

# LEGAL FRAMEWORKS FOR SOCIAL ENTERPRISE

Lessons from a Comparative Study  
of Italy, Malaysia, South Korea,  
United Kingdom and United States

Anna Triponel and Natalia Agapitova



**WORLD BANK GROUP**

## ABSTRACT

Social enterprises are emerging as a new area of public policy: several countries seek to stimulate private sector contribution to development outcomes, and social enterprises could be important players in that agenda. However, those seeking a middle ground between for-profit and non-profit sectors to enable social enterprise have found legal frameworks to be lacking. This has triggered a range of legal developments over the past ten years, with a number of countries seeking to implement appropriate legal frameworks that can support and stimulate the development of social enterprise. These legal frameworks can both define social enterprise as well as to structure it, through the creation of new legal forms and regulations. The objective of this study is to analyze various definitions and forms under which social enterprises operate in five countries and the implications for public policies. The study is based on literature review and a small number of interviews clustered around Italy, Malaysia, South Korea, the United Kingdom and United States, where social enterprise has attracted government's interest. The study analyzes how the government operationalized its engagements with social enterprises. It takes a historical perspective to understand the legal forms available to, and adopted by, social enterprises, and the advantages and disadvantages of various approaches.

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**Keywords:** Social Enterprise, Legal Framework, Innovation, Service Delivery  
**JEL Codes:** L31, L38, M14, O35

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# ACRONYMS

BIS	United Kingdom Department of Business, Innovation and Skills <sup>2</sup>
CIC	Community Interest Company
CSR	Corporate Social Responsibility
ILO	International Labour Organization
LLC	Limited Liability Company
LLP	Limited Liability Partnership
L3C	Low-Profit Limited Liability Company
MaGIC	Malaysian Global Innovation and Creativity Centre
NGO	Non-Governmental Organization
SEM	Social Enterprise Mark
SEUK	Social Enterprise United Kingdom
SPC	Social Purpose Corporation

<sup>2</sup> The UK Department for Business, Innovation and Skills was replaced by the Department for Business, Energy and Industrial Strategy in July 2016.

# 1. INTRODUCTION

We can safely say that Milton Friedman’s words, that the social responsibility of business is to increase its profits, no longer apply today (Friedman 1970). A change in attitude has occurred since the 1970s with regard to the role of business, and this has been followed by a number of legal developments.

There have been changes to business law to reflect the changing view of the role the board of directors plays, the body that governs a company on behalf of its owners (the shareholders). U.S. business law started to evolve in the 1980s with the adoption of constituency statutes that permitted directors to look beyond shareholder interests to consider the effects their decisions would have on other stakeholders. This included employees, local communities and customers (Bainbridge 1992). In the United Kingdom, the Companies Act of 2006 adopted for the first time what is known as the “enlightened shareholder value” approach, which requires U.K. company directors to “have regard to” a range of stakeholder interests as they promote the success of the company for shareholders.<sup>1</sup> These interests include the interests of the company’s employees as well as the impact of the company’s operations on the community and the environment. Courts and parliaments in other countries have also resorted to the enlightened shareholder value approach as a way to ensure that their company directors are not prioritizing profit at all costs.<sup>2</sup>

More recently, international, European Union, and domestic laws have sought to keep pace with the increase in wealth, power, and influence of large multinational companies resulting from globalization. In 2011, the UN Human Rights Council unanimously endorsed a new framework for companies in the field of human rights, encapsulated in the UN Guiding Principles on Business and Human Rights. Although this document represents soft law with no binding effect per se, the concepts it contains have since been transposed into a range of guidelines and domestic laws.

In particular, in 2011 the European Commission re-defined corporate social responsibility (CSR) to mean “the *responsibility* of [companies] for their *impacts* on society.” (European Commission 2011) This is a significant move away from *asking* companies to offer philanthropy to *requiring* companies to manage their potential and actual negative impacts on people. Companies are already subject to a range of laws governing their societal impact, for instance, in the areas of consumer protection, customer privacy, worker rights and environmental impacts. Since the UN Guiding Principles, which make clear that all companies are expected to respect human rights, company laws and guidance from stock exchanges have evolved, to require greater consideration from companies on how they could infringe on human rights as they conduct their day-to-day business.

