SOCIAL ENTERPRISES: DOES THE LEGAL FORM MATTER?

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Abstract

Purpose. The purpose of this paper is to try to answer the question what are the main legal approaches to facilitate the creation of social enterprises? What kind of advantages or disadvantages have these models?

Design/methodology/approach. Research focuses on the analytical review of the legal acts and previous insights of researchers. Theoretically this paper employs the philosophical doctrine of the realism. In the social world objects have varying probabilities of coming into existence and causing new objects, which connect into identifiable structures. We investigate the social world in its context, which counts as evidence, concepts, measures, etc. (Letherby et all, 2013). This research also uses the qualitative research methods, such as textual analysis (Lockyer, 2008), comparative method (Vogt, 2005), and generalization (Willams, 2004).

Findings. The main scenarios in creating the legal framework for social enterprises are whether the adaptation of existing legal forms or creation of new legal forms taking into account the specific features of social enterprises. Some law makers react in different way by creating the so called social enterprise legal status, or legal qualification. However, the ultimate European legal form of social enterprise is particularly difficult to develop considering very different traditions of the development of social entrepreneurship in different countries.

Research limitations/implications. This is a general review of the EU legislation regulating this area, and of social entrepreneurship legal regulation in the selected EU Member States and the USA, which possibly could stimulate the further research and discussion.

Practical implications. This research will contribute to the deeper analysis of the legislation in this area and more defined legal categories and positioning of social entrepreneurship in the legal systems of the EU Member States. The results of the research can be useful improving the national legal framework on social entrepreneurship, which is clearly insufficient in nowadays stage of rapid popularization of social entrepreneurship in Lithuania.

Originality/Value. This research looks for the legal preconditions of social entrepreneurship in the EU legislation and uses the comparative method to identify and examine the most common legal framework for social enterprises in the EU Member States.

Keywords: social enterprise; social enterprise law; corporate form; certification.

Research type: general review.
Introduction

Social enterprises (or social entrepreneurship in general) aims to be the nowadays alternative for the traditional business models or the corporate social responsibility in pursuit of social mission and sustainable profit-generating activity. Moreover, social entrepreneurship is not only about to facilitate its social mission, but its initiatives create new forms of business and society partnership, from which benefit not only target social groups, but also the whole society.

In order to use the opportunities of social entrepreneurship, particular countries in the European Union have created, and some are just developing, the legal frameworks for this form of economic activity. Though, the existing legal forms of social enterprises in the EU member states vary from state to state. The current EU legislation also doesn't form any legal framework for social enterprises.

The justification of the concept of social entrepreneurship and definition of its legal framework and regulatory characteristics are important for every state individually. Lithuania is also starting its way toward the national definition of the social entrepreneurship and its legal framework. In this step different legal approaches should be considered to define what kind of legal forms are available to facilitate the legal concept of social enterprises.

However, many countries still lack an enabling framework for encouraging the creation and development of social enterprises. However, there is no, and can't be the ideal type of social enterprise.

The European Commission defines 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 its 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, involves employees, consumers and stakeholders affected by its commercial activities.¹

It should be noted that the Communication of the Commission doesn’t emphasize any specific form of legal entity as a social enterprise.

In the EU Member States situation differs from state to state. But some patterns can be distinguished. The researchers who concentrate on the investigation of social enterprises all over the Europe and beyond highlight that social enterprise may take a number of different organizational forms: non-profits, partnerships, foundations and other (Kerlin, 2006).

So far it is up to the particular country to decide whether the social enterprise is supposed to obtain special legal form or not. The main goal of this research is to define what are the main legal approaches to facilitate the creation of social enterprises? What kind of advantages or disadvantages have these models? In order to answer these questions, we investigate some recent legal initiatives in the selected EU countries and the United States of America.

The researchers usually deal with the problems of social entrepreneurship through the prism of economics. Individually it can be mentioned such authors as Austin et al (2006), Lasprogata and Cotten (2003), Bacq and Janssen (2011), etc., whose insights can be valuable for the further research of this topic.

