of its application, it must be acknowledged that the UK's Industrial and Provident Societies Act (IPSA) of 1965 already provided for the establishment of a 'Community Benefit Society', that is, a society whose business 'is being, or is intended to be, conducted for the benefit of the community' (see section 1(2)(b) IPSA 1965, and now section 2(2)(a)(ii) of the Co-operative and Community Benefit Societies Act of 2014).

[29] Cf. Art. 66 on social cooperatives (*socijalne zadruga*), of Law of 11 March 2011, no. 764, on cooperatives.

the Czech Republic,[30] France,[31] Greece,[32] Hungary,[33] Poland,[34] Portugal[35] and Spain.[36] Social cooperatives are differently denominated and regulated in each jurisdiction. In some countries, only work integration social cooperatives are explicitly recognised by law.[37] In other MSs, such as Germany, although they are not explicitly provided for by law, cooperatives with the substantial features of social cooperatives may however be established.[38] 'Social purpose' cooperatives also exist in Belgium following the reform of organisational law in 2019, but they are legally recognised in a different manner, as will be described later.

Italian social cooperatives are a sub-type of cooperatives with a particular function (different from that of 'ordinary' cooperatives),[39] which is 'to pursue the general interest of the community in the human promotion and social integration of citizens', either through the management of socio-health or educational services (commonly referred to as social cooperatives of type A) or through the conduct of any business for the employment of disadvantaged persons (commonly referred to as social cooperatives of type B or work integration social cooperatives), who must be at least 30% of the workers of the social cooperative. Both types of social cooperatives may have volunteer members, but no more than 50% of total members. In type B social cooperatives, the disadvantaged persons must be members of the social cooperative if it is compatible with their subjective situation. Both types of social cooperatives may distribute profits to their members as dividends on the paid-up capital, but only up to a precise limit, which is 2.5 points more than the maximum interest of postal bonds. Italian social cooperatives enjoy several tax breaks and are

30 Cf. sections 758 et seq., on social cooperative (*sociální družstvo*), of Law no. 90/2012 on commercial companies and cooperatives.

31 Cf. Arts 19-*quinquies* et seq., on collective interest cooperative societies (*sociétés coopérative d'intérêt collectif*), of Law no. 47-1775 of 10 September 1947 on cooperatives.

32 Cf. Laws no. 2716/1999 and no. 4019/2011 on social cooperatives (*Κοινωνικοί Συνεταιρισμοί*).

33 Cf. Arts 8, 10(4), 51(4), 59(3), 60(1), 68(2)(e), on social cooperatives (*szociális szövetkezetnek*), of Law no. X-2006 on cooperatives.

34 Cf. Law of 27 April 2006 on social cooperatives (*spółdzielni' socjalnà*).

35 Cf. Law-Decree no. 7/98 of 15 January 1998 on social solidarity cooperatives (*cooperativas de solidariedade social*).

36 Cf. Art. 106, on social initiative cooperatives (*cooperativas de iniciativa social*), of Law no. 27/1999 of 16 July 1999 on cooperatives.

37 In Hungary and Poland.

38 Also thanks to the fact that German cooperatives may be established to pursue not only the economic interests but also the 'social and cultural interests' of their members (see Art. 1, para. 1 of the German cooperative law of 1889 as amended in 2006).

39 The 'mutual purpose' (as referred to in some jurisdictions) that in general characterises cooperatives is to act in the interest of the members as consumers/users, providers or workers of the cooperative enterprise. In contrast, social cooperatives pursue a 'non-mutual' purpose, because they act primarily in the general interest. A social cooperative's members, therefore, cooperate not to serve themselves (as is the case in ordinary cooperatives), but to serve the others.

recipients of various supporting measures provided by the state, by virtue of their status as third sector organisations.[40]

The drivers of this form of legislation on social enterprise can be identified with the specific characteristics of the cooperative legal form of business organisation. The Italian legislator, and the other national legislators following the Italian example, evidently considered the cooperative the most appropriate legal form to host social enterprises. Indeed, this was the legal form chosen in Italy by those who first set up social cooperatives even before the enactment of the relevant law of 1991.[41]

Firstly, cooperatives in general are recognised by the Italian Constitution, as well as by many other national constitutions in Europe, as enterprises with a social function, which justifies the legislator's constitutional obligation to support them.[42] Therefore, nothing appeared more appropriate for those who wanted to establish a business enterprise with explicit social purposes than to use this legal form to which the fundamental law of the state attributed a social function, providing for their promotion by the state.

Secondly, cooperatives have a governance structure that is immediately and straightforwardly consistent with the nature and purposes of a social enterprise. This is mainly due to the fact that, according to the applicable legislation, cooperatives are democratic organisations in which members of the assembly (the 'supreme body' of a cooperative) each hold one vote regardless of the amount of capital held. Member control and participation are additional principles normally enacted and promoted by the relevant cooperative laws (for example, by mandating the presence of at least a majority of members in a cooperative's board of directors). Other features, such as the 'variable capital', the 'variable number of members', and the 'open door', as well as the compulsory allocation of minimum percentages of profits to reserves that are indivisible among members, also contribute to this conclusion.

The above leads to a preference for the social enterprise in the cooperative form which is found even in countries, like Italy, that adhere to the model of

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40 After the 'great' reform of the third sector which took place in 2017 in Italy, social cooperatives are *de iure* social enterprises and therefore also third-sector organisations *ope legis*: see A. Fici, 'Social Enterprises and Social Cooperatives in the New Italian Legal Framework for Third Sector Organizations' in W. Tadjudje and I. Douvitsa (eds), *Perspectives on Cooperative Law. Festschrifts in Honour of Professor Hagen Henry*, Springer, Singapore 2022, pp. 77 ff.; and A. Fici, 'The New Italian Code of the Third Sector. Essence and Principles of a Historic Legislative Reform' in A. Fici (ed.), *The Law of Third Sector Organizations in Europe. Foundations, Trends and Prospects*, Springer/Giappichelli, Singapore/Turin, forthcoming.

41 Cf. *Le cooperative di solidarietà sociale*, Consorzio Gino Mattarelli, Forlì 1988.

42 The list of countries is very long: it includes Italy, Spain, Portugal and many others. See also, for further references, A. Fici, 'La función social de las cooperativas: notas de derecho comparado' (2015) 117 *Revesco* 77; I. Douvitsa, 'National Constitutions and Cooperatives: An Overview' in W. Tadjudje and I. Douvitsa (eds), *Perspectives on Cooperative Law. Festschrifts in Honour of Professor Hagen Henry*, Springer, Singapore 2022, pp. 57 ff.

legislation on social enterprise described below in section 4 of this report, and in which, therefore, social enterprises may assume different legal forms, not only the cooperative form. Indeed, in these jurisdictions social cooperatives receive better legal treatment (under tax law, for example) than social enterprises established in other legal forms.

The preference for the cooperative form of social enterprise is still more evident in the case of Belgium, which has moved from a model of social enterprise legislation based on the company form to one based on the cooperative form. In this MS, the law previously provided for a specific form of company with a social purpose or rather a specific label that could be attached to any form of company meeting the necessary legal requirements (*société à finalité sociale* or SFS). After the reform in 2019 that led to the adoption of the Code of Companies and Associations (which in reality also regulates other forms, including foundations), the SFS was repealed, and it is now provided that only cooperatives may be accredited as social enterprises. Cooperatives will qualify for this status if their 'main objective is not to provide their shareholders with an economic or social advantage, in order to satisfy their professional or private needs', but 'to generate a positive societal impact for the human being, the environment or the society' (Art. 8:5).[43]

As the analysis conducted thus far shows, 'social enterprises as social cooperatives' characterises the first generation of laws on social enterprise in the MSs of the EU. The Belgian and Italian examples show that MSs continue to express a positive attitude towards the cooperative form of social enterprise.

By way of contrast, in the first two decades of specific legislation on social enterprise in the EU, national legislators very rarely adopted social enterprise solutions focused on the company form. A 'social purpose' company, as a subtype or modified type of company with a particular function (not to distribute profits to shareholders or to maximise their value, but to pursue the general interest, the interest of the community, or, if one prefers, the 'social value'),[44] existed only in Belgium before the reform of 2019. Of course, before Brexit, the British 'community interest company' or CIC was the most prominent example of this type of legislation at the EU level, also in virtue of the huge success of this form of social enterprise,[45] even greater than that of the first form to

[43] Translation by the rapporteur. The French original text is as follows: their '*but principal ne consiste pas à procurer à ses actionnaires un avantage économique ou social, pour la satisfaction de leurs besoins professionnels ou privés*', but '*de générer un impact sociétal positif pour l'homme, l'environnement ou la société*'.

[44] Cf. J.S. Liptrap, 'The Social Enterprise Company in Europe: Policy, Theory and Isomorphism', Paper no. 5/2020, Legal Studies Research Paper Series, University of Cambridge, p. 15.

[45] 26,000 CICs as of 31 March 2022, according to the Regulator of Community Interest Companies' Annual Report 2021/2022. On this specific subject, cf. J.S. Liptrap, 'British social enterprise law' (2021) 21(2) *Journal of Corporate Law Studies* 595.

appear in Europe, namely the Italian social cooperative.[46] In the Netherlands, in 2021, the Ministry of Economic Affairs launched a proposal to introduce a limited liability company with a social objective, which attracted criticism from commentators questioning why other legal forms, including cooperatives, were to be excluded from the status.[47]

The limited use, if not non-use, of the company form for social enterprises by MSs in the first phase of the legislation on social enterprise was not only due to the ample diffusion of the cooperative model but also to the concerns surrounding this alternative. Companies are normally used for making and distributing profits to their shareholders and have a governance structure based on the capital, with the unlimited possibility for a single member, even profit-oriented, to control the enterprise. This increases the risk of a social enterprise adopting a company form deviating from its social purposes. In other words, the risks of abuses were considered to be greater with the company form than with others, notably the cooperative form.

This preoccupation emerges from the relevant legislation. In Belgium, where social enterprises in the form of companies were permitted before the reform of 2019, in a social purpose company (*société à finalité sociale*) no shareholder could have more than one-tenth of the votes in the shareholders' general meeting.[48] This line of thought permeates other legislation as well. In Italy, for example, companies with the status of social enterprises may not be formed by a single member who is an individual or a for-profit legal entity, nor may a social enterprise company be subject to the dominant influence (by way of majority shareholding or other means) of a for-profit legal entity.[49] In Slovenia, for-profit companies may establish social enterprises only in order to create new jobs for redundant workers, but not with the exclusive aim of transferring their businesses or assets to the social enterprise.[50]

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[46] The current number of active Italian social cooperatives ranges between 15,000 and 17,000.

[47] Cf. G. van der Sangen, 'The Legal Infrastructure of the Third Sector and the Social Economy in the Netherlands' in A. Fici (ed.), *The Law of Third Sector Organizations in Europe. Foundations, Trends and Prospects*, Springer/Giappichelli, Singapore/Turin, forthcoming.

[48] Cf. repealed Art. 661, para. 1, no. 4, of the Belgian Company Code. This maximum percentage was even lower (i.e. equal to one-twentieth) if the shareholder were a '*membre du personnel engagé par la société*' (staff member employed by the company). Cf. also Art. 23 of Slovenian Law no. 20/2011, which imposes on social enterprises the obligation to treat members equally in decision-making processes and, in particular, prescribes a single vote for all members, regardless of the particular law of the entity's incorporation.

[49] Cf. Art. 4, para. 3, Italian Legislative Decree no. 112/2017, as well as Art. 7, para. 2, of the same act. Even stricter is the solution found in Spanish Law no. 44/2007, given that only not-for-profit entities, associations and foundations may promote the establishment of integration enterprises (see Arts 5, lit. a) and 6).

[50] Cf. Art. 9, para. 1, of Slovenian Law no. 20/2011. In addition, it is worth mentioning that the second paragraph of the same article of this national law suggests that an entity may not acquire the social enterprise qualification if it is subject to the dominant influence of one or more for-profit companies.

However, it is worth mentioning that in some countries, like Germany and Ireland, the company form is widely used to obtain public-benefit or charitable status.[51] Although not formally recognised as such, these public-benefit non-profit companies fit neatly into the concept of social enterprise. They are de facto social enterprises, even though their qualification as public benefit organisations prevents them from distributing any profit to their shareholders.

Indeed, with a proper regulation that seeks to reduce the risk of abuse and mandates and safeguards the primacy of the social purpose (which may imply specific rules on the nature and composition of shareholding, on the use of profits and on governance), even the company form may therefore be usefully employed to shape a social enterprise.

The social enterprise in the company form may also have some comparative advantages over cooperative alternatives. Among other things, a social enterprise taking a company form may attract more risk capital and finance when necessary for certain business operations, may be used to arrange relationships for which the democratic structure of a cooperative would be unfit, and may be employed by other NPOs to conduct a commercial activity separately. Such functions might also be served by other legal types of entities, including foundations. The specificities of this legal form of organisation may serve for structuring a business in a different way.[52]

These are some of the main reasons why, after two decades dominated by the cooperative model of social enterprise, a change in the approach to the legislation on social enterprise took place, favoured by the European Commission's pluralistic and more substantial approach to the topic.

3. SOCIAL ENTERPRISES IN THE COMMISSION'S 'SOCIAL BUSINESS INITIATIVE' OF 2011

As stated, social enterprises are not specifically regulated at the EU level, but they have been envisaged in policy documents. The most important of these is the European Commission's Communication no. 682 of 25 October 2011 entitled 'Social Business Initiative Creating a favourable climate for social enterprises, key stakeholders in the social economy and innovation' (SBI).[53] Based on the assumption that social enterprises generate several positive socio-

[51] In Germany, according to sections 51 et seq. of the Tax Code; in Ireland, according to the Charities Act 2009. The relationship between social enterprise and public-benefit organisations is a topic that would be very useful to explore. It would contribute to a better understanding of both organisational categories.

[52] Cf. for example H. Hansmann and S. Thomsen, 'The Governance of Foundation-owned Firms' (2021) 13(1) *Journal of Legal Analysis* 172.