Nonetheless, these developments have been viewed as insufficient for those seeking to harness the potential of enterprise to tackle the world’s major development issues, such as housing, access to basic necessities and employment for marginalized populations. Social enterprises—broadly understood as businesses that prioritize achievement of social and environmental benefits over profit-making for their owners—have the potential to make a significant difference in economic development and reach the Sustainable Development Goals. However, founders of social enterprise can face difficulties when operating within existing legal frameworks. Traditional business law and

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<sup>1</sup> See Section 172(1), Duty to promote the success of the company, UK Companies Act 2006.

<sup>2</sup> From the Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, May 2011, p15.

the structures it provides for typically inhibit companies' ability to prioritize a social mission over the interests of shareholders. Individuals can resort to non-profit structures, such as charities, to prioritize a social mission. At the same time, although non-profits benefit from generous tax incentives, they are typically restricted in how they can access financing from the private sector.

Those seeking a middle ground between the for-profit and non-profit sectors to enable social enterprise have found legal frameworks lacking. This has triggered a range of legal developments over the past 10 years, with a number of countries seeking to develop appropriate legal frameworks to support and stimulate the development of social enterprise. These legal frameworks can both seek to define social enterprise as well as to structure it, through the creation of new legal forms. Although non-profits are becoming more cost-effective and business-like in the social enterprise arena, this paper focuses on for-profit structures since all of the countries analyzed have amended their existing for-profit structures for social enterprise (with the exception of South Korea).

The objective of this report is to analyze various forms under which social enterprises operate in developed and developing countries, and the implications for public policies. The study is based on a literature review and a small number of interviews clustered around five country cases where social enterprise has attracted the interest of the government. The study analyzes how the government has operationalized its engagements with social enterprises. It takes a historical perspective to understand the various legal forms available to, and adopted by, social enterprises, and the advantages and disadvantages of various approaches.

The report is structured as follows:

- Section 2 provides an overview of the significance and nature of the legal framework for social enterprise.
- Section 3 describes how a select number of countries (see Box 1) has sought to define and structure social enterprise.
- Section 4 concludes with some lessons learned from these countries with regard to legal frameworks for social enterprise.

This study is intended for development practitioners engaged in activities to develop social enterprise. Understanding the types of legal frameworks countries have put in place for social enterprise can help with assessing the merits and potential pitfalls in adopting legal definitions and forms for social enterprise. The study does not delve into the broader legal frameworks needed to support social enterprise, for instance, related to financing, business or governance. In addition, the lessons learned are influenced by the choice of countries selected as a focus of the study.

**Box 1: Rationale for selection of countries for this study**

- The **United States** has developed a number of legal forms for social enterprise since 2008.
- The **United Kingdom's** social enterprise movement has strong government support, benefits from a government-backed working definition and a legal form specifically created for social enterprise.
- **Italy** is commonly seen as the country where the modern social enterprise movement in Europe began in the early 1980s and 1990s and benefits from both a legal definition as well as a legal form commonly used for social enterprise.
- **South Korea** is the only Asian country to propose a legal definition for social enterprise and also has a social cooperative legal form that is used for social enterprise.
- **Malaysia** is seeking to define its approach to social enterprise and is learning from other countries in that process.

## 2. SIGNIFICANCE AND NATURE OF THE LEGAL FRAMEWORK

Social enterprises are a relatively new and expanding field of study. There is a large number of definitions for social enterprises, which are sometimes conflicting. The comparative reviews of various definitions (Dacin et al 2010) identify different schools of thought, most of which agree on the broad definition of social enterprises:

*Social enterprises could be private for-profit, non-profit and hybrid organizations with a social mission that use business approaches to achieve their objectives.*

Social enterprises typically draw upon a range of laws to govern their creation, day-to-day management, tax arrangements and dissolution. Since social enterprise sits at the inter-section of the for-profit and non-profit sectors, policy makers have, in certain countries, sought to encourage it by creating a tailored legal framework. When deciding on an appropriate legal framework, they are faced with two related questions:

*Should government seek to define social enterprise, or leave the definition to academics, practitioners and other commentators?*

*Should government create specific structures (i.e., legal forms) for social enterprise, or leave it to social entrepreneurs to tailor existing legal forms to suit their needs?*

A range of different approaches exist. A country can:

- Not define social enterprise, and leave it to social entrepreneurs to adapt pre-existing structures to social enterprise (e.g., Malaysia).
- Not define social enterprise, while creating a range of legal forms that can be used for social enterprise (e.g., United States).
- Adopt a working definition of social enterprise (which is adopted by the executive branch) and complement this working definition with a legal form specifically created for social enterprise (e.g., United Kingdom).
- Adopt a legal definition for social enterprise (which is adopted by the legislative branch) and combine this with a legal form that could be used for social enterprise-type activities (e.g., Italy, South Korea).

