

Gdansk Social Economy Conference

Gdansk, June 26-28, 2008

Panel E

Whether to regulate social entrepreneurship and why?

**Regulating social enterprises:
a comparative view on some of the legal models
in the European context**

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Structure

- ✓ Why to regulate social enterprise?

- ✓ How to regulate social enterprise?

Comparing some European models

*(looking at laws specifically – not only incidentally -
concerning social entrepreneurship)*

I. A view from recent legislation (Italian SE; English CIC)

II. Some legal issues: a comparative analysis

- ✓ Concluding remarks and hints for discussion

Why to regulate social enterprise?

In abstract terms:

- ⇒ to *legitimate* a social and economic phenomenon and reduce uncertainty on rules which are applicable to it (this could imply a selection or coordination among already existing rules or the introduction of new regulation)
- ⇒ to provide *incentives* (monetary or not) to promote a specific type of organisation which has been proved to be efficient and apt to produce social and economic value
- ⇒ to provide new organisational models which are more consistent than the ones already available with the objectives of a social enterprise
- ✓ The list, of course, is not all-inclusive
- ✓ The mentioned scopes are not alternative

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- ✓ For example, in Italy, the need for a regulation arose because:
 - ✓ (1) a legal definition of the social enterprise was still lacking;
 - ✓ (2) it was not definitively clear which entities could legally operate as enterprises and which legislation should be applied in that case;
 - ✓ (3) even preliminarily, many of the entities, that were eligible in abstract terms, lacked (appropriate) legislation concerning the exercise of an enterprise and the legislation concerning the ordinary enterprise could not be considered adequate with respect to the social finality

- ✓ For example, in the United Kingdom the existing legislation on charities, although supporting many important initiatives in this area, especially thanks to a favourable tax regime, is considered as too demanding on an administrative level and too restrictive with respect to the potentiality of the sector; moreover it does not address relevant aspects of social enterprises, like financing or economic reporting;
 - ✓ “Compared to a charitable company the CIC has: greater flexibility in terms of activities, no trustees and no trustee control, directors who can be paid, but this is regulated, light touch regulation, but no tax incentives” (official presentation, <http://www.cicregulator.gov.uk>)⁴

How to regulate social enterprise

(I) A view from recent legislation in Europe – *The case of Italian social enterprise (l.d. 155/2006)*

- **Definition of SE:** any kind of private organisation (e.g. associations, foundations, co-operatives, non-cooperative companies) which permanently and principally operates an economic activity aimed at the production and distribution of social benefit goods and services while pursuing general interest goals.
- SE may not limit their goods or services to members only.
- **Social benefit goods and services** qualified on the basis of
 - economic and social sectors (social assistance, healthcare, education, environment, cultural sector, social tourism, university education, research and cultural services, instrumental services for SEs), or
 - the specific scope of the enterprise, namely the working integration purpose of the organisation (minimum 30% disadvantaged workers)
- **Non-distribution constraint** (also for companies), except for:
 - “capped” remuneration of financial instruments in favour of non-members (today 5%).

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- (In associations companies) majority of **directors** shall be appointed by members (non-members may appoint the remaining part)
- SE may not be “controlled” by for profit entities and/or by public entities (**independency requirement**)
- Required: **beneficiaries’ and workers’ involvement** (information, consultation, participation, influence on specifically relevant decisions)
- **Limited liability** if assets amount to a certain value
- **Accounting and reporting rules** (derived by company law)
- **Social balance** sheets requirement
- **Internal or external auditors** (if applicable on the basis of legal requirements mainly concerning the size of the firm)
- *Please, note that social cooperatives are considered as SEs, provided that they meet the social balance sheet requirement and the requirement concerning beneficiaries’ and workers’ participation.*

How to regulate social enterprise
(I) A view from recent legislation in Europe –
The case of English Community Interest Company
(Companies Bill 2004)