[53] https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0682:FIN:EN:PDF.

economic effects, the SBI contemplated a series of key actions in their favour,[54] some of them related to 'improving the legal environment' for social enterprises. More precisely, key action no. 9 of the SBI included: launching a proposal for simplification of the existing regulation on the European Cooperative Society (in order to make it more independent from national laws and easier for its potential adoption by social cooperatives); making a proposal for the introduction of a European Foundation Statute (along the same lines as those on the European Company and the European Cooperative Society); and conducting a study on the situation of mutual societies in all MSs.[55]

None of those specific actions was eventually taken, but the Commission's Communication on the SBI, by providing a definition of social enterprise, has however significantly promoted and influenced the legislation on social enterprises in the EU MSs.[56] Following its promulgation, several MSs adopted specific laws on social enterprises in which the social enterprise was regulated according to the definition it contained. This has also led to the development of a particular model of legislation on social enterprise, namely that in which social enterprise is not conceived of as a particular type (or sub-type) of legal entity, i.e. as a specific legal form of an entity's incorporation, but rather as a particular legal 'status' (or 'qualification', 'accreditation', 'label', etc.) that entities meeting certain requirements may acquire, regardless of their legal form of organisation (association, foundation, company or cooperative).

The SBI Communication was strongly influenced by the EMES Research Network's approach to social enterprises. EMES has adopted the position that social enterprises should not be precisely defined, but identified through substantial criteria (or indicators) related to three different dimensions: the entrepreneurial dimension (social enterprises are at least prevalently engaged in commercial activities), the social dimension (social enterprises prioritise a social purpose), and the organisational dimension (social enterprises have a democratic or inclusive governance, which ensure the involvement of their different stakeholders).[57] Following this theoretical approach, and also with the

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54 Cf. S. Haarich, S. Holstein et al., *Impact of the European Commission's Social Business Initiative (SBI) and its Follow-up Actions*, Study for DG Employment, Social Affairs and Inclusion, European Commission, European Union, Luxembourg 2021.

55 Curiously, no specific action on the regulation of social enterprises at the EU level was envisaged in the SBI. It is also curious that, in this regard, the SBI did not refer to associations and the European Statute thereof.

56 In fact, not only the definition per se, but also subsequent actions based on that, such as the mapping study on social enterprise in Europe, contributed to this result. Cf. European Commission, *Social enterprises and their ecosystems in Europe. Comparative synthesis report*, Publications Office of the European Union, Luxembourg 2020.

57 More precisely, these indicators are: (1) economic and entrepreneurial dimensions of social enterprises, which comprises: (a) a continuous activity of producing goods and/or selling services; (b) a significant level of economic risk; (c) a minimum amount of paid work; (2) social dimensions of social enterprises, which comprises: (d) an explicit aim to benefit the

aim of respecting national diversity, the SBI Communication defined a social enterprise as:

> an operator in the social economy whose main objective is to have a social impact rather than make a profit for their owners or shareholders. It operates by providing goods and services for the market in an entrepreneurial and innovative fashion and uses its profits primarily to achieve social objectives. It is managed in an open and responsible manner and, in particular, involve employees, consumers and stakeholders affected by its commercial activities.[58]

It clearly emerges from this definition that social enterprise is not considered here as a specific legal form but as a general concept.

The SBI's operational definition was subsequently employed by the EU legislator in regulations providing for specific funding. In the 'EaSI' Regulation No. 1296/2013,[59] in Article 2(1), a social enterprise was understood (for the purposes of the same Regulation) as:

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community; (e) an initiative launched by a group of citizens or civil society organisations; (f) a limited profit distribution; (3) participatory governance of social enterprises, which comprises: (g) a high degree of autonomy; (h) a decision-making power not based on capital ownership; (i) a participatory nature, which involves various parties affected by the activity. Cf. J. Defourny and M. Nyssens, 'The EMES Approach of Social Enterprise in a Comparative Perspective', EMES Working Papers Series no. 12/03 (2012). EMES is a non-profit association incorporated under Belgian law, composed of research centres and individual researchers. Its conception of social enterprise has been reshaped over time. Cf., initially, J. Defourny, 'From Third Sector to Social Enterprise' in C. Borzaga and J. Defourny (eds), *The Emergence of Social Enterprise*, Routledge, London/New York 2001, pp. 1 ff.

58 Cf. COM(2011) 682 final, of 25 October 2011, p. 2. The EC goes on to specify the types of business covered by the term 'social enterprise', namely:

'– those for which the social or societal objective of the common good is the reason for the commercial activity, often in the form of a high level of social innovation,
– those where profits are mainly reinvested with a view to achieving this social objective,
– and where the method of organisation or ownership system reflects their mission, using democratic or participatory principles or focusing on social justice.

Thus:

– businesses providing social services and/or goods and services to vulnerable persons (access to housing, health care, assistance for elderly or disabled persons, inclusion of vulnerable groups, child care, access to employment and training, dependency management, etc.); and/or
– businesses with a method of production of goods or services with a social objective (social and professional integration via access to employment for people disadvantaged in particular by insufficient qualifications or social or professional problems leading to exclusion and marginalisation) but whose activity may be outside the realm of the provision of social goods or services'.

59 'EaSI' stands for 'European Union Programme for Employment and Social Innovation'. The programme ran from 1 January 2014 to 31 December 2020, with the aim 'to contribute to the implementation of Europe 2020, including its headline targets, Integrated Guidelines and flagship initiatives, by providing financial support for the Union's objectives in terms of

an undertaking, regardless of its legal form, which:

(a) in accordance with its Articles of Association, Statutes or with any other legal document by which it is established, has as its primary objective the achievement of measurable, positive social impacts rather than generating profit for its owners, members and shareholders, and which:
  (i) provides services or goods which generate a social return and/or
  (ii) employs a method of production of goods or services that embodies its social objective;
(b) uses its profits first and foremost to achieve its primary objective and has predefined procedures and rules covering any distribution of profits to shareholders and owners that ensure that such distribution does not undermine the primary objective; and
(c) is managed in an entrepreneurial, accountable and transparent way, in particular by involving workers, customers and stakeholders affected by its business activities.

A similar notion of social enterprise appeared in Article 3(1)(d) of the 'EuSEF' Regulation (EU) No. 346/2013,[60] namely, social enterprise is an undertaking that:

(ii) has the achievement of measurable, positive social impacts as its primary objective in accordance with its articles of association, statutes or any other rules or instruments of incorporation establishing the business, where the undertaking: – provides services or goods to vulnerable or marginalised, disadvantaged or excluded persons, – employs a method of production of goods or services that embodies its social objective, or – provides financial support exclusively to social undertakings as defined in the first two indents;
(iii) uses its profits primarily to achieve its primary social objective in accordance with its articles of association, statutes or any other rules or instruments of incorporation establishing the business and with the predefined procedures and rules therein, which determine the circumstances in which profits are distributed to shareholders and owners to ensure that any such distribution of profits does not undermine its primary objective;
(iv) is managed in an accountable and transparent way, in particular by involving workers, customers and stakeholders affected by its business activities.

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promoting a high level of quality and sustainable employment, guaranteeing adequate and decent social protection, combating social exclusion and poverty and improving working conditions' (Art. 1 Reg. 1296/2013).

60 'EuSEF' stands for 'European social entrepreneurship funds'. The Regulation 'lays down uniform requirements and conditions for managers of collective investment undertakings that wish to use the designation "EuSEF" in relation to the marketing of qualifying social entrepreneurship funds in the Union, thereby contributing to the smooth functioning of the internal market. It also lays down uniform rules for the marketing of qualifying social entrepreneurship funds to eligible investors across the Union, for the portfolio composition of qualifying social entrepreneurship funds, for the eligible investment instruments and techniques to be used by qualifying social entrepreneurship funds as well as for the organisation, conduct and transparency of managers that market qualifying social entrepreneurship funds across the Union' (Art. 1 Reg. 346/2013).

These Regulations were later replaced by Regulation No. 1057/2021 establishing the European Social Fund Plus (ESF+),[61] where the definition of a social enterprise is found in Article 2(1)(13), which reads:

> 'Social enterprise' means an undertaking, regardless of its legal form, including social economy enterprises, or a natural person which:
>
> (a) in accordance with its articles of association, statutes or with any other legal document that may result in liability under the rules of the Member State where a social enterprise is located, has the achievement of measurable, positive social impacts, which may include environmental impacts, as its primary social objective rather than the generation of profit for other purposes, and which provides services or goods that generate a social return or employs methods of production of goods or services that embody social objectives;
> (b) uses its profits first and foremost to achieve its primary social objective, and has predefined procedures and rules that ensure that the distribution of profits does not undermine the primary social objective;
> (c) is managed in an entrepreneurial, participatory, accountable and transparent manner, in particular by involving workers, customers and stakeholders on whom its business activities have an impact.

This new definition is substantially in line with the one previously provided by the repealed regulations, except for the (surprising) reference to 'natural persons'[62] as possible social entrepreneurs, and to 'social economy enterprises', which is a more general category of organisations that ultimately have become the new focus of EU policies.

4. THE IMPACT OF THE SBI COMMUNICATION ON NATIONAL LEGISLATION (2011–2022): SOCIAL ENTERPRISE AS A LEGAL STATUS

The SBI and some actions based on it, including the mapping study on 'Social enterprises and their ecosystems in Europe' concluded in 2020,[63] triggered a

[61] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R1057&from=IT.

[62] Only in a few jurisdictions of the EU do legislators allow even an individual entrepreneur to acquire the qualification of social enterprise. This happens in Finland, where Law no. 1351/2003 allows the registration as social enterprises of all traders, including individuals, registered under section 3 of Law no. 129/1979, and in Slovakia, where Art. 50b, para. 1, of Law no. 5/2004 refers, in defining a social enterprise, to both legal and physical persons. The same occurs in Slovakian Law no. 112/2018, with regard to the definition of the subjects of the social economy, among which are social enterprises.

[63] Cf. European Commission, *Social enterprises and their ecosystems in Europe. Comparative synthesis report*, Publications Office of the European Union, Luxembourg 2020, https://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=8274.

new wave of national social enterprise laws in Europe. Several MSs introduced dedicated laws on social enterprise into their national legal systems inspired by the concept of social enterprise adopted by the European Commission in the SBI. This trend is ongoing.[64] These second-generation laws[65] were even adopted by MSs, like France, Italy and Slovakia, which already had social enterprise laws based on the social cooperative model previously examined in this report. Thus, now there are some MSs that have more than one law addressing social enterprise. This evolution is also influencing the debate on social enterprise in those MSs, like Ireland and the Netherlands, which continue to lack specific legislation on this subject.[66]

The main characteristic of second-generation national laws is that they consider the social enterprise as a legal status based on some requirements related to the purpose pursued (a social purpose, a general interest or public benefit purpose, etc.), the activity carried out (an enterprise of social utility or of general interest, as well the work integration of disadvantaged people) and the governance (which must be democratic or inclusive) and transparency of the organisation (including the obligation to draft and publish a social report). The legal form of incorporation of the entity is in principle not relevant for the acquisition of the status, so that these laws allow associations, foundations, companies and cooperatives all to qualify as 'social enterprises'. The exclusive social mission does not prevent social enterprises from being able to distribute part of their profits to their shareholders (as is the case in Belgium, Denmark and Italy, among others), although in some jurisdictions, like Poland, a full prohibition regarding profit distribution exists.

Furthermore, an organisation does not incorporate as a social enterprise, but acquires this status by its own decision, if and when it can meet the necessary legal requirements. Accordingly, an organisation may lose the status of social enterprise while remaining legally organised, if it chooses to do so or fails to maintain the legal requirements for social enterprise qualification. The legal status is supervised, and enforcement ensured, by public authorities, which de-qualify an entity when they find irregularities and these irregularities are not resolved. Upon de-qualification, an organisation has to devolve disinterestedly its assets, or rather either all its assets or only those accumulated after registration, depending on the national law.

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64 See recently Cypriot Law on social enterprise of 2020 and Maltese Social Enterprise Act no. IX of 2022. The last MS that has followed this model of legislation is Poland, where the status of social enterprise is now provided for in the law of social economy of August 2022.

65 Yet, in some MSs, like Finland and Italy, laws such those described in the main text were adopted before the SBI Communication.

66 Like Ireland: cf. T. Lalor and G. Doyle, *Research on Legal Forms for Social Enterprises*, Government of Ireland, Dublin 2021.

The impact of this status-based model of legislation on national laws has been so strong that in some countries it was applied even to a specific legal form. Rather than providing for the establishment of a social cooperative as a sub-type of cooperative and of a social purpose company as a sub-type of company, Belgium and Latvia introduced an accreditation system limited to single type of entity. In Belgium, only a cooperative may qualify as a social enterprise.[67] In Latvia, only a limited liability company may so qualify.[68] There are also MSs, such as Luxembourg, that limit the status to some legal forms.[69] But the majority of MSs, as noted earlier, make the social enterprise legal status or qualification available to any organisation regardless of the legal form.[70]

This model of legislation on social enterprise has been widely praised. It has been recommended by legal scholars[71] and was bolstered by the European Parliament's Resolution of 5 July 2018.[72] This document called on the European Commission to introduce at Union level a 'European Social Economy Label' to be awarded to enterprises complying with certain criteria but incorporated in any form available in the legislation of the MSs and the EU.[73]

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67 Cf. Art. 8:5 of the Code of Companies and Associations of 2019.

68 Cf. Social Enterprise Law of 12 October 2017.

69 Cf. Law of 12 December 2016 on social impact societies. Along the same lines, the qualification as an 'integration enterprise' according to Spanish Law no. 44/2007 is limited to those enterprises with the legal form of a commercial company (*sociedad mercantil*) or a cooperative (*sociedad cooperative*) (Art. 4, para. 1).

70 As clearly stated in Art. 1, para. 1, of Italian Legislative Decree no. 112/2017 on social enterprise, which reads: 'all private entities, including those established in the forms of the fifth Book of the Civil Code, may acquire the qualification of social enterprise'. The legal forms of the fifth Book are companies and cooperatives. See also Bulgarian Law no. 240/2018 on social and solidarity enterprises; Danish Law no. 711 of 25 June 2014 on registered social enterprises; Finnish Law no. 711 of 25 June 2014 on registered social enterprises; Art. L3332-17-1 of the French Labour Code on the solidarity enterprise of social utility; Greek Law no. 4430/2016 on the social and solidarity economy; Lithuanian Law no. IX-2251 of 1 June 2004; Arts 8 et seq. of Romanian Law no. 219/2015 of 23 July 2015 on the social economy; Slovakian Law no. 112/2018 of 13 March 2018 on social economy and social enterprises; Slovenian Law no. 20 of 2011 on social entrepreneurship; Spanish Law no. 44/2007 of 13 December 2007, on integration enterprises, and Arts. 43 et seq. of Spanish Royal Legislative Decree no. 1/2013 of 29 November 2013, on special employment centres.