### 2.1. Defining Social Enterprise

All of the countries analyzed view social enterprise differently. This is due to central differences in opinion on what social enterprise entails, as further described in Box 2.

#### **Box 2: Key factors explaining the difficulty in defining social enterprise**

**Origin of social enterprise.** In some countries, social enterprises emerged primarily from the public sector as spin-outs and from the non-profit sector. In others, they emanated primarily from the for-profit sector. The origins of social enterprise in a particular country will invariably influence what are perceived as its key characteristics.

**Purpose of social enterprise.** Some view social enterprise as encompassing any activity, as long as it helps the community, while others view social enterprise as focused on a particular



activity, such as service delivery to the poor or access to employment for disadvantaged populations. Most agree that the social enterprise should have an explicit social or environmental objective.

**Transparency of results.** Social enterprises are required to report their social and/or environmental benefits, but there is no common definition and metrics for reporting social impact. Some countries require results assessments by third party standards.

**Financial sustainability.** Some view social enterprise as needing to generate their own income from trading and be capable of attracting “patient capital,” whereby shareholders are rewarded for investing in social enterprise with some limited dividends. Others see social enterprise as relying primarily on public contracts, public sector grants and private donations.

**Distribution of profits.** Some social enterprises include only organizations that totally prohibit the distribution of profits. Others set a cap on profit redistribution and add restrictions on privatization of assets.

**Innovation.** Social enterprises are often assumed to be innovative, especially with regard to promoting frugal and inclusive innovation. In the United Kingdom, social enterprise surveys show that social enterprises are on average more innovative than small-to-medium-sized enterprises. However, innovation is not an inherent feature of social enterprises.

**Workforce.** Some definitions accept community-based organizations based on voluntary or government-paid worker contributions. Others require that social enterprises employ paid workers, often with an explicit focus on disadvantaged populations. Some countries also set caps for salaries of social enterprises employees, especially at the senior management level.

Countries can choose to adopt a:

- **Legal definition** of social enterprise, when that country’s parliament agrees on a definition that is then enshrined in law. Legal definitions can take the form of a general statement of the nature of social enterprise, or can enumerate different components an entity would need to have to qualify as a social enterprise. In this case, entities that qualify as social enterprise under the law (sometimes referred to as social enterprises ex lege) typically benefit from certain privileges also provided for in the law, such as preferential procurement with governmental authorities or tax treatment. This approach is taken in Italy and South Korea.
- **Working definition** of social enterprise, when the executive branch agrees to a definition that it applies consistently in that country in its review of and support to social enterprise. There is no certification procedure and entities evaluate themselves whether they would meet these requirements. This approach is taken in the United Kingdom. Working definitions can also refer to definitions that are generally accepted in a particular country that are not adopted by the executive branch, for example, a definition adopted by a think tank or an academic institution. However, this paper focuses on government-adopted working definitions.

In other instances, social enterprise can not be defined by parliament or government. In this case, commentators, academics and practitioners can fill the vacuum with proposed definitions of social enterprise. This approach is taken in the United States and Malaysia.

## 2.2. Structuring Social Enterprise

The forms (or structures) for social enterprise refer to how an entity that fulfills the activities of social enterprise is organized. A range of different forms can be used to conduct social enterprise

activities. These forms are typically already provided for by law and include both for-profit legal forms (such as companies and LLCs) and non-profit legal forms (such as charities). These forms can be incorporated forms (wherein the entity benefits from a separate legal personality distinct from its owners) or unincorporated forms (wherein the law looks through the entity to the owners).

Table 1 lists typical features of the most common legal forms used for social enterprise.

**Table 1. Typical features of common legal forms for social enterprise**

<b>Entity</b>	<b>Typical Features</b>
Company (known as corporation in the United States)	<ul style="list-style-type: none"> <li>• Provides a separate legal personality. The company has standing to sue and be sued and is liable for the actions and debts of the business (rather than its shareholders).</li> <li>• Can raise capital through the sale of ownership shares (equity) and loans (debt finance).</li> <li>• Governed by a board of directors that owes its duties to shareholders and delegates day-to-day management to executives.</li> </ul>
Limited Liability Company/Limited Liability Partnership (LLC/LLP)	<ul style="list-style-type: none"> <li>• A hybrid structure, which combines some of the features of a company (limited liability) with some of the features of a partnership (flexibility in governance, taxed at the level of each member).</li> <li>• Issues such as management duties, voting and transaction approvals and aim of the entity are contained in the articles of incorporation and operating agreement, drafted by the managers.</li> <li>• Members are not subject to the same fiduciary duties as directors of companies.</li> </ul>
Non-Governmental Organization (NGO)	<ul style="list-style-type: none"> <li>• Non-profit, voluntary citizens' group that is driven by people with a common public good interest.</li> <li>• The legal form is diverse and depends upon the country's laws and practices.</li> <li>• Can include trusts, charities, non-profit associations, independent cooperatives and foundations.</li> <li>• Formed or registered under specific nonprofit laws.</li> <li>• Benefits from tax exemptions.</li> </ul>