- “A company satisfies the community interest test if a reasonable person might consider that its activities are being carried on **for the benefit of the community**” (political parties are explicitly excluded)
- **Limited profit distribution** admitted (below a **cap**, as defined by public authority, today 5%) in favour of equity holders
- **Limited remuneration** of debt holders (below a cap, also defined by public authority): they do not become members
- **Appointment of the majority of directors**: reserved to members
- **Voting powers**: correlated with equity shares (in companies limited by shares); “one member one vote rule” (in companies limited by guarantees)
- **Stakeholders’** participation: it may include information practices, consultation processes, methods of feedback, open forum
- Substantial **monitoring powers** awarded to public authority (e.g.: directors’ appointment and removal, management’s appointment, property restriction or transfer to a public agent)
- Economic and **social balance sheet** and report (Community interest annual report), also (possibly) based on **evaluation by beneficiaries**

How to regulate social enterprise

(II) Some of the issues

1. Should the law identify a specific legal form for SE? If ever, should it be one of the already existing legal forms or should it be a “tailor-made” legal form?
2. How to define the notion of social entrepreneurship as distinctive from or within the non-profit area?
3. Which constraints is it appropriate to introduce in terms of asset allocation and destination of profits?
4. Which interests should be represented in the governance structure of the organisation? How should this structure be defined?
5. How should accountability and responsibility be regulated and enforced?

1. The legal forms – Three main options

THE “CO-OPERATIVE” OPTION, e.g.:

Italy (I-sc)

Social co-operative (SC-It), l. 381/91

Portugal (Pt)

Social solidarity co-operative (SSC), law of December 22, 1997

France (Fr)

Société Co-opératif d'Intèrêt Collectif (SCIC) – law of July, 17, 2001, n. 624

Poland (Pl)

Social co-operative (SC-Pl) – law of April, 27, 2006

THE “COMPANY” OPTION, e.g.:

Belgium (B)

Société a finalité sociale (SFS) - reform of company code by law of April 13, 1995

United Kingdom (UK)

Community Interest Company (CIC) - Companies – Audit, Investigations and Community Enterprise – Bill (2004, in force since July 2005)

THE “OPEN FORM” OPTION, e.g.:

Finland (Fi)

(Work integration) Social enterprise (WISE) - law 1351/2003, in force since January 2004

Italy (I-se)

Social enterprise (SE), d. lgs. 155/06

(a) The “co-operative” option **[e.g. Italy, Portugal, France, Poland]**

- ✓ The social enterprise is legally construed as a cooperative company
 - ✓ its aim is to benefit the public at large or specific categories of disadvantaged persons;
 - ✓ social inclusion and work integration represent the main focus; however some legal systems extend the role of social cooperatives beyond this domain (I, Pt, F);
 - ✓ members are usually workers, but legal systems differ for the threshold of necessary disadvantaged workers (30% in I, 80% in PI) and for the (sometime mandatory) inclusion of other categories of members (F, Pt);
 - ✓ different rules on profits allocation apply depending on the legal system (see below);
 - ✓ “one member one vote rule” generally applies, although exceptions are made (e.g. I, see below).

(b) The “company” option

[e.g. Belgium, UK]

- ✓ The social enterprise is legally construed as a company (in its several forms, including the cooperative one)
 - ✓ the distinctive element of this form is given by the particular nature of the scope and activity of the organisation (the ability of satisfying “community interest” for the CICs in the UK; the “social purpose” and the exclusion of economic benefit for the members of the SFS in Belgium);
 - ✓ so conceived, the social enterprise inherits the advanced regulation of for-profit companies, although deviation from the standard rules is made in relation to the social finality of the company;
 - ✓ particularly, profits distribution is more widely accepted, although within limits;
 - ✓ the “one member one vote rule” is generally substituted by the ordinary correlation between capital investment and voting rights, although limits are determined also under this profile;
 - ✓ this model tends to be assimilated to the previous one if the cooperative form is chosen (part.: Belgium).

(c) The “open form” option

[e.g. Finland, Italy]

- ✓ No specific legal form is connected with social enterprise, nor a new legal form is created.
- ✓ Whatever legal form of organisation (e.g. association, foundation, cooperative company, non-cooperative company) may be adopted, provided that some requirements are met.
- ✓ According to the purpose of legal intervention (e.g. directing public funds to a certain area of interest – Fi - / providing more clear legal and operational models for SEs – It -), these requirements may regard more extensively the finality, the type of activity, the governance structure of the organisation, etc.
- ✓ Therefore the “open form” is more a “label” apt to include quite different realities than a model as such.