71 Cf., in particular, K.E. Sørensen and M. Neville, 'Social Enterprises: How Should Company Law Balance Flexibility and Credibility?' (2014) 15(2) *European Business Organization Law Review* 267; and more recently T. Lavišius et al., 'Social entrepreneurship in the Baltic and Nordic countries. Would the variety of existing legal forms do more for the impact on sustainable development?' (2020) 8(1) *Entrepreneurship and Sustainability Issues* 276.

72 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018IP0317&rid=4. This resolution was based on the final recommendations provided in A. Fici, *A European Statute for Social and Solidarity-Based Enterprise*, European Union, Brussels 2017.

73 Cf. C. Vargas Vasserot, 'Las empresas sociales. Regulación en derecho comparado y propuestas *de lege ferenda* para España' (2021) 150 *Revista del Ministerio de trabajo y economía social* 63, and A. Liptrap, 'Social Enterprise Company in EU Organisational Law?' (2021) 23 *Cambridge Yearbook of European Legal Studies* 193.

A number of advantages may be attributed to this status-based model of social enterprise legislation in comparison to models based on specific legal forms. The first advantage is practical. A status-based model permits existing organisations to become social enterprises without having to reincorporate using alternative forms and permits existing social enterprise to shed this qualification without having to dissolve, convert or reincorporate. By reducing the cost of classification as a social enterprise, the status-based model thereby facilitates access to (and exit from) the social enterprise domain.[74]

Rather than imposing a specific legal form for said purpose, the status-based model of social enterprise legislation[75] also promotes pluralism of organisational forms, through a multiplication of the options available to those who wish to create a social enterprise. The most suitable legal form for running a social enterprise may vary according to the circumstances and the nature of a particular business or the legal and cultural background found in a given country. Permitting entities adopting various organisational forms to access the social enterprise status recognises these specific needs and contexts. This openness particularly favours associations and foundations, whose capacity to run a business has not been addressed by many MSs or at the EU level. It also legitimates the social enterprises taking company forms, which, as explained above, may present particular advantages under some circumstances. Of equal importance, this model of legislation allows legislators to organise and combine the legal requirements for qualification in different ways depending on the legal form of incorporation of the social enterprise, thereby making the qualification as social enterprise more flexible.[76]

A status-based model can resolve the dilemma between the company form and the cooperative form, which the other model of social enterprise legislation inevitably poses,[77] while still imposing consistent and exacting demands. Imposing robust requirements on all social enterprises (or rather, on all organisations that wish to qualify as social enterprises), independently from their legal form of incorporation, ensures that all social enterprises share a

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74 Cf. K.E. Sørensen and M. Neville, 'Social Enterprises: How Should Company Law Balance Flexibility and Credibility?' (2014) 15(2) *European Business Organization Law Review* 267, 284.

75 In F. Cafaggi and P. Iamiceli, 'New Frontiers in the Legal Structure and Legislation of Social Enterprises in Europe: A Comparative Analysis' in A. Noya (ed.), *The Changing Boundaries of Social Enterprises*, OECD, Paris 2009, this model of legislation is referred to as the 'open-form' model.

76 For example, the democratic and participatory character of a social enterprise in the cooperative form permits relaxation of the profit non-distribution requirement, while the non-democratic character of a social enterprise in the company form imposes rigidity as regards profit distribution, as well as specific measures to ensure stakeholders' involvement.

77 This does not mean, however, that the social enterprise in the company form does not also require specific rules under this model of legislation, in order to make it (more) consistent with a social enterprise's identity, as we have clarified above in the main text.

common identity.[78] Finally, under this model of legislation, imposing sanctions may be simpler for the public authority in charge of the enforcement of the social enterprise qualification (and less onerous for the same organisation). In circumstances of non-compliance, it can suffice to revoke the qualification (or threaten to revoke it if irregularities are not removed), rather than requiring the legal entity to dissolve or convert to another form.[79]

5. CONCLUSIONS: THE COMMISSION'S ACTION PLAN ON THE SOCIAL ECONOMY AS THE NEW FRONTIER

'Unconventional' forms of enterprise, such as social enterprises, and more generally NPOs, including associations, foundations and mutual societies, have not attracted the EU legislator's attention for many years. The focus of European integration was on the internal market and those that were seen as its 'traditional' actors, namely for-profit companies. European directives and regulations favoured the development of an enabling legal framework limited to companies (and cooperatives), which includes optional European forms, such as the European Company (and the European Cooperative Society), and rules allowing and simplifying the cross-border activity and mobility of national companies. In contrast, NPOs could not count on equivalent European forms, nor on secondary legislation promoting their cross-border activity and mobility across the EU. In this last regard, only some important CJEU judgments came in favour of NPOs, trying to resolve national tax law barriers to their cross-border operations.

Only since the crisis of 2008, when complements to the 'welfare state' needed to be identified, has the interest of EU institutions in 'alternative' models of enterprise, not based on profit maximisation but on other values, increased. The SBI Communication was the result of this new attitude. Unfortunately, however, the decennial programme foreseen in the SBI has not led, at the Union level, to any change of the legal environment regarding social enterprises (apart from the regulations providing for funding measures). Positive effects were produced only at the national level, as many MSs, encouraged by the Commission's actions, adopted specific laws on social enterprises. Inspired by the concept of social enterprise found in the SBI, these national laws conceived

[78] Moreover, nothing prevents legislators from providing different treatment for social enterprises established in different forms, for example to favour, under tax law or policy measures, a social enterprise in the cooperative form, in consideration of its democratic nature as compared to a social enterprise in the company form.

[79] Cf. K.E. Sørensen and M. Neville, 'Social Enterprises: How Should Company Law Balance Flexibility and Credibility?' (2014) 15(2) *European Business Organization Law Review* 267, 284 f.

of 'social enterprise' as a legal status open to entities established in different legal forms and meeting the necessary requirements for qualification. This model of legislation offers many potential benefits, as previously highlighted in this report.

Nevertheless, at the Union level, the action of EU institutions has begun to re-emerge, albeit in a somewhat changed direction. In December 2021, the European Commission launched a new decennial programme, which this time does not directly address social enterprises but instead the 'social economy'. The EC Communication regarding the 'Action Plan on the Social Economy' now has a larger scope and a more comprehensive and ambitious objective than the SBI, aiming to build a different economy that works for people. After having highlighted the benefits of the social economy (in terms of quality job creation, contribution to the green and digital transitions, complementing welfare state systems, implementing the United Nations' Sustainable Development Goals at the Union and global levels, etc.), the Communication identifies its addressees, namely 'social economy entities'.[80] According to the Commission, these entities share some common principles and features, which are:

- the primacy of people as well as social and/or environmental purpose over profit,
- the reinvestment of most of the profits and surpluses to carry out activities in the interest of members/users ('collective interest') or society at large ('general interest').
- and democratic and/ or participatory governance.

The Commission goes on to explain that, 'traditionally, the term social economy refers to four main types of entities providing goods and services to their members or society at large: cooperatives, mutual benefit societies, associations (including charities), and foundations. They are private entities, independent of public authorities and with specific legal forms'.

The Commission does mention 'social enterprises' as part of the social economy, and explains that:

> social enterprises operate by providing goods and services for the market in an entrepreneurial and often innovative fashion, having social and/or environmental objectives as the reason for their commercial activity. Profits are mainly reinvested with a view to achieving their societal objective. Their method of organisation and ownership also follow democratic or participatory principles or focus on social progress. Social enterprises adopt a variety of legal forms depending on the national context.

80 The influence of national legislation of some MSs providing for the category of social economy entities is evident: cf., above all, Spanish Law no. 5/2011; Portuguese Law no. 30/2013; and French Law no. 2014-856. See also A. Fici (ed.), *The Law of Third Sector Organizations in Europe. Foundations, Trends and Prospects*, Springer/Giappichelli, Singapore/Turin, forthcoming.

The Action Plan of 2021 aspires to create the right framework, including a legal one, for the social economy to thrive, to open up opportunities for social economy entities to develop, and to enhance recognition of the social economy and its potential. Many actions are foreseen to fulfil these general objectives. Unfortunately, as regards the legal framework of social economic entities, the Action Plan does not identify the creation of EU legal forms or statuses or harmonisation or uniformisation measures necessary to ensure the development of social enterprises at the Union level as action items. The only action foreseen is a Recommendation to MSs to better adapt policy and legal frameworks to the needs of social economy entities. A proposal for such a Recommendation was adopted by the European Commission in June 2023 and is about to be approved.

The Action Plan makes references to a forthcoming EP initiative on associations and NPOs. Indeed, as already mentioned in this report, in February 2022, after the adoption of the Action Plan by the EC, the EP finalised a resolution with recommendations to the Commission about the adoption of a European Regulation establishing the European Association (along the same lines as the existing EU legal forms of the European Company and the European Cooperative Society, previously mentioned in this report) and of a European Directive on common minimum standards for NPOs. At the time of writing, the European Commission is evaluating whether and how to react to the EP's request.

The choice of the Commission to shift attention from social enterprises to social economy entities presents the classical risk of all very large and ambitious projects: to remain 'on paper', without producing any concrete result. Indeed, whilst the difficulties in treating the legal aspects of social enterprises at the Union level were already great, it will be yet more complex to deal with the even wider and more diversified universe of 'social economy entities'. There is already complexity regarding a preliminary issue, namely the identification of these organisations. Not surprisingly, in the Action Plan of 2021, the Commission fluctuates between various identification criteria. It refers both to precise legal forms (associations, foundations, cooperatives, etc.) and to legal statuses identified on the basis of substantive requirements that the entities must meet (primacy of people, reinvestment of profits, etc.). How to combine the two criteria remains to be understood.

The hope is that this enlarged focus on the social economy will not disorient the Commission and that the Commission will be able to resume the path interrupted several times and put forward concrete proposals to address social enterprises. These include the introduction of EU legal forms for NPOs (the European Association, the European Foundation and the European Mutual Society), as well as of an EU legal label for social enterprises or for public-benefit organisations more generally.

B CORPORATION, BENEFIT CORPORATION AND NEOLIBERAL GREENWASH

The Private American Branding Attempt to Globally Capture the Definition and Regulation of 'Good' Business

Carol Liao*

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In the 2008 article '"Implicit" and "Explicit" CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility', Dirk Matten and Jeremy Moon observed a curious phenomenon. While many US corporations were publicly proclaiming their allegiance to corporate social responsibility (CSR), this was not so common elsewhere.[1] Did that mean non-US corporations were neglecting their social responsibilities? Actually, no. The answer, they found, rested with the different legal frameworks across national business systems.[2] A lack of strong infrastructure meant US corporations felt

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1 D. Matten and J. Moon, '"Implicit" and "Explicit" CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility' (2008) 33(2) *Academy of Management Review* 404, 404.

2 Ibid., p. 407.

compelled to engage in deliberate and voluntary expressions of 'explicit' CSR, which was not the case in countries that recognised the role of corporations within wider formal and informal institutions.[3] Responsible business practices were 'implicit' in these non-US corporations' day-to-day business activities.

Explicit CSR, therefore, was a response to US state deregulation, corporate discretion, and values of individualism and liberalism.[4] For example, basic health care benefits in many American CSR policies would be inconceivable in countries where governments already provide for such things. Implicit CSR, on the other hand, reflected principles of collectivism and solidarity, consisting of 'values, norms, and rules that result in (mandatory and customary) requirements for corporations to address stakeholder issues … in collective rather than individual terms.'[5] Despite these differences, Matten and Moon noted the growing trend toward explicit CSR in Europe and other non-US countries due to coercive and imitative pressures for non-US corporations to publicly declare their CSR practices.[6] On an institutional level, they advised corporations to 'take into account how different national backgrounds influence their CSR agenda … [or] ignore this at their peril.'[7] This advice remains true for governments in developing laws and policies designed to grow and foster CSR-type practices from corporations.

Matten and Moon's comparative analysis of implicit and explicit CSR is a helpful lens in understanding the American B Corporation brand, which over the years has sought to capture international market share in defining discretionary 'business for good' standards from private industry, and reposition itself as an international brand despite its American roots. The explicit nature of branding itself and the voluntariness in choosing such standards resonates as a profound form of explicit CSR. Specifically, the non-profit organisation which created the private B Corporation certification, B Lab, engages in intensive international lobbying to push other nation state governments to adopt alternative corporate legal vehicles for so-called 'benefit' and 'public benefit' purposes.[8] The seemingly innocuous adoption of an alternative corporate legal structure, as opposed to reforming existing dominant structures, leads to preferentially explicit CSR

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3 Ibid., p. 410.

4 Ibid.

5 Ibid., p. 409.

6 Ibid., p. 411. Matten and Moon observed in 2008 how corporations around the world were beginning to adopt the language and practice of CSR – particularly in Europe, but also in Africa, Australasia, South America, and South, East and Southeast Asia (p. 404). Canada has been no exception.

7 Ibid., p. 419.

8 Some states such as Delaware and Colorado use the title 'public benefit corporation'. For Delaware's 'public benefit corporation' regulations, see: Del. Code tit. 8, §1-362 (2022). For Colorado's, see: Colo. Rev. Stat. §7-101-503 (2022).

environments in jurisdictions where implicit CSR may have been the original premise. The actions exhibited by B Lab arguably echo the coercive and imitative practices identified by Matten and Moon in their observations on the explicit CSR phenomenon. Such actions may also negatively alter the potential for future implicit CSR integration within the legal frameworks of national business systems, at a time when such integration is urgently needed amidst our climate crisis.[9]

Much has been said about the development of social enterprise law in the past few decades.[10] This report does not delve into the definition of social enterprise law,[11] nor its intricacies, which I have done elsewhere.[12] Instead, I seek to focus specifically on this troublesome development of B Lab lobbying other nation state governments to enact the supposed legal reiteration of its B Corporation certification – the benefit corporation. B Corporation and the benefit corporation are often labelled as part – if not the majority – of what constitutes social enterprise law by American scholars, and recently international scholars have tended to follow suit.[13] But the heightened attempts by B Corporation to transplant benefit corporation legislation into other countries,[14] with little

[9] The Intergovernmental Panel on Climate Change, '2018: Summary for Policymakers' (2018) https://www.ipcc.ch/sr15/; The Intergovernmental Panel on Climate Change, 'Sixth Assessment Report' (2022) https://www.ipcc.ch/assessment-report/ar6/.