¹ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Social Business Initiative. COM (2011) 682 final.
The Main Concepts of Legal Framework

We already mentioned that the European Commission doesn’t emphasize any specific form of legal entity as a social enterprise. However, some countries have chosen to adopt the legislation defining specific legal form of the social enterprise. We have to mention that here we speak about the social enterprises in broader sense of their definition in contrary to the social enterprises that in some countries are linked only to employment of disadvantaged people or people from specific socially vulnerable groups (so called work integration social enterprises). For example, this kind of social enterprises is defined by the Law on Social Enterprises of the Republic of Lithuania.¹

But recently some progress was done also in Lithuanian national legislation defining the social entrepreneurship. In 2015 Lithuanian Ministry of Economy adopted the Concept of the Social Entrepreneurship, which aims to define the main principles of the social entrepreneurship, identify the problematic areas and determine general tasks to foster the development of the social entrepreneurship. The document doesn’t define any specific legal form of the social enterprise yet, but it aims to evaluate the best practices of other European countries in legislation of the social entrepreneurship.²

Lithuanian model of the legal framework for the social enterprises is yet to be defined. Some other countries have more advanced legal frameworks that basically can be divided in the two broad categories (EC, 2015). The main models are:

1. Adaptation of existing legal forms or creation of new legal forms taking into account the specific features of social enterprises;
2. Creation of a social enterprise legal status, or legal qualification.

In the first category some countries have created new legal forms for social enterprise by adapting or modifying existing legal forms. In some Member States of the EU a separate new legal form for social enterprise has been created by adapting the cooperative legal form (e.g. in France, Greece, Italy, and Poland). Some other countries recognize social cooperatives in their existing legal form covering cooperatives in general (e.g. in Portugal, Spain, etc.). The United Kingdom developed a legal form (Community Interest Company) for use by social enterprises only (EC, 2015).

In the second category some countries have introduced the so called social enterprise legal status. The idea of this concept is that the legal status of social enterprise can be adopted by different types of organizations, but these organizations have to meet the pre-defined criteria (e.g. in Denmark, Belgium, etc.). The legal status can be obtained by the most of traditional organizations: cooperatives (traditional and social), investor-owned companies (share companies), associations, or foundations (EC, 2015).

To be more objective, it is useful for this research to have a comparison with some beyond-EU legislation. Recently many states of the USA have introduced three new

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¹ The Law on Social Enterprises of the Republic of Lithuania links social enterprises only with the employment of persons from specific social groups who have lost their professional and general capacity for work, are economically inactive and are unable to compete in the labor market under equal conditions, to promote the return of these persons to the labor market, their social integration as well as to reduce social exclusion. See: Law on Social Enterprises of the Republic of Lithuania. Official Gazette. 2004, No. 96-3519.
² Concept of the Social Entrepreneurship adopted by the order of the Minister of Economy of the Republic of Lithuania. 2015, No. 4-207.
legal structures: the low-income limited liability company, the benefit corporation and the flexible purpose corporation.

As emphasized by some researchers (Urich, 2013), the low-income limited liability company offers changes to the limited liability company format in an effort to create small business interested in social good. The benefit corporation and flexible purpose corporation offer changes to corporate law shifting the primary purpose of the business to serve the needs of shareholders and permitting social and environmental objectives.

Some authors stress that social entrepreneurship can be defined as the so called for-profit charity and point out that historically philanthropic activities and legal structures are largely unrecognized by the legal literature. Today's social changes influence development of the legal environment. It leads to development of new legal entities like for-profit charitable enterprises. The science has to provide adequate attention to the investigation of this phenomenon (Rana, 2013).