Standardisation v. flexibility

- ✓ *(Flexibility)* The “open form” option offers the advantage of “shopping” through the models and legal forms and searching for the “optimum result”, without forcing entrepreneurs to become familiar with a new form and new comprehensive legislation.
- ✓ However, it faces the challenge of the problem of major co-ordination among the several forms (whose regulation is separately applicable)
- ✓ *(Standardization)* Not to bear such “co-ordination costs” a legislator may prefer to introduce a totally new form of enterprise or to refer to a sole existing legal form (e.g., a co-operative company).

2. What is a social enterprise? About finality and activity

Two questions

✓ **Who will be in charge of defining what social finality means?**

- ✓ The social finality is directly defined by the law (Italy, France, Portugal, Poland, Finland).
- ✓ The definition is delegated to a public regulator different from the legislator (United Kingdom).
- ✓ The definition is delegated to private parties by reference to the bylaws of the private organisations which operate as social enterprises (Belgium).

✓ **How should this be defined?**

- ✓ The social finality is defined as mainly regarding the *sectors* in which the enterprise will operate (Italian social enterprise, partially Italian type A social co-operative).
- ✓ The social finality is defined as mainly regarding the *type of beneficiaries* (United Kingdom, Portugal).
- ✓ The social finality is defined as mainly regarding the *results* that the activity is intended to achieve (work integration, social inclusion, answering not-satisfied needs, access to certain goods or services, etc.) (France, Italian type B social co-operatives, Poland, Finland).

Legal definition v. self-regulation

- ✓ The one of “social purpose” is a dynamic concept, whose contents may vary according to the legal, social and economic context: more than others it is influenced by the varieties of legal systems.
- ✓ Given this awareness, legislators should at least provide a minimum set of criteria or proxies apt to define the domain of SE, however broadly.
- ✓ Within this framework an approach which allows private organisations (e.g. non-profit network associations) to specify the possible applications of this concept may help to determine its contents in a direction which is closer to social needs.
- ✓ The several dimensions and practices of social enterprise in Europe would suggest that an open approach inclined to consider a plurality of areas of interest for SE (e.g. beyond the work integration function) would better reflect the potential of SE.

3. The asset allocation and the distribution of profits

A double constraint is normally imposed on the allocation of assets:

- ✓ a *negative* one, concerning the prohibition of distributing profits and other resources to members (and, in some laws, directors, employees, financiers);
- ✓ a *positive* one, regarding the allocation of these resources to reserves or, generally, to the financing of social institutional activities
 - ⇒ Distinction btw a SE and an ordinary non-profit organisation

Several options within the “asset lock” of SE

- ✓ Total non-distribution constraint (SC in Portugal and in Poland)
- ✓ “Capped” remuneration allowed in favour of members holding shares or equivalent financial instruments (SCICs in France, SC in Italy, SFS in Belgium, CICs in the UK)
- ✓ “Capped” remuneration allowed in favour of non-members holding financial instruments (SCICs in France, SCs and SEs in Italy, CICs in the UK)

The impact on governance structure

- ✓ Where remuneration to members holding financial instruments is allowed, restrictions normally apply in terms of voting power and/or right to appoint or to be appointed as directors (see part.: Italy and, partially, UK)

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On the one side:

- ✓ The allowance for a partial remuneration of financial instruments in the social enterprises is an important tool for its sustainability and growth. It contributes to reducing or annulling the dependency of the enterprise on public support and fosters its capability of making innovative investments in order to successfully compete in the market.
- ✓ Financiers' participation could help the enterprise to operate according to efficiency standards.

On the other:

- ✓ At some point, this complementary view may enter a conflict with other major interests as pursued by the social enterprise in terms of safeguarding beneficiaries, for instance.

This is why legal systems:

- ✓ limit the remuneration below a cap: the enterprise is interested in financiers who are willing to give up part of the remuneration in favour of social goals;
- ✓ limit the financiers' power of participating in the governance below the "control threshold", so that critical decisions may always be controlled by persons whose major interest is not financial.