[10] See e.g. D.B. Reiser and S.A. Dean, *Social Enterprise Law: Trust, Public Benefit, and the Capital Markets*, Oxford University Press 2017.

[11] While the founders have insisted B Corporation is separate and apart from social enterprise law, their preference to be classified differently does not abdicate responsibility for causing disruptions within that space, nor limit scholars from disagreeing. But that is not the debate I engage with here.

[12] See C. Liao, 'Early Lessons in Social Enterprise Law' in B. Means and J. Yockey (eds), *The Cambridge Handbook for Social Enterprise Law*, Cambridge University Press 2018, pp. 101–22.

[13] For example, *The Cambridge Handbook for Social Enterprise Law* focuses mainly on initiatives in the US and the benefit corporation in particular, with C. Liao and N. Boeger as the only non-US contributing authors: see B. Means and J. Yockey (eds), *The Cambridge Handbook for Social Enterprise Law*, Cambridge University Press 2018. The benefit corporation was named as the 'current front runner' in social enterprise law in D.B. Reiser and S.A. Dean, 'Chapter 3: Evaluating the Current Menu of Legal Forms' in *Social Enterprise Law: Trust, Public Benefit, and the Capital Markets*, Oxford University Press 2017, pp. 52–75; but see more recently H. Peter, C.V. Vasserot and J.A. Silva (eds), *The International Handbook of Social Enterprise Law: Benefit Corporations and Other Purpose-Driven Companies*, 1st ed., Springer 2022. For a global overview over 40 social enterprise law initiatives identified across 30 countries beyond the benefit corporation, see C. Liao, E. Tawfik and P. Teichreb, 'The Global Social Enterprise Law Lawmaking Phenomenon: State Initiatives on Purpose, Capital and Taxation' (2019) 36 *Windsor Yearbook of Social Justice* 84.

[14] B Corporation is lobbying Canada, Argentina and Chile (with legislation already enacted in Italy, Colombia, Ecuador and Puerto Rico): see B Lab, 'International Legislation', https://benefitcorp.net/international-legislation. See also C. Liao, 'BC MLAs Should Recognize "Benefit Corporation" Is an American Branding Exercise', *Globe and Mail* (21.10.2018).

sensitivity toward existing legal ecosystems within those nations,[15] has led to perverse results which have curtailed broader efforts for corporate legal reform in some jurisdictions.

This report begins in section 1 with a brief overview of the B Corporation and benefit corporation, particularly their 'legal' features. Then in section 2, using the case study of the Canadian benefit company[16] legislation which passed in the British Columbia legislature in May 2019, I note how the legislation attempts to offload regulatory oversight onto private interests, and has circumvented local efforts for change in favour of watered-down and private Americanised interpretations of what constitutes 'good' business. I conclude with a comment on the harmful legacy of neoliberal greenwashing in the wake of the B Corporation/ benefit corporation movement, and how legal reform efforts should be put to more transformative use in this climate emergency and age of the Anthropocene.

1. BRIEF OVERVIEW OF B CORPORATION AND THE BENEFIT CORPORATION

The Philadelphia-based non-profit organisation B Lab, founded by three white[17] wealthy businessmen, created the B Corporation certification in 2006.[18] In order to become a privately certified B Corporation, a company takes a 'B Impact Assessment,' which surveys issues relating to governance, workers, customers, community and the environment.[19] A corporation is 'certified' by B Lab once an acceptable score is obtained under its rating system (80 out of 200), and the company is required to submit supporting documents for a portion of the answers.[20] B Lab relies on the assessment and a separate auditing system

15 See e.g. A. Bartolacelli, 'The Unsuccessful Pursuit for Sustainability in Italian Business Law' in B. Sjåfjell and C. Bruner (eds), *The Cambridge Handbook for Corporate Law, Corporate Governance and Sustainability*, Cambridge University Press 2019, pp. 290–303. Italy has a very strong cooperative and social cooperative sector, see P. Gosling, 'Social Co-operatives in Italy: Lessons for the UK', Social Enterprise London (2011) http://socialeconomyaz.org/wp-content/uploads/2011/06/SocialCooperativesInItaly.pdf.

16 In BC, these are called benefit companies rather than benefit corporations to conform with existing statutory language.

17 J.C. Gilbert, 'I'm Complicit to Institutional Bias, Here's What I'm Doing About It?', *Forbes* (18.09.2018) https://www.forbes.com/sites/jaycoengilbert/2018/09/18/im-complicit-to-institutional-bias-heres-what-im-doing-about-it/.

18 R. Feloni, 'More than 2,600 companies, like Danone and Patagonia, are on board with an entrepreneur who says the way we do business runs counter to human nature and there's only one way forward', *Insider* (08.12.2018) https://www.businessinsider.com/b-corporation-b-lab-movement-and1-cofounder-2018-11.

19 B Lab, 'B Impact Assessment', https://www.bcorporation.net/en-us/programs-and-tools/b-impact-assessment/?_ga=2.14766517.245170334.1645250697–1289241412.1645250697.

20 B Lab, 'About B Corp Certification', https://www.bcorporation.net/en-us/certification.

to ensure B Corporations are pursuing and achieving their social mandates.[21] Within an allotted time following certification, B Corporations are required to amend their articles of incorporation requiring directors to consider more than just shareholder interests when carrying out their duties.[22]

The presumed intention behind amending the articles of American B Corporations is to directly carve them out of the well-known court decision of *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[23] (*Revlon*). In the case, the Supreme Court of Delaware held that at the point of change of control where a corporation is being sold, the board essentially does not have a choice in the matter; they effectively become an auctioneer and must choose the highest bidder. This means that in takeover contexts, directors owe a fiduciary duty to maximise shareholder value, regardless of non-shareholder stakeholder interests. The *Revlon* decision is generally regarded as the leading judicial precedent in support of shareholder primacy in corporate America, even though the decision was limited to the point of change of control. The belief that boards must maximise share value is one that has curiously seeped down and managed to pervade common understanding for other levels of corporate decision-making, to the detriment of sustainable business.[24] B Lab's language in their amendment requirements to articles of incorporation has evolved considerably over the years and has, at times, included the insertion of the consideration of stakeholder interests 'as the Director deems relevant', which significantly softens any supposed obligation to consider such interests, and indeed already echoes the laws of many other jurisdictions. Companies that exist in jurisdictions where benefit corporation legislation is available are required to adopt the benefit corporation status within a certain length of time, although in some jurisdictions, depending on the original corporate form, they may retain the option to simply amend their articles.[25]

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21 M.B. Dorff, 'Assessing the Assessment: B Lab's Effort to Measure Companies' Benevolence' (2017) 40(2) *Seattle University Law Review* 515.

22 B Lab, 'About B Corp Certification', https://www.bcorporation.net/en-us/certification.

23 *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A2d 173, ALR 4th 157 (Del Sup Ct 1985) (*Revlon*).

24 I argue elsewhere that the repetitive shareholder vs. stakeholder debate in American corporate legal scholarship has only entrenched the status quo, supplemented lucrative and comfortable careers for select law professors, and failed to acknowledge or challenge existing structures, thus ensuring an unsustainable and very uncertain future. See C. Liao, 'An Anti-Racist Feminist Agenda for Sustainable Corporate Law' in C. Bruner and M. Moore, *A Research Agenda for Corporate Law*, Edward Elgar 2023.

25 B Lab, 'The Legal Requirement for Certified B Corporations', https://www.bcorporation.net/en-us/about-b-corps/legal-requirements?_ga=2.146185908.1294970332.1645598555-1289241412.1645250697. For example, B Lab requires Italian companies to adopt the *società benefit* (benefit company) legal status to obtain their B Corp certification. B Lab directs BC companies to adopt the benefit company status. B Lab directs Delaware companies to adopt the public benefit corporation status, and directs benefit LLCs, LC3s, limited liability

As aforementioned in this report, what particularly sets B Lab apart from other private certification organisations is that B Lab actively lobbies state and international governments to adopt the alternative benefit corporation form, which is often confused with B Corporation by the public. Legal features within this separate legal vehicle vary slightly across states, but in Delaware it includes requiring boards to balance their fiduciary duties under corporate law with a loosely defined 'public benefit' purpose (and in most states, it merely requires boards to consider other stakeholders). Benefit and public benefit corporation laws also can require a periodic benefit reporting requirement, the ability for certain shareholders to invoke a benefit enforcement proceedings (with damages limited only to non-monetary damages of specific performance), and the requirement that benefit corporations be affirmed by a 'third-party standard' set by a 'third-party standard-setting body'.[26] These legal features are addressed further in section 2.

B Lab has aimed to saturate the social sector in several jurisdictions, partnering with local advocates within those jurisdictions to lobby for this benefit corporation form. Since 2010, the benefit corporation form has been implemented in 40 American states and the District of Columbia.[27] The benefit corporation form has also been implemented in Italy, Puerto Rico, Colombia, Ecuador and British Columbia, Canada, with legislation pending in Argentina and Chile.[28] Of note, Australian benefit corporation legislation was rejected in 2020 and B Lab ceased its advocacy after its failure to be implemented; the reasons for this failure are also further discussed in section 2.

The benefit corporation, as a separate corporate legal entity, aims to address the needs of good businesses operating in the 'for-profit' sector by creating a supposed alternative to the shareholder primacy model of governance in the corporation. In addition to *Revlon*, these benefit corporation laws presumably are designed to address additional strange quirks in US corporate laws that have been hotly contested. Most state laws require boards to exercise their fiduciary duties in the best interests of the corporation *and* the shareholders. This dual

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companies and limited liability partnerships to add specific language to their governing documents. B Lab gives Colombian companies the option to either add specific language to governing documents or to adopt Colombia's benefit form.

26 Bill M-216 *Business Corporations Amendment Act, 2018*, 3rd Sess., 41st Parl., British Columbia (assented to 16.05.2019) SBC 2002, c. 15.

27 Grunin Center for Law and Social Entrepreneurship, 'Social Enterprise Law Tracker', https://socentlawtracker.org/#/bcorps; Grunin Center for Law and Social Entrepreneurship, 'The State of Social Enterprise and the Law 2019–2020', p. 7, https://socentlawtracker.org/wp-content/uploads/2021/02/ICBRSSEL21.1-Grunin-Tepper-Report_Web.pdf.

28 G. Ferrarini and S. Zhu, 'Is There a Role for Benefit Corporations in the New Sustainable Governance Framework?', University of Genoa Working Paper (2021) https://ecgi.global/sites/default/files/working_papers/documents/ferrarinizhufinal.pdf.

focus for which boards are to be concerned invariably leads directors to choose the more tangible personification of the two, being the shareholders, with share value as a convenient substitute measure for such interests. Yet a significant majority of American states have 'other constituency' legislation expressly permitting directors to consider interests of groups in addition to shareholders in decision-making.[29] These legal nuances have muddied the waters for Americans in terms of identifying what the law says and what boards of corporations are supposed to do in the face of competing stakeholder interests. Debates such as the infamous shareholder vs. stakeholder debate continue to carry on with great fervour in academic circles,[30] while holding seemingly minimal relevance to practice.

It is important to emphasise what may seem evident – that these legal oddities in American corporate law are specific to the US and not necessarily reflective of corporate laws in other jurisdictions around the world.[31] Mistaken beliefs in American neoclassical economic theory and corporate law have formed the basis for the weak benefit corporation structure. Other nations do not need to adopt American solutions to these American-specific problems in US corporate laws. B Lab and its advocates are motivated to assume that American corporate laws are universal so that there is an international problem their global brand can supposedly challenge. Global convergence to shareholder primacy as a *legal* requirement is incorrectly assumed in jurisdictions outside the US, as shown in the in-depth cross-jurisdictional analysis undertaken in *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*.[32] Aggressive and misplaced private lobbying has led to neutered and nefarious legislative reform in some jurisdictions, along with harmful interpretative implications across other forms. In the face of a global climate emergency, policymakers must utilise the legal and institutional frameworks at their disposal to hold all corporations to a higher standard.

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29 For more on this, see A.R. Keay, 'Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value and All That: Much Ado About Little?' (04.01.2010) (unpublished manuscript); J. Taylor, 'Negating the Legal Problem of Having "Two Masters": A Framework for L3C Fiduciary Duties and Accountability' (2010) 35 *Vermont Law Review* 117; L.M. Fairfax, 'Doing Well While Doing Good: Reassessing the Scope of Directors' Fiduciary Obligations in For-Profit Corporations with Non-Shareholder Beneficiaries' (2002) 59 *Wash. & Lee L. Rev*. 404.

30 See e.g. L. Bebchuk and R. Tallarita, 'The Illusory Promise of Stakeholder Governance' (2020) 106(1) *Cornell L. Rev.* 91.

31 See B. Sjåfjell et al., 'Shareholder Primacy: The Main Barrier to Sustainable Companies' in B. Sjåfjell and B. Richardson (eds), *Company Law and Sustainability: Legal Barriers and Opportunities*, Cambridge University Press 2015, identifying how shareholder primacy is explicitly not the law across several jurisdictions.

32 B. Sjåfjell and C. Bruner (eds), *The Cambridge Handbook for Corporate Law, Corporate Governance and Sustainability*, Cambridge University Press 2019.

2. FUNDAMENTAL FLAWS AND OBFUSCATIONS OF THE B CORPORATION MOVEMENT

British Columbia (BC) is the only Canadian province or territory to date that has followed the US trend of adopting benefit corporation legislation into the suite of corporate legal options.[33] The following briefly outlines how B Lab has subverted broader corporate reform in Canada, while using the government to channel businesses into potential clients for the private market of 'good' business verification.