Bacq and Janssen emphasize that the social entrepreneurship organization can adopt either a non-profit or a for-profit organizational form and should not be limited to any specific legal form. This perspective results in the emergence of various hybrid organizational forms: independent, they can generate profit, employ people and hire volunteers. This new legal form represents a hybrid organizational type, partly non-profit and partly limited company (Bacq and Janssen, 2011). Many European countries have introduced such special legal entities, but despite all these newly created legal forms across Europe, there are legal forms that have existed for a long time, namely associations, co-operatives or traditional business forms (some examples are investigated in this paper later on).

**Dedicated Forms of Legal Entities or a Social Enterprise Legal Status: Who Really Wins?**

Whether it is a dedicated legal form, or a legal status, it can be noticed that in any way the legal recognition of social enterprises is essential in every country. The legal forms or statuses allow to recognize the specificity of social enterprise and contributes to giving them a clear identity. Moreover, the definition of the identity of social enterprise allows policy makers to design and implement specific public policies for social enterprises, such as measures under tax and public procurement law. It also helps to prevent misuse of the social enterprise status and allows for social investors to identify the potential investees (EC, 2015).

But which way (legal form or legal status) is more beneficial for social enterprises and society? A new corporate form can be introduced as an entirely new form, unconnected with existing company law, or as new category within the existing regulation with a few special rules or exemptions. If the new corporate form is launched, there will be inevitable costs for companies that would like to switch to new legal form. Such situation could be avoided or minimized by introducing a new category of existing corporate forms without launching a new legal form (Sorensen and Neville, 2014).

This approach has been used in the United States for the benefit corporations, and in the United Kingdom by the community interest companies. The benefit corporation in the US is a class of corporation which legally requires companies to provide a general benefit to society and stakeholders (employees, communities and the
environment). It is a for-profit business, that aims to create a material positive impact on society and the environment.

Urich (2013) emphasizes that as the society modifies its values, the legal system must adapt and accommodate the new perspectives and the American legal system responds to these changes. In the United Kingdom the community interest company is a limited company, which activities are being carried on for the benefit of the community. In both cases, if this option is chosen, undertakings of an existing legal form can be re-registered as a social enterprise without incurring significant costs.

France in 2014 provided a combined model, allowing traditional corporate entities and new enterprises to become social enterprises. The French Law on Social and Solidarity Economy (2014) acknowledges both the historical social economy entities (cooperatives, associations, mutuals and foundations) and the newly created enterprises with a social goal (Kolosy, 2014).

Another method how a company can obtain a social enterprise status is through a dedicated certification scheme. In Denmark a law on registered social enterprises was adopted by the Government in June 2014. The law aims to introduce a registration system for social enterprises that can provide the basis for a common identity. The registration system will allow enterprises that meet certain standards for their operation and transparency to demonstrate their social characteristics to authorities, business partners and customers through an exclusive right to use the term “registered social enterprise”. More than 14 different legal forms are currently being used by social enterprises in Denmark. The majority of social enterprises are established as associations, foundations or companies limited by shares. All of them will be able to apply for a registered social enterprise status (EC, 2014).

Quite similar example can be presented from Belgium social enterprise legal framework. The Belgian Parliament approved a law creating the legal status of a “social purpose company” back in 1995. The Law sets out the conditions that an organization must meet in order to obtain this status. But there is no specific legal form designed exclusively for social enterprise. Social enterprises adopt a variety of legal forms in Belgium, the most common being a non-profit organization (EC, 2014).

From the point of view of the legal realism, such situation illustrates that the social world objects have varying probabilities of coming into existence and causing new objects. As the assumption of realism we understand the idea that things in the world happen regardless of whether we observe them, or even know them. The starting point of the realist account of law is its critique of a purely doctrinal understanding of law. In the above mentioned examples we see that law is a going institution (or set of institutions) caused by the tensions: between power and reason, and tradition and progress and a social process is not something that can happen at a certain date (Dagan, 2015).