Social enterprises can theoretically select any of the legal forms provided for by law in its country of operation and use any flexibility that is provided in the law to adapt the legal form to its social or environmental mission. The legal form chosen is irrelevant to the status of social enterprise: what matters is that as structured, the entity fulfills the components for social enterprise that are generally accepted in its particular country of operation.

Social enterprises in the countries reviewed use a number of these traditional forms. The form chosen to run a social enterprise will depend on a range of factors. Those creating a social enterprise will need to consider how they wish to run and finance the organization to choose a suitable form (see Box 3).

**Box 3. Key considerations for choice of legal form**

- **Sources of financing.** Some forms are more favorable to equity investment (shares), whereas others are more favorable to debt (loans), private donations from foundations, or public grants.
- **Tax.** Some forms will enable the social enterprise to be tax exempt or provide tax breaks for investors. Some forms are taxable as separate entities and some are not.
- **Governance and accountability.** Some forms enable more inclusive decision-making, imposing more accountability to the social or environmental mission on those in charge.
- **Liability.** Incorporated forms (where the social enterprise has its own legal personality) provide limited liability to the founders while unincorporated forms do not.
- **Partnerships.** Some forms (e.g., NGO) allow social enterprises to more easily attract donor funding and other incentives. In some countries, companies have advantages when competing for government contracts.
- **Other.** Some forms note the extent to which profits will be distributed, to which the social enterprise wishes to commit to transparency in its mission, whether it will have employees, and its size and location also have influence.

However, when considering the features they would like to benefit from, many founders of social enterprises have found traditional legal forms lacking. There is typically only a limited amount of flexibility contained in the law to adapt the features of a traditional legal form to the needs of a social entrepreneur. For instance, those opting for a company form can be limited in their ability to prioritize a social mission over shareholder returns. A company's shareholders can easily remove the social or environmental mission of a company. And they can be limited in their ability to benefit from government support and socially responsible investment without clear recognition as a social enterprise. Those opting for a charity form can be subject to stringent restrictions on how the charity is governed. They can also be restricted in the extent to which they can rely on entrepreneurial activities.

In response, governments in some countries have opted to create new legal forms that can be used for social enterprise. This does not remove the ability to continue to use traditional legal forms, but adds an additional option to founders of social enterprise.

It is also relevant to note that what is considered a legal form for social enterprise in one country may not be considered a form for social enterprise in another. The legal form will need to fit with the definition for social enterprise used in that country. For instance, in the United States, a new legal form called the benefit corporation, as well as B corporations (companies that have been awarded a certification from non-profit B Lab), are commonly associated with social enterprise ventures. However, for U.K. commentators, these would not qualify as social enterprises because they do not require an asset lock or a redistribution of profits to the company's social mission.<sup>3</sup>

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<sup>3</sup> Civil society news, Bates Wells Braithwaite are among the United Kingdom's first benefit corporations (September 2015).

# 3. COUNTRY PRACTICES

Legal frameworks for social enterprise vary country-by-country. The following provides an overview of whether a definition and legal form is included within the legal frameworks for social enterprise in the United States, United Kingdom, Italy, South Korea, and Malaysia.

## 3.1. United States

### 3.1.1. Definition

In the United States, social enterprise has not been defined by Congress, the U.S. administration or states. Instead, some U.S. federal states have focused on creating legal structures to enable social enterprise. For example, benefit corporations, which have recently been created in a number of states, are seen as a version of social enterprise. Although there is no legal or governmental working definition of social enterprise, the features present in these recently created legal forms are helpful indications of the kinds of features states see as inherent to social enterprise. These features are addressed in Section 3.1.2.

This vacuum has left academics and commentators to suggest definitions of social enterprise. Proposed definitions commonly emphasize the use of business and the address of social or environmental goals (see examples in Table 2).