2.1. PROMOTING A LEGAL MYTH THAT HARMS PROGRESS

A highly effective marketing strategy is to convince potential customers of a problem they weren't even aware they had, then advance a product designed specifically to address such problem and sell them the solution.[34] B Lab advocates frequently reinforce legal myths while promoting the B Corporation certification in the media. For example, Jay Coen Gilbert, one of B Lab's founders and former *Forbes* columnist, at the end of each *Forbes* column would consistently promote the B Corporation certification and benefit corporations, while claiming that without them, corporations are subject to a 'Milton-Friedman-theory-based law of the land … meaning maximize financial returns to shareholders no matter the long-term effects on the planet, communities or even the marketplace itself.'[35] Statements such as these are highly problematic, and simply not true in Canada[36] (nor for that matter, the US).[37] The questionable nature in which purported news magazines are providing advertisements disguised as news columns (entirely different from paid advertisements as a revenue stream) parallels the concern of state-sponsored corporate branding disguised as law discussed below.

In the effort to spur support for the pending legislation in BC in the lead-up to the provincial vote, well-intentioned businesses were told that benefit company legislation was necessary because it 'gives protection and permission to consider

33 Federal incorporation of corporations is governed under the Canada Business Corporations Act and all Canadian provinces and territories also have laws governing the incorporation of corporations within their jurisdictions.

34 R. Cialdini, *Pre-suasion: A revolutionary way to influence and persuade*, Simon & Schuster 2016.

35 J.C. Gilbert, 'Why a Delaware Corporate Lawyer Went From Business-With-Purpose Skeptic to Full-Time Legal Advocate', *Forbes* (16.10.2017) https://www.forbes.com/sites/jaycoengilbert/2017/10/16/why-a-delaware-corporate-lawyer-went-from-business-with-purpose-skeptic-to-full-time-legal-advocate/?sh=2bbbc9d840b1.

36 It isn't even reflective of Milton Friedman's theory.

37 See M. Manesh, 'Introducing the Totally Unnecessary Benefit LLC' (2019) 97 *North Carolina Law Review* 603, 657–61.

non-financial stakeholders' and 'protection to be good corporate citizens'.[38] The duality of this meaning seemed to be lost as BC supporters assumed such messaging meant the legislation provided protection to pursue a 'public benefit' purpose rather than purely profit.[39] However, the meaning of 'protection' with respect to the Canadian version of the benefit corporation was, in actuality, the opposite of the messaging, discussed further in section 2.2 below. Furthermore, the public messaging from B Lab that regular BC companies are legally obliged to ignore all interests other than profit is deeply misrepresentative of BC and Canadian corporate law.

To be unequivocal here I note that, contrary to B Lab marketing, there is no legal risk for corporations to pursue CSR, environmental, social and governance (ESG) principles, corporate sustainability, or any of its iterations in BC or in Canada. Rather, the consideration of stakeholders in corporate decision-making has always been relevant in Canadian and provincial corporate laws. In the 2008 decision in *BCE Inc. v. 1976 Debentureholders*[40] the Supreme Court of Canada reiterated its holding in *Peoples Department Stores Inc. (Trustee of) v. Wise*[41] that directors were 'not confined to short-term profit or share value', but that when the corporation is of a going concern directors were to look to the long-term interests of the company.[42] Furthermore, in exercising their duties to the corporation, directors 'may look to the interests of, *inter alia*, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions'.[43] The Supreme Court provided directors with considerable flexibility in considering the interests of other stakeholders in determining the best interests of the corporation, but was also explicit in stating that 'this duty also comprehends a duty to treat individual stakeholders affected by corporate

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38 B Lab, 'Benefits of Benefit Corp Adoption: An Update on Benefit Corp Legislation in Canada: Webinar with Rick Alexander, Andrew Weaver, and Dennis Tobin' (2019) http://go.pardot.com/l/39792/2019-01-28/8tgvms. In this B Lab webinar, MLA Andrew Weaver of the BC Greens stated the benefit company is needed because BC companies 'want protection to be good corporate citizens.'

39 See numerous replies to tweets from the BC Green Party announcing the benefit company legislation: https://twitter.com/BCGreens.

40 *BCE Inc. v. 1976 Debentureholders* [2008] SCC 69, [2008] 3 SCR 560 (*BCE*).

41 *Peoples Department Stores Inc. (Trustee of) v. Wise* [2004] SCC 68, [2004] 3 SCR 461. For more on the decision see C. Francis, '*Peoples Department Store Inc. v. Wise*: The Expanded Scope of Directors' and Officers' Fiduciary Duties and Duty of Care' (2005) 41 *Canadian Business Law Journal* 175; E. Iacobucci, 'Indeterminacy and the Canadian Supreme Court's Approach to Corporate Fiduciary Duties' (2009) 48 *Canadian Business Law Journal* 232; D.L. MacPherson, 'Supreme Court Restates Directors' Fiduciary Duty: A Comment on *Peoples Department Stores v. Wise*' (2005) 43 *Alta L. Rev.* 383. Regarding the oppression remedy, the court found there was no violation by the directors in their fiduciary duties.

42 Ibid., para. 38.

43 *BCE*, para. 39.

actions equitably and fairly'.[44] The Court also reinforced its support for the business judgment rule.

Most interestingly, the Supreme Court held that directors were required to act in the best interests of the corporation 'viewed as a good corporate citizen'[45] and 'commensurate with the corporation's duties as a responsible corporate citizen'.[46] Perhaps presciently, some scholars painted *Peoples* and *BCE* as creating a potential future duty for directors to recognise environmental issues in their corporate decision-making. However, this position arguably has always been the case in Canadian corporate law, with section 122 of the Canada Business Corporations Act[47] (CBCA) requiring directors to act in the 'best interests of the corporation' and non-financial principles never being barred from directors' considerations. The Court's statements, nevertheless, lent more support to a broader conception of governance and lessened the likelihood of doubt in such a position.

Canada's governance model was further entrenched in 2019, 11 years after the *BCE* decision, when the Canadian federal government seemingly codified several parts of the *BCE* decision into the CBCA. The amended CBCA provision, section 122(1.1), which came into force in June 2019, states:

> When acting with a view to the best interests of the corporation …, the directors and officers of the corporation may consider, but are not limited to, the following factors: (a) the interests of (i) shareholders, (ii) employees, (iii) retirees and pensioners, (iv) creditors, (v) consumers, and (vi) governments; (b) the environment; and (c) the long-term interests of the corporation.

Thus, the statute mirrored the stakeholders identified in *BCE*, with the addition of 'retirees and pensioners' explicitly included in this non-exhaustive list. Both the common law and legislature have affirmed a broader stakeholder model of governance in line with a board's fiduciary duties to the corporation, rather than a shareholder primacy norm.[48]

Importantly, significant stakeholder remedies and protections in Canadian corporate law also oblige directors to consider non-shareholder stakeholders, discussed in section 2.2 below. Thus, B Lab's marketing of the benefit corporation as a necessary legal alternative to 'protect' a company from liability if it were to pursue anything other than profit is not only false, but dangerously so.

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44 Ibid.

45 Ibid., para. 66.

46 Ibid., para. 82.

47 Canada Business Corporations Act (CBCA), RSC 1985, c. C-44, s. 122.

48 Shareholder primacy is not the law across several jurisdictions: see B. Sjåfjell et al., 'Shareholder Primacy: The Main Barrier to Sustainable Companies' in B. Sjåfjell and B. Richardson (eds), *Company Law and Sustainability: Legal Barriers and Opportunities*, Cambridge University Press 2015.

2.2. LOWERING STANDARDS OF CORPORATE ACCOUNTABILITY

Directors and officers of a benefit company have supposed new fiduciary duties under the legislation to conduct business in a 'responsible and sustainable manner' and are only expected to 'promote' (and not actually produce) 'public benefits.'[49] These benefits are legally defined to include anything under the sun – virtually any business would qualify.[50] Any business wanting to proclaim they benefit society can incorporate as a benefit corporation – after all, they provide a good or service to the public, they employ people, and/or they pay fair wages and taxes. Directors and officers are to balance these duties with their existing duties of loyalty and care, and there is no guidance as to how potential conflicts in these duties are to be resolved.

While these new duties may seem like a positive development for social advocates, what the legislation does next is the opposite of what it purports to do for the public, by insulating directors from any liabilities in their failure to conduct business in a 'responsible and sustainable manner' and limit any claims from the stakeholders the company is supposedly meant to benefit. Section 51.991 states that, despite the new duties, directors and officers have no duty to an individual person whose well-being may be affected by the company's conduct or who has an interest in a public benefit set out in the company's benefit provision. Furthermore, such persons may not bring legal proceedings against a director or officer of a benefit company for breach of the new duties. Thus, the benefit company legislation actually strips stakeholders from making a claim against the company if it fails to act responsibly and sustainably or promote any public benefit. The only possible claimants to sue for a benefit company's failure are shareholders owning 2% of shares or shares equivalent to $2 million, and these claimants are restricted to only suing for non-monetary damages.[51] At minimum, these extensive enacted limitations certainly 'raise the question as to whether the benefit company provisions create a liability shield which would not have existed previously at common law.'[52]

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[49] BC Business Corporations Act (BCBCA), SBC 2002, c. 51, s. 51.992.

[50] Specifically, s. 51.991 states public benefit 'means a positive effect, including of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature, for the benefit of (a) a class of persons, other than shareholders of the company in their capacity as shareholders, or a class of communities or organizations, or (b) the environment, including air, land, water, flora and fauna, and animal, fish and plant habitats.' Section 51.991(2) then goes on to carve out any duties or liability protections for stakeholders. BCBCA ss. 51.991–51.992.

[51] BCBCA s. 51.993(4). See also A. MacLeod, 'Taking Care of Business? Experts Call New BC Law a Gift to Corporations', *The Tyee* (04.06.2019) https://thetyee.ca/News/2019/06/04/Experts-Call-New-BC-Law-Gift-To-Corporations/.

[52] M. Reid, J. Sved and J. Lin, 'Is there any benefit to a benefit company in British Columbia?', DLA Piper (2022) https://www.dlapiper.com/en-ca/insights/publications/2022/07/benefit-companies-in-british-columbia.

In fact, numerous stakeholder remedies and minority protections are available under Canadian corporate law, with the oppression remedy being a particularly notable protection. Minority protections also include derivative actions,[53] Multilateral Instrument 61-101 Protection of Minority Security Holders in Special Transactions,[54] and specific rules under the Toronto Stock Exchange requiring minority approvals,[55] to name a few. The principle of minority protection is 'baked into [Canadian] corporate laws'.[56] Nevertheless, section 51.993(5) explicitly states that, '*[d]espite any rule of law to the contrary*, a court may not order monetary damages' in relation to any breach of their purported duties (emphasis added).[57] Benefit company laws insulate the company and its directors from liability unlike any existing corporate laws and actual alternative legal structures, such as the cooperative ownership model. Thus, while a benefit enforcement proceeding may seem innovative in the US, it is legally redundant in Canada given available stakeholder remedies, particularly the oppression remedy, and likely limits these existing remedies and minority protections, while B Lab advocates claim the opposite.

It is important to note that, unlike the derivative action where a complaint is brought on behalf of the corporation for wrongs done to the corporation,[58] the Canadian oppression remedy is a personal claim. It provides the broad right of action on behalf of certain stakeholders to apply to a court to rectify matters complained of where:

> (i) any act or omission of the corporation effects a result, (ii) the business or affairs of the corporation have been carried on or conducted in a manner, or (iii) the powers of the directors of the corporation have been exercised in a manner … that is *oppressive or unfairly prejudicial to or that unfairly disregards* the interests of any security holder, creditor, director or officer [emphasis added].[59]

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[53] CBCA s. 239 and equivalent provincial statutes. In *Ford v. OMERS* [2006] 1 SCR 715, the court indicated a willingness of courts to accept complaints that are derivative in nature along with oppression remedy claims. In practice, oppression applications dominate derivative actions, as the claim is a personal one as opposed to an action brought on behalf of the corporation, thus the grounds for complaint are much broader.

[54] Multilateral Instrument 61-101: Protection of Minority Security Holders in Special Transactions, OSC MI 61-101 (2008), 31 OSCB 1321.

[55] Stikeman Elliott LLP, 'M&A in Canada: Minority Shareholder Protections' (01.07.2017) www.stikeman.com/en-ca/kh/guides/MA-Canada-Minority-Shareholder-Protections.

[56] Quote from a practitioner within the empirical study in C. Liao, 'Canadian Model of Corporate Governance' (2014) 37 *Dalhousie Law Journal* 549, 583.

[57] See BCBCA s. 51.993.

[58] I use the CBCA oppression remedy as an example; there are slight differences in BC and across provinces, but I use CBCA for these purposes as the risk of adoption now rests outside BC.

[59] CBCA s. 241 and equivalent provincial statutes.

A complainant entitled to bring an oppression remedy claim is defined under Section 238 of the CBCA as either:

a. a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,
b. a director or an officer or a former director or officer of a corporation or any of its affiliates,
c. the Director [of the CBCA], or
d. any other person who, in the discretion of a court, is a proper person to make an application …[60]

This final discretionary category is significant in its potential permissiveness. In the past, courts have allowed creditors, employees and other various stakeholders to sue in the context of their relationships with the corporation under section 283(d).[61] This remedy thus explicitly goes beyond the shareholders of a corporation, allowing for a range of corporate stakeholders to bring an action for unfairly prejudicial and oppressive behaviour, or unfair disregard of their interests. Any stakeholder is a potential complainant to bring forth a claim.

Take the hypothetical example of a social investor committed to combating climate change, which would automatically qualify as a potential complainant under the oppression remedy as a current or former securityholder under section 238(a). The corporation in question has a CSR policy that is publicly displayed on its website and widely promotes its eco-products, yet unbeknownst to the public it is a major polluter during its manufacturing and packaging processes. Key to the assertion of a claim for oppression in Canada is one's expectations of its relationship with the corporation. The test that has developed from the courts has been one of foreseeability and reasonable expectations that can arise through the relationship with the corporation. There is no requirement of bad faith or intention to harm the complainant.[62] Canadian corporate law focuses on harm to the legal and equitable interests of a wide range of stakeholders affected by oppressive acts of corporations or their directors and gives courts broad jurisdiction to enforce not just what is legal, but what is fair.

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60 CBCA s. 238 and equivalent provincial statutes.

61 S. Ben-Ishai and P. Puri, 'The Canadian Oppression Remedy Judicially Considered: 1995–2001' (2004) 30 *Queen's Law Journal* 79.