It is clear that legal frameworks of social entrepreneurship develop in many countries responding to the needs of society in new ways to practically facilitate the ideas of social entrepreneurship. The law makers react in different ways, but the common patterns in pursue of this mission can be spotted. Because otherwise in different countries laws on associations, foundations, non-profit corporations and charities would have limited or no ability at all to carry out business activities, since the mentioned legal forms were originally dedicated for the development of donative or redistributive activities, rather than for business activities. Company law was

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designed to maximize shareholder value. Therefore, the pure legal forms of the non-profit sector and the pure forms of the for-profit sector are inadequate to accommodate the phenomenon of a social enterprise (Fici, 2015).

It has to be stressed that the social enterprises influence the theoretical concept of enterprise in general: the conception of enterprises as organizations promoting the exclusive interests of their owners is questioned by the emergence of enterprises supplying general-interest services and goods in which profit maximization is no longer an essential condition (Galera and Borzaga, 2009).

Legislators may, and probably have to promote the role of social enterprises by defining organizational models. These models, first of all should be set to maximize the effectiveness of enterprises. Legislation should be based on default rules for social enterprises, allowing a reasonable amount of self-regulation. So, in this way we speak about the framing the main principles of the governance of social enterprises (Cafaggi and Iamiceli, 2009). Drawing the line between for-profit and social enterprises, it can be emphasized that both legal entities are created and governed under the state law, have organizational structure, governing rules and capital formed by shareholders. However, social enterprises can and often earn a profit, but they are not permitted to distribute those earnings to their shareholders. This restriction supposed to be included in the articles of incorporation of such social enterprise (Lasprogata and Cotten, 2003).

The international research on the legal forms of the social enterprise distinguished three main models of legislation on social enterprise: the cooperative model, the company model, and a model based on a freedom of choice of legal forms (Fici, 2015).

The last mentioned case covers the certification schemes. Now it can be noticed that certification schemes have some visible advantages. All corporate forms can use them if the companies’ legislation allows the pursuit of social purposes. One of the most important advantages is that certification doesn’t require reincorporation as a new form of company, because reincorporation can lead to significant costs.

Because certification usually would be administered by a public authority, which would supervise and apply sanctions, the misuse of the certificate could be avoided. Regarding the sanctions, it could be simpler implemented with a certification scheme than with a new corporate form. In the case of failure, it would be easier to revoke the certification, while a similar action applied to a new corporate form requires the company either to be converted into other form, or wound up (Sorensen and Neville, 2014).

In any way, all above mentioned examples have a common attribute – the countries have introduced legal framework, acknowledging the importance of legal certainty in the field of social enterprise. It should be emphasized one more time that mostly social entrepreneurship is not defined by legal form, as it can be pursued through various vehicles and examples of social entrepreneurship that can be found within non-profit, business or even governmental sector. The authors define social entrepreneurship as innovative, social value creating activity that can occur within or across the non-profit, business or government sectors. Despite the distinguishing of social entrepreneurship by its social purpose and through multiple organizational forms, there is still significant heterogeneity in its definition (Austin et al, 2006).

Probably the biggest challenge in the countries seeking further development of the social entrepreneurship is to develop company law rules that ensure that social
enterprises actually pursue their social purposes, avoiding the misuse of the status of social enterprise on one hand and ensure sufficient flexibility in their regulation on the other, eliminating obstacles in further development of social entrepreneurship sector in general.

The Common EU Legal Framework: Does it Exist?

The question, whether the common EU legal framework for social enterprises exist, can be answered positively. We have mentioned the Commissions Communication on Social Business Initiative. The Communication is a not binding document, so the Member States can define their own legal status and general legal framework for the social enterprise. However, there are several cases where the social entrepreneurship is mentioned in the obligatory EU legislation.

The EU included the definition of the social enterprise into the Regulation on a European Union Programme for Employment and Social Innovation.\(^1\) The definition in the Regulation doesn’t differ much from the one defined in the above mentioned Social Business Initiative. Of course, this definition shall be used only for the purposes of this Regulation – defining the subjects who can benefit from the measures set in the Regulation.