**Table 2. Proposed definitions for social enterprise**

Source of Definition	Definition of Social Enterprise
Social Enterprise Alliance, a national membership organization for social enterprise in the United States	An “organization or initiative that marries the social mission of a non-profit or government program with the market-driven approach of a business.”
Paul Light, Professor of Public Service at New York University, <i>The Search for Social Entrepreneurship</i> , 2008	An “organization or venture that achieves its primary social or environmental mission using business methods, typically by operating a revenue-generating business.”
James Fishman, Professor of Law at Pace Law School, <i>Wrong Way Corrigan and Recent Developments in the Nonprofit Landscape</i> , 2007	A “for-profit vehicle [...] committed to philanthropic activity.”
Kyle Westaway, Lecturer on Law at Harvard Law School and Founding Partner at Westaway Law, <i>Something Republicans and Democrats Can Agree On</i> , 2012	An entity that offers “market-based solutions to social and environmental problems.”

### 3.1.2. Legal Forms

The primary driver for the creation of new legal forms for social enterprise in the United States relates to the fiduciary duty owed to the owners of the corporation by the directors. Under US business law, directors are required to act in the best interest of the corporation and owe their duties of “complete loyalty, honesty and good faith” to the corporation and its shareholders.<sup>4</sup> Directors and

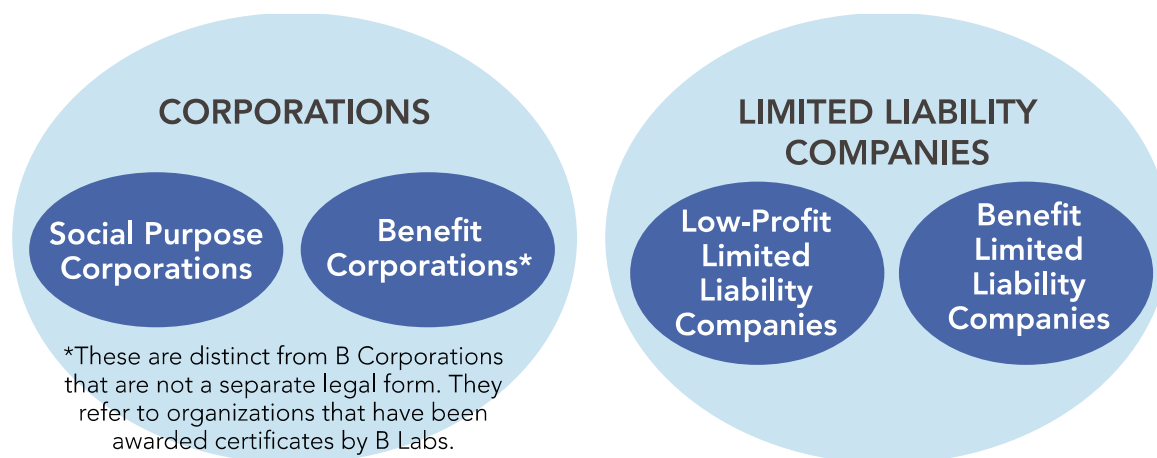
<sup>4</sup> See Advice for Corporate Directors, Mergers & Acquisitions 2010: Trends & Developments p. 141 (2010). See also Folk on the Delaware General Corporation Law: Fundamentals, 2016 Edition.

officers are typically seen as being subject to a standard of conduct to seek to maximize shareholder wealth, as the examples of Ford and Ben & Jerry's Ice Cream demonstrate:

- In 1919, Henry Ford was not allowed to prioritize the reduction of employee salaries and the cost of cars over the declaration of a dividend for the Ford Corporation's shareholders.
- In 2000, Ben & Jerry's Ice Cream, a triple bottom line business, considered itself compelled under US business law to sell to multinational company Unilever.

Although the law provides some flexibility, in the form of the business judgment rule and constituency statutes,<sup>5</sup> this flexibility has been deemed insufficient to protect those running social enterprises from lawsuits on behalf of their shareholders. This situation has triggered the creation of four legal forms in US states building on the corporation and LLC forms<sup>6</sup>, as depicted in Figure 1.

**Figure 1. Four legal forms in U.S. states**



Social purpose corporations and benefit corporations have become particularly popular vehicles for social enterprise activities in the United States. They enable founders of social enterprise to benefit from a structure that is well known to investors, a corporation, while providing enhanced transparency to their stakeholders on how they are fulfilling the enterprise's mission and protecting those running the enterprise from liability for prioritizing a social mission over shareholder returns.