62 *Downtown Eatery (1993) Ltd v. Ontario* [2001] OJ No. 1879, 200 DLR (4th) 289 (ONCA), leave to appeal refused (2001) SCCA No. 397 (SCC). See also *Ferguson v. Imax Systems Corp* [1983] OJ No. 3156, 150 DLR (3d) 718 at 727 (ONCA), leave to appeal refused [1983] 2 OAC 158; *UPM-Kymmene Corp v. UPM-Kymmene Miramichi Inc.* [2002] OJ No. 2412, 214 DLR (4th) 496 (ONSC), additional reasons at 2002 CarswellOnt 3579 (ONSC (Commercial List)), affd (2004) OJ No. 636 (ONCA).

Determining whether a stakeholder had a 'reasonable expectation' of fairness requires a fact-based inquiry, with consideration given to the relationship between the parties and general commercial practice.[63] Notably, these reasonable expectations can change over time[64] and non-monetary interests may be reasonable expectations and have been considered by the courts.[65] What a court may consider just and equitable is judged by the reasonable expectations of stakeholders in context and in regard to relationships at play. In the hypothetical of our social investor, they must show that they had reasonable expectations with respect to the behaviour of the corporation, its officers or its directors. Whether the stakeholder indeed had a reasonable expectation is a fact-specific inquiry. In this hypothetical scenario where the social investor procures a relationship with the company, that may raise reasonable expectations.

The courts have considered the following factors in determining reasonable expectations. First, what is general commercial practice and what is the industry standard? This standard can vary, and if the corporation operates in an industry that is raising CSR standards, even if the company itself does not have an explicit policy, they could still be held to account for general commercial practice. B Corporation certified companies could arguably be held to a higher standard given the explicit branding and reasonable expectations of its stakeholders. Second, what is the nature of corporation – what is the business of the corporation, what is its purpose? Again, this is context-specific and purportedly would hold self-aggrandising corporations to their own pronouncements. Third, what is the relationship between the parties? If the social investor is a known figure for caring about ESG risks, and particularly if they provide notice to the corporation of their ESG interests, these actions can change the expectations. Thus, in the context of a more closely held corporation, where the 'compact of stakeholders' may resemble a partnership, there may be more accountability risk due to their relationality to the company. Fourth, past practice provides evidence of expectation – so the social investor would need to ensure that they do not let their concern for ESG standards wane, otherwise the expectations then lower. Fifth, what are the steps the complainant could have taken to protect itself? This is largely a creditor question but goes to the social investor's abilities to mitigate. Sixth, did the corporation make any representations and agreements – what did

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63 *Naneff v. Con-Crete Holdings* [1995] OJ No. 1377 (QL) (ONCA); Blair J notes, 'a strong theme running through the authorities dealing with the oppression remedy is its emphasis on the protection of reasonable shareholders' expectations in the context of the shareholders' corporate relationship'.

64 *820099 Ontario Inc. v. Harold E Ballard Ltd* [1991] CarswellOnt 142 (Ont Gen Div) at para. 135; *Aquino et al. v. First Choice Capital Fund Ltd et al.* [1996] 6 WWR 33, SJ No. 184 at paras 24–27.

65 See for example N. Perfetto and B. Fish, 'All in the Family – Using the Oppression Remedy to Resolve Family Business Disputes' (2016) *Annual Rev. of Civil Litigation* 529; *Cohen v. Jonco Holdings Ltd* [2005] MBCA 48 at 36.

the corporation promise and how does that relate to the expectations a party would carry? Here, CSR policies would be measured up against actions, and other statements, meetings, filings, public declarations and presentations could solidify such arguments. Finally, seventh, the court will consider whether there is a fair resolution of conflicting interests between stakeholders – because not all stakeholders are going to be satisfied.

Once a reasonable expectation of fairness is established, the complainant must demonstrate that the corporation's failure to meet this expectation caused detrimental consequences that amount to 'oppression', 'unfair prejudice' or 'unfair disregard' of the stakeholder's interest.[66] Generally, oppression involves conduct that is coercive, abusive, burdensome, harsh, in bad faith, an abuse of power or some other kind of serious wrong. Unfair prejudice and unfair disregard involve a less culpable state of mind and in the past has included conduct such as providing certain shareholders with a disproportionate economic benefit or simply ignoring the claimant's interest in a manner that is contrary to its reasonable expectations.[67]

Regarding the business judgment rule, '[a]bsent bad faith, or some other improper motive, business judgment that, in hindsight, has proven to be mistaken, misguided or imperfect, will not give rise to liability through the oppression remedy'.[68] However, if the board does not act on reasonable grounds, it can be disentitled to such deference. The Canadian business judgment rule is not an automatic entitlement for the board and thus is narrower than in the US. Furthermore, the barometer may be shifting in terms of expected levels of due diligence and reasonableness.

The oppression remedy in Canada 'really does work' in that it 'scares directors and majority shareholders more than anything'.[69] As for what kind of order the court can make if a claim under the oppression remedy is found valid – effectively, the court has limitless options. Section 241(3) of the CBCA provides a non-exhaustive list of possible remedies available to the court. The court can set aside a transaction, make a corporation or another person buy another's shares or pay them money, the court can dissolve the corporation, etc. It is open-ended. Courts have noted the breadth of the oppression remedy and how the

[66] In the case of *Sidaplex-Plastic Supplies Inc. v. Elta Group Inc.* [1998] 111 OAC 106 (CA), a creditor brought a successful claim for oppression against a corporation arising from a personal guarantee given to it by the corporation's principal (the corporation's sole director and shareholder). In that case, the creditor used a reasonable expectations analysis to persuade the court that its interests had been unfairly prejudiced or unfairly disregarded when the principal had let the guarantee lapse.

[67] *BCE*, para. 67.

[68] *Ford Motor Co. of Canada v. OMERS* [2006] OJ No. 27 (CA).

[69] C. Liao, 'Canadian Model of Corporate Governance' (2014) 37 *Dalhousie Law Journal* 549, 584.

provision 'gives the court tremendous latitude' allowing a judge 'to use his [or her] ingenuity to effect the remedy most suitable to the situation'.[70] The court has discretion to offer whatever remedy they want to rectify the oppression, but this does not mean the court is authorised to punish.[71] Canadian courts have not been shy in exercising this wide discretion and designing personalised remedies for successful applicants.[72]

The oppression remedy is widely acknowledged as being one of the most powerful weapons in the arsenal of shareholders and other corporate stakeholders. The strength of Canada's statutory remedies, including those which specifically enable non-shareholder stakeholders to act as complainants, means that not only is shareholder primacy *not* reflected in Canadian corporate law, but boards that view their role solely through a shareholder primacy lens are likely violating their duty of care to the corporation. Built-in principles within Canadian common law are designed to protect a range of stakeholders (including the environment) from exploitation. Through private corporate litigation, stakeholders in Canada can sue directors for breaching their fiduciary duties of care in failing to consider social and environmental risks and sue corporations for failing to consider ESG and other sustainability-specific interests based on reasonable expectations established between them and the corporation. A new wave of private litigation in turn may push policymakers to enhance legal and regulatory frameworks that enable businesses to learn how to mitigate their own sustainability risks, via greater public disclosure, oversight and lower-cost methods for measuring negative externalities.

The potential for corporate governance mechanisms to supercharge private sustainability-related litigation in the fight to innovate corporate behaviour cannot be ignored. Safeguarding the potential of stakeholder remedies to ensure continued accountability will be important in these formidable years where climate and human rights-related litigation is on the rise. It will be critical to ensure the door to stakeholder-based accountability in Canadian corporate law does not shut before it even adequately opens.

Benefit company legislation effectively protects corporate interests and limits rising corporate accountability and legal risks. It acts as a legal placebo while channelling businesses to a 'third-party standard' developed by a 'third-party standard-setting body' for verification of public benefit.[73] The benefit corporation creates an explicit opening for private interests to benefit, while obscuring and thwarting existing legal solutions that are available to a range of stakeholders.

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70 *Naneff v. Con-Crete Holdings* [1995] OJ No. 1377 (QL) (ONCA).

71 Ibid.

72 S. Ben-Ishai and P. Puri, 'The Canadian Oppression Remedy Judicially Considered: 1995–2001' (2004) 30 *Queen's Law Journal* 79.

73 BCBCA ss. 51.994 and 51.991.

2.3. USING THE STATE TO ADVERTISE FOR PRIVATE INTERESTS; BUSINESSES REGULATING THEMSELVES

The implementation of benefit company legislation is a significant opportunity for B Lab to harvest new clients. B Lab has called Canada an important market for them.[74] Prior to their departure in 2022, the three founders of B Lab kept their names prominently at the helm of the movement, becoming the global self-help celebrities of corporations.[75] Vancouver was once called Canada's Social Silicon Valley;[76] B Lab advocates have attempted to rebrand it as the B Corp Community.[77] Canadian social leaders increasingly have been labelled as B Corp Ambassadors. The implementation of benefit corporations in non-US jurisdictions has led to an expanded global market share for B Lab. Benefit corporation and B Corporation are easily confused by the public; even certified B Corporations themselves and politicians backing the legislation frequently mix up the two.[78] Benefit corporations are required to be assessed each year by a 'third-party standard' developed by a 'third-party standard-setting body' under sections 51.994 and 51.991 of the BCBCA.[79] While the legislation may not expressly require certification by B Lab, www.benefitcorp.net is operated by B Lab, containing full details and links to its B Corporation certification. We are witnessing the hollowing out of implicit CSR infrastructure and the attempted private Americanisation of good business standards around the world.

Joel Bakan, author and filmmaker of *The New Corporation*, notes that '[t]hough operating under the patina of progressiveness, the B-corp movement is part of the problem, not the solution … By delegating detailed norm creation and enforcement to private … certifiers, [the legislation] propels the privatization trend'.[80] The name B Corporation itself suggests conflated comparisons to the S Corporation and C Corporation tax classifications in the United States. The creation of a benefit corporation structure is state-sponsored advertising of private American interests. State laws provide free marketing and an ongoing

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74 B. Houlahan, B Lab founder, remarks at Seattle University Berle Conference, 'The Benefit Corporation and Firm Commitment Universe', 2016.

75 See e.g. B Lab, 'Certified B Corporation 2019 Champions Retreat', https://bcorporation.net/2019-champions-retreat.

76 P. Marcoccia, 'Innovation Gathering in Canada's "Social Silicon Valley"', *Axiom News* (2013).

77 B Local Vancouver, 'About Page', https://www.blocalvancouver.eco/about-2.

78 As witnessed in one-on-one conversations with MLA Andrew Weaver; multiple articles also conflate the B Corporation and benefit corporation, see for example, 'Proposed B Corps Offer both Economic and Social Benefits', *Lawyers Daily* (26.09.2018) https://www.thelawyersdaily.ca/articles/7400/b-c-s-proposed-b-corps-offer-both-economic-and-social-benefits.

79 BCBCA ss. 51.994 and 51.991.

80 A. MacLeod 'Taking Care of Business? Experts Call New BC Law a Gift to Corporations', *The Tyee* (04.06.2019) https://thetyee.ca/News/2019/06/04/Experts-Call-New-BC-Law-Gift-To-Corporations/.

stream of potential clientele to B Lab, which charges annual fees ranging from US$2,000 to US$50,000+ per company.[81]

Incentives are misaligned when B Lab acts as a private regulator for the state while also seeking to retain clients and fees, and establish a private global brand. If companies consider de-certifying, B Lab has been known to offer discounts on products provided by other certified B Corporations to keep them on board.[82] B Lab claims to 'work with companies' to keep them certified,[83] and for years proudly published its growing numbers on its homepage.[84] Empirical studies have shown a considerable lack of integrity and oversight in the third-party standard-setting body mechanism to privately regulate American benefit corporations. Ellen Berrey in her empirical study, for example, found that 'the field of U.S. benefit corporations is mostly full of inactivity, activity that is not socially beneficial, and some questionable activity. A considerable number of benefit corporations are subverting and undermining the integrity of the legal innovation.'[85]

The B Corporation and benefit corporation movement in the United States highlights a disturbing trend towards private enterprise lobbying for new legal structures that shift the power of defining purpose to non-state actors, with little to no ability for proper regulatory oversight or legal remedies upon any deviation from that purpose. The growth and influence of private certifications in the 'good' business and social enterprise arena around the world at times can compete with state-run certifications, and B Lab's heavy promotion of its certification outside of the US is notable in comparison to other private certifications in other jurisdictions. Especially surprising has been B Lab's lobbying in nations that already have robust existing state infrastructure for such businesses.[86]

2.4. ARROGANCE, IGNORANCE AND POLITICAL GAMING

The BC government's adoption of benefit company legislation was the result of a peculiar nexus of political interests. In 2017, the BC provincial government

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81 B Lab, 'Process, Requirements, and Fees', https://usca.bcorporation.net/process-requirements-fees/.

82 B Lab offered Tyze Personal Networks Ltd., an early Canadian B Corporation, a discount at Salesforce that amounted to Tyze's annual fees to B Lab, to entice Tyze to remain certified after the company expressed that it no longer wanted to be certified (I was the Director of Corporate Innovation at Tyze at that time). Other anecdotal evidence suggests the offering of discounts from other B Corporations to keep companies certified is a common occurrence.

83 B. Houlahan, B Lab founder, remarks at Seattle University Berle Conference, 'The Benefit Corporation and Firm Commitment Universe', 2016.

84 B Lab, 'Make Business a Force for Good', https://www.bcorporation.net/en-us/.

85 E. Berrey, 'Social Enterprise Law in Action: Organizational Characteristics of U.S. Benefit Corporations' (2018) 20(1) *Tennessee Journal of Business Law* 21, 103; see also M. Manesh, 'Introducing the Totally Unnecessary Benefit LLC' (2019) 97 *North Carolina Law Review* 603 at Part III (State Sponsored Branding Without Accountability).