Moreover:

- ✓ Legal provisions on conflict of interests should also be included in the legal framework of SEs that assign voting rights to remunerated financiers (this is not always the case today)

4. Which rights for which stakeholders?

ABOUT MEMBERSHIP

Several options (not necessarily alternative)

- ✓ Mandatory membership for one or more classes of stakeholders:
 - ✓ beneficiaries (SCs in Poland)
 - ✓ workers (type B SCs in Italy, but only preferably; SFS in Belgium: workers have a right to be admitted as members)
 - ✓ beneficiaries or workers (SCs in Portugal)
 - ✓ beneficiaries and workers (SCICs in France)
- ✓ Mandatory multi-stakeholder membership:
 - ✓ 3 different classes have to be included (SCICs in France)
- ✓ Non-discrimination principle regarding the admission of members (Italian SE)

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ABOUT MEMBERS' VOTING RIGHTS

- ✓ within the “*co-operative model*” the “one member, one vote rule” is generally adopted, although with exceptions;
 - ✓ within the “*company model*”, the ordinary correlation between capital investment and voting rights operates, although, in some cases, the law mitigates this correlation establishing a minimum and maximum concentration of votes in favour of a single member (as in the Belgian law) or includes legal forms in which the “one member, one vote rule” operates (as for companies limited by guarantees in the UK);
 - ✓ within the “*open form model*”, one of the two mechanisms comes into account depending on the specific legal form of the social enterprise.
- => Dynamic **convergence** towards a rule which favours pluralism and avoids the emergence of controlling rights for single members

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ABOUT NON-MEMBERS

- ✓ Right of information, consultation and participation rights for employees, customers and the community at large as prime stakeholder (English law) or for workers and beneficiaries (Italian law on SE)
 - ✓ See, part. the Italian provision (art. 12):
beneficiaries and workers have a formal right to be involved in the governance of the organisation through mechanisms of information, consultation and participation which allow them to influence internal decision-making, at least with reference to those issues which affect work conditions and the quality of the goods or service supplied

5. Accountability and responsibility issues

- ✓ Some laws merely include information and reporting duties directed to make the SE accountable with respect to the economic and financial situation (Pt)
- ✓ Many more tend to require a so called “**social balance sheets and reporting**” (Fr, B, UK, I, PI)
- ✓ See, part. the Italian provision on social balance sheets’ structure, as recently enacted:
 - ✓ Introduction and methodology
 - ✓ General information on the organisation and its directors
 - ✓ Governance structure and administration
 - ✓ Objectives and activity performed to achieve these objectives
 - ✓ Financial situation
 - ✓ Other (optional) information (e.g. involvement of beneficiaries and workers)

Some concluding remarks: a proposal left to discussion

The set of rules concerning SE, whatever the specific legal form/s and overall legislation, should guarantee:

- ✓ the possibility of carrying on an activity, which can be qualified as entrepreneurial, as the main activity of the organisation;
- ✓ a control mechanism over the social nature of the finality pursued by the organisation, as defined at least per broad principles by the law;
- ✓ the enforcement of a positive (although not total) assets lock to ensure the achievement of social goals (this also implies a non distribution constraint, although partial);
- ✓ the possibility for the enterprise to sustain its own activity through remunerated financing;

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- ✓ a certain degree of stakeholders' interests representation inside the governance of the enterprise, with specific but not necessarily exclusive representation with regard to beneficiaries and employees;
- ✓ the enforcement of a non-discrimination principle concerning the composition of membership, if any;
- ✓ the enforcement of a democratic principle inside the governing bodies which allows pluralism, fair dialogue and no emergence of controlling rights, unless in favour of non profit organisations which share the social goals and the democratic nature of the social enterprise;
- ✓ an adequate degree of accountability which allows sufficient information disclosure (also in favour of third parties) about the governance and the activity of the social enterprise.

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- ✓ If (some of) these contents are deemed as appropriate, should the law be in charge of covering all these issues?
- ✓ Which should the role of self-regulation be, if any?
- ✓ Which adaptation and coordination would such a law require with respect to other pieces of legislation, such as the ones regarding non-profit organisations in general, company law, labour law, tax law?
- ✓ Could it be possible and appropriate to regulate social enterprise without specifically regulating its fiscal status (like in Italy and in the United Kingdom)?