The other example is the Directive 2014/24/EU on public procurement. This Directive establishes rules on the procedures for procurement across the EU.\(^2\) It also allows the Member States to include the provision on so called “reserved contracts” in national legislation, to create better conditions for the economic operators whose main aim is the social and professional integration of disabled or disadvantaged persons to participate in public procurements.

For the moment there are no more binding legal acts at the EU level defining some sort of obligations for the Member States regarding the legal status for social enterprise. Even the above mentioned legal acts cannot be called legal binding in the strict way of sense, because the specific legal regime for the social enterprise is applied only in the context of the purposes of particular Regulation and Directive. Coming back to the question raised in the beginning of this chapter, supposedly we should raise it another way: is the common EU legal framework for social enterprises really necessary?

Considering the interruption to the work on the Statute for a European foundation the perspectives of a potential European social enterprise might look unclear and unpredictable. The Proposal on the Statute for a European Foundation was presented in 2012. The main purpose of the Proposal was to create new European legal form intended to facilitate foundations' establishment and operation in the single market. It would allow foundations to more efficiently channel private funds to public benefit purposes on a cross-border basis in the EU. After the unsuccessful negotiations the Proposal was withdrawn from the EU legislative agenda in December 2014.\(^3\)

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The ultimate form is particularly difficult to develop given the diversity of approaches among EU member states (Fici, 2015). In any way, poor understanding of the concept of social enterprise could be defined as one of the most important aspects for the future development of this sector.

It was mentioned in this paper that the legal framework didn’t necessarily have to include the creation of the specific legal form of social enterprise in every Member State. Considering very different traditions of the development of social entrepreneurship in different countries, the unified European legal form of the social enterprise wouldn’t help either. However, some legal frameworks at national level are necessary to provide legitimacy and visibility to social enterprises; attract tax incentives related to furthering a social purpose; and to allow the social enterprises to undertake unlimited economic activity (EC, 2015).

From the scientific point of view, continuing research and evaluation in this field will be needed, given the complexity and variation across Member States. Future evolution of different types of social enterprises is inevitable. The future research of different practices in different countries would help moving barriers and looking for solutions that would suit in different cultural environment of social entrepreneurship in different states.

**Conclusions**

Legal frameworks are important tools for establishing social enterprises. It can provide clarity by defining which entities can be considered as social enterprises, what are their duties, main objectives, and fiscal aspects of their operation. In any way such legal regulation shouldn’t be too strict, to avoid the over-regulation and allow to use more flexible legal tools.

Social entrepreneurship legal frameworks develop in many countries responding to the needs of society in new ways to practically facilitate the ideas of social entrepreneurship. The main scenarios in creating the legal framework for social enterprises are whether the adaptation of existing legal forms or creation of new legal forms taking into account the specific features of social enterprises. Some law makers react in different way by creating the so called social enterprise legal status, or legal qualification.

Some common patterns of the above mentioned forms can be spotted. If the new corporate form is launched, there will be inevitable costs for companies that would like to switch to new legal form. Such situation could be avoided or minimized by introducing a new category of existing corporate forms without launching a new legal form. This approach has been used in the United States for the benefit corporations, and in the United Kingdom.

A dedicated certification scheme that was recently introduced in Denmark and earlier in Belgium is based on a freedom of choice of legal forms and has some visible advantages. All corporate forms can use them if the companies’ legislation allows the pursuit of social purposes. One of the most important advantages is that certification doesn’t require reincorporation as a new form of company, because reincorporation can lead to significant costs.

Probably the biggest challenge in the countries seeking further development of the social entrepreneurship is to develop company law rules that ensure that social enterprises actually pursue their social purposes, avoiding the misuse of the status of
social enterprise on one hand and ensure sufficient flexibility in their regulation on the other.

The ultimate European legal form of social enterprise is particularly difficult to develop considering very different traditions of the development of social entrepreneurship in different countries. Therefore, it could be recommended to continue the research on different practices in different countries, which would help moving barriers and looking for solutions that would suit in different cultural environment of social entrepreneurship in different states.

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