86 Such as Italy with a very active cooperative community.

found itself uniquely configured – two major parties in the BC provincial government were very closely matched in their seats and the BC Green Party, a fringe political party that historically held only one or two seats in the legislature at most, found itself holding the balance of power with three seats from 2017–2019 during a BC New Democratic Party minority government. The BC Greens have often been labelled as right-wing at the same time as being labelled left-wing by opponents.[87] Andrew Weaver, the BC Green Party Leader and Member of the Legislative Assembly (MLA), had the opportunity to push the B Lab off-the-shelf benefit company legislation forward as the first private member bill in the legislature and with some backroom dealing, the legislation passed unanimously.[88]

The process could be viewed as MLAs rubber stamping what looked to be innocuous corporate legislation, potentially influenced by political wariness to avoid the appearance of opposition to a virtuous-sounding 'benefit' company. Implementing legislation is relatively cheap and copying American solutions is easy, particularly if local B Lab lobbyists are adamant and insistent. BC experienced the B Lab lobbying machine in the form of pre-drafted letters and other activist mechanisms that had been fine-tuned from B Lab's experience lobbying numerous state legislatures. No doubt many MLAs who voted to introduce benefit corporation legislation in BC believed it had some value or neglected to see how it could be harmful.[89] They nonetheless failed to meaningfully interrogate how the benefit corporate form could create a dichotomy in Canadian corporate law, erode implicit CSR laws and allow possible loopholes for the directors of companies that adopt it. Politicians are incentivised to focus on the appearance of their actions in the immediate future, as a victory for the little guy,[90] and not the creation of long-term fissures that are untraceable to them. Here, the result was bland short-term 'social-washing'[91] enabling politicians to adopt the good business label as a public relations exercise with little accompanying action.

Interestingly, after the implementation of the BC benefit company, B Lab set its energies on lobbying for a benefit corporation structure in Australia. The Australian academic community, including scholars who had written

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87 A. Olsen, 'Left-right politics' (10.12.2014) https://www.bcgreens.ca/left_right_politics.

88 B. Geiss, 'British Columbia gets Benefit Company Legislation', *Cove Continuity Advisors* (2019) https://www.coveadvisors.com/resources/british-columbia-gets-benefit-company-legislation/.

89 Conversations with the Attorney General David Eby.

90 A. MacLeod, 'Stars Aligned to Make BC First to Protect "Force for Good" Businesses', *The Tyee* (22.05.2019) https://thetyee.ca/News/2019/05/22/BC-First-For-Good-Businesses/.

91 J.J. McMurtry and F. Brouard, 'Social Enterprises in Canada: An Introduction' (2015) 6(1) *Can. J. Nonprofit & Soc. Econ. Research* 6, 15.

critically about the benefit corporation prior to the B Lab lobbying onslaught,[92] became aware of what occurred in Canada and resisted supporting the benefit corporation form, recognising that their own corporate laws were sufficient.[93] Various groups clarified that the proposed legislation was not necessary given that current Australian corporate law allowed companies to consider interests beyond just financial profit.[94] B Lab Australia and New Zealand (ANZ) then abandoned its attempts at legislative reform through a blog post which admitted two things: (i) Australia's current legislative environment was flexible enough to achieve the same result of what the benefit company was proposed to do; and (ii) directors of Australian companies already assumed they had to take on a more holistic view of the company's actions apart from just profit.[95] B Lab ANZ later admitted concerns that benefit corporation legislation could 'give traditional companies licence to operate poorly'.[96] It is a pity that B Lab did not take such care in Canada.

3. CONCLUSION: NEOLIBERAL GREENWASHING AND THE BENEFIT CORPORATION

While the B Corporation certification by itself may be helpful for businesses to brand themselves as 'a force for good', B Lab's venture into the laws of other countries is a severe ethnocentric overstep.

Benefit corporations may be the way to elicit change in the US given their reliance on corporate discretion, adherence to American values of liberalism, deregulation and explicit CSR, and the nation's capability of electing a climate change denier as a former President. But B Lab is losing moral legitimacy as it spreads legal myths and then aggressively lobbies for benefit corporations in non-US countries. B Lab relies on ideas it generated over a decade ago. Governance principles in Canada – and many other parts of the world – have changed light years since that time. It is a pity that Canada has decided to borrow from the outdated B Corporation and benefit corporation playbook, which only

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92 V. Baumfield, 'How Change Happens: The Benefit Corporation in the United States and Considerations for Australia' in B. Sjåfjell and I.L. Fannon (eds), *Creating Corporate Sustainability: Gender as an Agent for Change*, Cambridge University Press 2018.

93 V. Baumfield, 'The Australian Paradox: Conservative Corporate Law in a Progressive Culture' in B. Sjåfjell and C.M. Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, Cambridge University Press 2019, pp. 161–75.

94 I. Ramsay and M. Upadhyaya, 'The Failed Attempt to Enact Benefit Company Legislation in Australia and the Rise of B Corps' in H. Peter, C.V. Vasserot and J.A. Silva (eds), *The International Handbook of Social Enterprise Law*, Springer 2022, pp. 395–424.

95 Ibid.; B Lab Australia & Aotearoa New Zealand, https://bcorporation.com.au/.

96 Ibid.; S. Khisty, 'The Evolution of Benefit Company Reform in Australia', https://www.bcorporation.com.au/post/benefit-company-australia.

preserves the status quo and offers a very American, explicit CSR solution to deep-seated problems.

The benefit corporation's definition of 'general public benefit' fits perfectly into the dogma that has been at the core of modern economics since Adam Smith's *Wealth of Nations*, where he famously opined: 'It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.'[97] Smith's concept of the 'invisible hand' has resonated within the theoretical economic underpinnings of the corporation for some time now. It postulates that shareholders have powerful incentives to maximise the value of the firm and monitor corporate directors' and officers' conduct. Managers, as shareholders' agents, seek to maximise shareholder wealth through the increase of share value and dividend payments, which presumably includes ensuring that stakeholders are appeased[98] and ultimately translates into benefits to consumers, and society as a whole. Charles Elson, an advocate of shareholder primacy in the US, stated: 'It's politically correct to suggest that a company benefit the public rather than its investors. But investors are the public.'[99] If indeed the proponents behind the benefit corporation believe the model is offering something clearly different from the mainstream corporation, and presumably they do, their legal features need to set them apart from the classic economic definition of how business translates to public benefit. Of course, benefit corporations also have the option to include the requirement to produce a 'specific public benefit' in their governing documents – but so can any Canadian corporation.

As noted previously, the benefit corporation in the US has had limited success, despite B Lab conflating numbers of B Corporation certifications and benefit corporations and running marketing campaigns stating otherwise. Outside the US, over 40 initiatives in 29 countries around the world have experimented with innovative new laws to foster and oversee social enterprise.[100] Some countries are implementing mandatory CSR laws for all corporations.[101] Each nation has had varying degrees of success, including the deflated community contribution company in BC. Yet unlike other certifications and legal structures, there are no legal features requiring a reinvestment of profit or other economic constraints built into the benefit corporation to ensure the social purpose of the business is

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97 A. Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776) 1 Eighteenth Century Collections Online at 1.1.2.

98 See e.g. R. Kraakman et al., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 2nd ed., Oxford University Press 2009, pp. 61–66.

99 A. Loten, 'Can Firms Aim to Do Good if It Hurts Profit?', *The Wall Street Journal* (11.04.2013) at B6 (quoting Elson).

100 C. Liao, E. Tawfik and P. Teichreb, 'The Global Social Enterprise Lawmaking Phenomenon' (2019) 36 *Windsor Yearbook of Access to Justice* 84, 87.

101 L. Lin, 'Mandatory Corporate Social Responsibility Legislation Around the World: Emergent Varieties and National Experiences' (2021) 23 *Journal of Business Law* 429.

maintained; these features in the benefit corporation would only be voluntary as they would for any corporation. B Lab's active pursuit of an international market for its brand and the benefit corporation puts it in stark contrast to government-led initiatives across jurisdictions that rarely prioritise the need for other nations to emulate them.

In order to secure a sustainable future for our planet, corporations will not only need to 'do no harm' – be more responsible, more sustainable – but commit to seeking innovative solutions to the world's global challenges. We are witnessing changing legal and regulatory frameworks that are raising global sustainability standards, rising demands in ESG disclosure, as well as a shift in attitude and behaviour as corporations are forced to face their insufficient, unsustainable behaviour.[102] Corporate law is a tool that can alter how corporations deploy products and services for the benefit of humankind and the planet.

Stakeholders and, increasingly, stakeholder *litigants*, are demanding corporations refrain from causing further damage by engaging in carbon-related business activities, while also urging corporations to proactively manage and mitigate climate risks in their business. Tort-based climate litigation is a 'backward-looking responsibility' where claimants are primarily seeking compensation for injuries caused in the past, while corporate law tools-based litigation is both a backward- and 'forward-looking responsibility'.[103] This litigation requires corporations to take responsibility for past harms, but to also proactively manage or mitigate sustainability-related risks because corporations occupy a special position of power in society and have the opportunity and capacity to improve the world's response to our sustainability crisis.[104] Claimants using corporate legal mechanisms will not only seek to hold corporations responsible for omitting information or disclosing false or inaccurate information, but will also seek that corporations be ordered to change their future conduct in relation to climate change and sustainability. The benefit company in Canada curtails any chance of these reform efforts, right from the get-go. The only reason state legislation is required in these benefit corporation forms is to *limit* corporate liability. This crucial point needs to resonate loud and clear and be put as a challenge towards misinformed proponents of benefit corporation forms.

The off-loading trend towards private regulation of corporate businesses leaves open the high probability of a form of social-washing. These social-

[102] The Canadian federal government and Office of the Superintendent of Financial Institutions' endorsement of the Task Force on Climate-related Financial Disclosures is but one example of the accelerating trajectory in corporate accountability within legal and regulatory frameworks. Task Force on Climate-related Financial Disclosures, last modified 20.07.2021, https://www.fsb-tcfd.org/. See also B. Sjåfjell, C. Liao and A. Argyrou (eds), *Innovating Business for Sustainability: Regulatory Approaches in the Anthropocene*, Edward Elgar 2022.

[103] H. Shue, 'Responsible for What? Carbon Producer CO2 Contributions and the Energy Transition' (2017) 144 *Climatic Change* 591, 592.

[104] Ibid., p. 595.

washing problems are akin to greenwashing concerns – where companies spend significantly more time and money on green advertising than on environmentally sound practices – that propagated the CSR movement.[105] Empirical studies have shown that CSR trends have been consistent with theories of strategic CSR and rational, profit-seeking management decision-making.[106] There are no built-in legal mechanisms to prevent this type of corporate behaviour in a benefit corporation beyond what is already available for regular Canadian corporations, and – again – the benefit company *limits* the ability for stakeholders to hold such companies accountable for failing to do what they say.

In the face of a global climate emergency, our democratically elected policymakers must use their capabilities, tools, and supporting legal and institutional frameworks to hold all corporations to a higher standard, and not find salvation through the private American B Corporation movement and the benefit corporation, as much as the B Lab founders and advocates would like.

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[105] See e.g. L.D. Mitchell and W.D. Ramey, 'Look How Green I Am! An Individual-level Explanation for Greenwashing' (2011) 12(6) *J. Applied Bus. & Econ.* 40.

[106] See e.g. D. Siegel and D. Vitaliano, 'An Empirical Analysis of the Strategic Use of Corporate Social Responsibility' (2007) 16 *Journal of Economic and Management Strategy* 773; R. Fisman, G. Heal and V. Nair, 'A Model of Corporate Philanthropy', Columbia Business School Working Paper (2007) http://knowledge.wharton.upenn.edu/papers/1331.pdf.

APPENDIX
QUESTIONNAIRE

Thank you for agreeing to complete a Special Report for the International Academy of Comparative Law on the topic: *The social enterprise: a new form of the business enterprise?*

The following questions are intended as a guide as you produce your report, but the report should take the form of an article, rather than a simple enumeration of the answers to this questionnaire.

PART I: WHAT IS A SOCIAL ENTERPRISE?

1. How, if at all, is the concept of a social enterprise understood in your jurisdiction?
2. Thinking of actual social enterprise firms, in which industries do they operate?
3. What is distinctive about social enterprise business models as compared to traditional ventures (e.g. WISE, 1-for-1, local economic development, employee ownership, etc.)? To the extent there is information available, how many social enterprises are currently operating in your jurisdiction? Please indicate the sources available to provide this information.
4. What is the oldest prominent social enterprise operating in your jurisdiction?
5. What is the most prominent social enterprise operating in your jurisdiction?
6. What is the largest social enterprise? Is it, or any other, publicly-held?
7. What is the most controversial social enterprise? What is the source of the controversy?
8. What are the principal sources of funding/finance for social enterprises in your jurisdiction?

PART II: FORMS OF ORGANISATION FOR SOCIAL ENTERPRISES

1. What legal forms of organisation are typically adopted by social enterprises? To what extent do these legal forms permit or require the pursuit of a social mission?

2. Do for-profit firms in your jurisdiction enjoy discretion to serve stakeholder interests other than investors? If so, please describe the bounds of this discretion and any enforcement mechanisms?
3. Has your jurisdiction created specialised legal forms of organisation designed for social enterprises? If so, when were these forms introduced?
4. Address the following elements for traditional legal forms for business enterprises, including corporate entities, cooperatives and unincorporated entities, in your jurisdiction:
   a. Organisation under international, national, regional or local law
   b. Permissible objects of adopting entities
   c. Limited liability
   d. Owner rights to participation in management
   e. Rights to participation in management by other stakeholders (e.g. employees)
   f. Continuity of existence
   g. Transferability of ownership
   h. Fiduciary duty or other conceptions of obligations for leaders
   i. Voting rights and other governance rights of investors and other stakeholders
   j. Entity and owner taxation
   k. Disclosure/reporting
   l. Discretion/limitations on serving stakeholders beyond investors
5. Address the above elements for non-profit legal forms and for specialised legal forms of organisation designed for social enterprise, if any, in addition to the following:
   a. Limitations on trading
   b. Limitations on profit distributions to owners (non-distribution constraint)
   c. Purpose/mission requirements
   d. Employee hiring requirements

PART III: LIFECYCLE

1. Formation
   a. What legal steps do you need to take to form a social enterprise?
   b. Does a social enterprise require pre-approval from one or more government agencies? If so, what must a social enterprise demonstrate in order to gain approval?
   c. Does a social enterprise need to file or register with one or more government agencies? If so, on what timeline? Even if not required, will filing or registration with one or government agencies provide

any benefits to a social enterprise? In either case, are social enterprise filings publicly available?

d. Is the board of directors (or its equivalent) of a social enterprise subject to any special requirements (e.g. independence of directors)?
e. Can a conventional organisation convert into a social enterprise legal form? Can a non-profit organisation convert into a social enterprise legal form? If so in either case, please describe the steps required for conversion.

2. Maintenance
   a. What ongoing filing/reporting requirements must a social enterprise meet, if any? Are any such reports public?
   b. Must social enterprises be audited on a regular basis?
   c. If social enterprises are subject to filing/reporting or audit requirements, what metrics are used to track their activities and impact?
   d. If fidelity to social mission is self-assessed, is compliance measured against a third-party standard?
   e. Does a dedicated regulator for social enterprises exist or does the same regulator oversee both non-profits/for-profits and social enterprises?
   f. If a dedicated social enterprise regulator exists, does it receive adequate funding and support? How is it funded?
3. Exit
   a. What steps must a social enterprise take to cease operations?
   b. What steps must a social enterprise take to convert to a conventional legal form?
   c. May shareholders, employees or other constituencies force a conversion?
   d. Must shareholders, employees or other constituencies approve such a change?
   e. Must one or more government agencies approve such a change?
   f. Can assets of a social enterprise be converted to for-profit use?
   g. Provide examples of social enterprises converting to for-profit or non-profit forms, if any.

PART IV: STATE/PRIVATE CERTIFICATIONS AND METRICS

1. Are government designations or certifications available for social enterprises? Explain how they are obtained, monitored and removed.
2. Are private designations or certifications available? Explain how they are obtained, monitored and removed.
3. What metrics exist to measure impact with respect to these designations?

4. When were the above designations/certifications/metrics introduced?
5. Are there significant conflicts or tensions between public and private designations for social enterprises in your jurisdiction?

PART V: SUBSIDIES/BENEFITS

1. Enterprise:
   a. Does any government entity or programme provide direct subsidies or tax preferences for social enterprises?
   b. What requirements must a social enterprise meet in order to qualify for those subsidies or tax preferences?
   c. Are those subsidies or preferences different than those available to other for-profit businesses? To non-profit organisations?
2. Investors:
   a. Does the government provide subsidies or tax preferences for social enterprise investors/contributors?
   b. What requirements must an investor/contributor meet in order to qualify for those subsidies or tax preferences?
   c. Are those subsidies or preferences different than those available to investors in other for-profit businesses? To contributors to non-profit organisations?
3. Other benefits:
   What other public benefits does formation/designation as a social enterprise provide? (e.g. procurement preferences)

PART VI: PRIVATE CAPITAL

1. What is the investment landscape for businesses with a social mission in your jurisdiction?
2. Does securities regulation treat social enterprises differently?
3. What types of investors participate in funding businesses with a social mission (impact investment firms and funds, foundations or other endowments, government bodies, development finance institutions, high-net-worth individuals)?
4. Do any restrictions exist on the ownership of/investment in social enterprises by entities (including foundations and for-profits)?
5. Are public securities exchanges open to listing securities of social enterprises in your jurisdiction?
6. Have any social enterprises in your jurisdiction listed securities on a public exchange?

PART VII: OTHER CONSTITUENCIES

1. Describe the role played by investors in preserving the mission of social enterprises.
2. Do employees or customers play a role in preserving the balance between profits and social mission?
3. Do formal mechanisms exist to give stakeholders beyond investors a role in governance of social enterprises?
4. Explain what mechanisms (e.g. litigation) stakeholders use to protect social mission.

PART VIII: PROSPECTIVE CHANGES IN LAW

Please describe any significant proposed changes in local, national, regional or international rules that might affect the regulation or taxation of social enterprises in your jurisdiction.

PART IX: OTHER

Please address any elements you believe are important to the establishment, maintenance and growth of social enterprise in your specific country (or from the perspective of your organisation) and which are not otherwise addressed by the questions herein.

QUESTIONNAIRE

Merci d'avoir accepté de rédiger un rapport spécial pour l'Académie internationale de droit comparé sur le thème : *L'entreprise sociale : une nouvelle forme d'entreprise commerciale ?*

Les questions suivantes ont pour objet de vous guider dans l'élaboration de votre rapport, bien que le rapport doive prendre la forme finale d'un article, plutôt que d'une simple énumération des réponses à ce questionnaire.

PARTIE I : QU'EST-CE QU'UNE ENTREPRISE SOCIALE ?

1. Comment, le cas échéant, le concept d'entreprise sociale est-il compris dans votre juridiction ?
2. S'agissant d'entreprises sociales existantes, dans quelles industries sont-elles actives ?
3. Qu'est-ce qui distingue les modèles d'entreprises sociales par rapport aux entreprises traditionnelles (par exemple, WISE,[1] « un pour un »,[2] développement économique local, actionnariat salarié, etc.) ? Dans la mesure où des informations sont disponibles, combien d'entreprises sociales opèrent actuellement dans votre juridiction ? Merci d'indiquer les sources disponibles pour obtenir ces informations.
4. Quelle est la plus ancienne entreprise sociale de référence exerçant ses activités dans votre juridiction ?
5. Quelle est l'entreprise sociale la plus importante de votre juridiction ?
6. Quelle est la plus grande entreprise sociale ? Cette entreprise sociale – ou toute autre – est-elle cotée en bourse ?
7. Quelle est l'entreprise sociale la plus controversée ? Quelle est la source de la controverse ?
8. Quelles sont les principales sources de financement/de subvention des entreprises sociales dans votre juridiction ?

PARTIE II : TYPES D'ENTREPRISES SOCIALES

1. Quelles formes juridiques sont généralement adoptées par les entreprises sociales ? Dans quelle mesure ces formes juridiques permettent-elles ou exigent-elles la poursuite d'un but social ?

[1] « Work integration social enterprise » : entreprise sociale d'insertion professionnelle.

[2] « Un pour un » est un modèle d'entrepreneuriat social dans lequel, pour chaque article acheté, un article est donné à une cause.

2. Les entreprises à but lucratif de votre juridiction peuvent-elles, de manière discrétionnaire, servir les intérêts de parties prenantes autres que les investisseurs ? Dans l'affirmative, veuillez décrire les limites de ce pouvoir discrétionnaire et les mécanismes de mise en œuvre.
3. Votre juridiction a-t-elle créé des formes juridiques spéciales pour les entreprises sociales ? Dans l'affirmative, quand ces formes ont-elles été introduites ?
4. Veuillez aborder les éléments suivants relatifs aux formes juridiques traditionnelles des entreprises commerciales, y compris les personnes morales, les coopératives et les entités sans personnalité juridique dans votre juridiction :
   a. Organisation selon le droit international, national, régional ou local
   b. Buts autorisés
   c. Responsabilité limitée
   d. Droit, pour les détenteurs de parts, de participer à la gestion de l'entreprise ;
   e. Droit, pour d'autres parties prenantes (p.ex. employés), de participer à la gestion de l'entreprise
   f. Continuité d'existence
   g. Transférabilité des parts sociales
   h. Devoir fiduciaire ou autre définition des devoirs des dirigeants
   i. Droit de vote et autres droits de gouvernance des investisseurs et autres parties prenantes
   j. Imposition des entités et des actionnaires/détenteurs de parts sociales
   k. Divulgation d'informations sur l'entreprise (finances, activité, etc.)/ reporting
   l. Pouvoirs discrétionnaires/limites des avantages et des services accordés aux non-investisseurs
5. Veuillez aborder les éléments ci-dessus concernant les entités à but non lucratif et, le cas échéant, concernant les formes juridiques conçues spécifiquement pour les entreprises sociales. Dans ce cadre, veuillez également aborder les éléments suivants :
   a. Restrictions des opérations commerciales
   b. Limitations dans la distribution des bénéfices aux propriétaires (exigences de non-distribution ou de non-retour)
   c. Exigences légales concernant le but et la mission
   d. Conditions d'embauche des employés

PARTIE III : CYCLE DE VIE

1. Formation
   a. Quelles sont les démarches juridiques à entreprendre pour créer une entreprise sociale ?

b. Une entreprise sociale nécessite-t-elle l'approbation préalable d'une ou plusieurs autorités ? Dans ce cas, que doit-elle démontrer à cette fin ?
c. Une entreprise sociale doit-elle s'annoncer ou s'enregistrer auprès d'une ou plusieurs autorités ? Le cas échéant, dans quel délai ? Même si cela n'est pas obligatoire, l'annonce ou l'enregistrement auprès d'une ou plusieurs autorités offre-t-il des avantages à cette entreprise ? Dans les deux cas, les dossiers des entreprises sociales sont-ils accessibles au public ?
d. Le conseil d'administration (ou son équivalent) d'une entreprise sociale est-il soumis à des exigences particulières (p.ex. indépendance des administrateurs) ?
e. Une entité juridique ordinaire peut-elle se transformer en une forme juridique d'entreprise sociale ? Une personne morale à but non lucratif peut-elle se transformer en entreprise sociale ? Le cas échéant, veuillez décrire les étapes requises pour la conversion dans les deux cas.

2. Entretien
   a. Quelles sont les exigences en matière de reddition de rapports financiers/fiscaux/d'activité, etc. concernant les entreprises sociales ? Ces rapports sont-ils publics ?
   b. Les entreprises sociales doivent-elles régulièrement être auditées ?
   c. Si les entreprises sociales sont soumises à des obligations de dépôt ou d'audit, quelles mesures sont utilisées pour suivre leurs activités et leur impact ?
   d. Si une entreprise sociale évalue elle-même sa fidélité à sa mission, utilise-t-elle un standard établi par un tiers ?
   e. Existe-t-il un régulateur dédié aux entreprises sociales ou le même régulateur supervise-t-il à la fois les organisations à but non lucratif/à but lucratif et les entreprises sociales ?
   f. S'il existe un organisme de régulation des entreprises sociales, celui-ci bénéficie-t-il d'un financement et d'un soutien adéquats ? Comment est-il financé ?
3. Cessation
   a. Quelles mesures une entreprise sociale doit-elle prendre pour cesser ses activités ?
   b. Quelles étapes une entreprise sociale doit-elle suivre pour se convertir en une forme juridique conventionnelle ?
   c. Les actionnaires, les employés ou d'autres parties prenantes peuvent-ils forcer une conversion ?
   d. Les actionnaires, employés ou autres parties prenantes doivent-ils approuver un tel changement ?
   e. Une ou plusieurs autorités doivent-elles approuver un tel changement ?

f. Les actifs d'une entreprise sociale peuvent-ils être convertis pour un usage à but lucratif ?
g. Si possible, indiquez des exemples d'entreprises sociales se convertissant en des formes à but lucratif ou à but non lucratif.

PARTIE IV : CERTIFICATIONS ET INDICATEURS D'ÉTAT/PRIVÉES

1. Des appellations ou certifications publiques sont-elles disponibles pour les entreprises sociales ? Expliquez comment elles sont obtenues, surveillées et révoquées.
2. Des appellations ou certifications privées sont-elles disponibles ? Expliquez comment elles sont obtenues, surveillées et révoquées.
3. Quels indicateurs existent pour mesurer l'impact par rapport à ces appellations ?
4. Quand les appellations/certifications/indicateurs ci-dessus ont-ils été introduits ?
5. Existe-t-il des conflits ou des tensions importants entre les appellations publiques et privées des entreprises sociales dans votre juridiction ?

PARTIE V : SUBVENTIONS/AVANTAGES

1. Entreprise :
   a. Existe-t-il une entité ou un programme gouvernemental qui offre des subventions directes ou des avantages fiscaux aux entreprises sociales ?
   b. Quelles conditions une entreprise sociale doit-elle remplir pour pouvoir bénéficier de ces subventions ou de ces avantages fiscaux ?
   c. Ces subventions ou allégements fiscaux sont-ils différents de ceux dont bénéficient les autres entreprises à but lucratif et/ou à but non lucratif ?
2. Investisseurs :
   a. Le gouvernement accorde-t-il des subventions ou des avantages fiscaux aux investisseurs des entreprises sociales ?
   b. Quelles conditions un investisseur/ contributeur doit-il remplir pour avoir droit à ces subventions ou avantages fiscaux ?
   c. Ces subventions ou allégements fiscaux sont-ils différents de ceux dont bénéficient les investisseurs dans les entreprises à but lucratif ? Et les contributeurs d'organisations à but non lucratif ?

3. Autres avantages :
   Quels sont les autres avantages publics que procurent la création et/ou la désignation d'une entreprise sociale ? (p.ex. préférences pour l'attribution de mandats)

PARTIE VI : CAPITAL PRIVÉ

1. Quelle est la perspective en matière d'investissements dans les entreprises à mission sociale dans votre juridiction ?
2. La réglementation sur le commerce des valeurs mobilières traite-t-elle les entreprises sociales différemment ?
3. Quels types d'investisseurs participent au financement d'entreprises à mission sociale (entreprises et fonds d'investissement à impact, fondations ou autres dotations, organismes gouvernementaux, institutions de financement du développement, investisseurs individuels fortunés) ?
4. Existe-t-il des restrictions à la propriété/à l'investissement dans les entreprises sociales par des entités (y compris les fondations et les entreprises à but lucratif) ?
5. Les bourses des valeurs mobilières sont-elles ouvertes à la cotation des titres d'entreprises sociales dans votre juridiction ?
6. Des entreprises sociales de votre juridiction ont-elles coté des titres en bourse ?

PARTIE VII : AUTRES PARTIES PRENANTES

1. Décrivez le rôle joué par les investisseurs dans la préservation de la mission des entreprises sociales.
2. Les employés ou les clients jouent-ils un rôle dans la préservation de l'équilibre entre bénéfices et mission sociale ?
3. Existe-t-il des mécanismes formels pour donner aux parties prenantes non-investisseurs un rôle dans la gouvernance des entreprises sociales ?
4. Expliquez quels mécanismes (p.ex. voies de droit) les parties prenantes utilisent pour protéger la mission sociale.

PARTIE VIII : MODIFICATIONS FUTURES DU DROIT

Veuillez décrire tout changement important proposé dans les règles locales, nationales, régionales ou internationales qui pourraient affecter la réglementation ou l'imposition des entreprises sociales dans votre juridiction.

PARTIE IX : AUTRE

Veuillez aborder tous les éléments que vous jugez importants pour l'établissement, le maintien et la croissance de l'entreprise sociale dans votre pays spécifique (ou du point de vue de votre organisation) et qui ne sont pas traités dans les questions ci-dessus.

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