These legal forms are not available in all federal states. However, it is possible for founders of social enterprises to choose their state of incorporation. While specific components of each form will vary on a state-by-state basis, the following provides key features of the legal forms recently created in the United States for social enterprise.

<sup>5</sup> Courts will generally apply the business judgment rule to directors, which means that courts provide deference to director decisions, so long as an appropriate process was followed. Constituency statutes were discussed in the introduction to this study.

<sup>6</sup> An LLC differs from a corporation in that it provides enhanced flexibility to its members in deciding governance structures, and members are taxed on an individual basis rather than at the level of the corporate entity. See Section 2.2 for the differences between corporation and LLC forms.

### 3.1.2.1. Social Purpose Corporations

**Where is this available?** In 2011, the first social purpose corporation (SPC) was created in Florida, where it was referred to as a flexible purpose corporation before its name change to social purpose corporation. As of writing, three states provide for SPCs: California, Washington and Florida.

**What are its key features?** An SPC benefits from the advantages of its corporate form, including access to capital. SPCs assist social enterprise in three ways.

#### 1) A social purpose that extends beyond shareholder wealth maximization

SPCs have a social purpose of creating a public benefit and may also have specific public benefits. This purpose is specifically provided for by law and refined in the company's articles of incorporation.

- An SPC in California has a specific purpose to pursue “charitable or public purpose activities that a nonprofit public benefit corporation is authorized to carry out” or may dedicate its purpose to “promoting positive effects of, or minimizing adverse effects of” the SPC’s activities on the SPC’s employees, suppliers, customers, creditors, the community and society, or the environment.<sup>7</sup>
- An SPC in Florida has the purpose of creating a public benefit that is “a positive effect, or the minimization of negative effects ... on the environment or on one or more categories of persons or entities ... of an artistic, charitable, economic, educational, cultural, literary, religious, social, ecological, or scientific nature.”<sup>8</sup> The company may elect to “identify one or more specific public benefits as its purpose.”<sup>9</sup>
- An SPC in Washington carries out its business for a general social purpose, which is “intended to promote positive short-term or long-term effects of, or minimize adverse short-term or long-term effects of, the corporation's activities upon any or all of (1) the corporation's employees, suppliers, or customers; (2) the local, state, national, or world community; or (3) the environment.”<sup>10</sup> The SPC may also choose one or more specific social purposes.

#### 2) Directors can make decisions that pursue the special purpose without fear of a shareholder derivative lawsuit for not maximizing profit

Shareholders cannot expect the same fiduciary duty of directors of SPCs as directors of traditional corporations. At the same time, stakeholders that are benefiting from the social purpose are not provided a new recourse against directors: directors remain responsible to the corporation's shareholders. The degree to which directors are to consider the social purpose in their decision-making varies between states.

- Since 2015, directors of SPCs in California are “*required* to consider and exercise discretion to further the corporation’s special 'social purpose.’”<sup>11</sup>
- In Florida, directors are *required* in their decisions to consider the corporation’s ability “to accomplish its public benefit or any specific public benefit purpose”<sup>12</sup> and are *permitted* to consider “(1) [t]he employees and work force of the social purpose corporation, its

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<sup>7</sup> Article 2602, California Corporation Code Section 2600-2605.

<sup>8</sup> Article 607.501(6), The 2015 Florida Statutes.

<sup>9</sup> Id. At Article 607.506(2).

<sup>10</sup> Chapter 23B.25.020, Revised Code of Washington, Washington State Legislature.

<sup>11</sup> Amendment (S.B. 1301) to the Corporate Flexibility Act of 2011 (emphasis added).

<sup>12</sup> Florida SPC Statute at Article 607.507(1)(a).

subsidiaries, and its suppliers, (2) [t]he interests of customers and suppliers ..., (3) [c]ommunity and societal factors ..., (4) [t]he local and global environment [and] (5) [t]he short-term and long-term interests of the social purpose corporation....”<sup>13</sup>

- In Washington, the certificate of incorporation must specifically state that the SPC’s mission is not necessarily compatible with and may be contrary to maximizing profits and earnings for shareholders, or maximizing shareholder value.<sup>14</sup> A director is *permitted* to “consider and give weight to one or more of the social purposes of the corporation as the director deems relevant.”<sup>15</sup> Directors cannot be held responsible for considering social purposes.

### 3) Enhanced public transparency with regard to the social purpose pursued

The laws specifically require the SPC to prepare information that is relevant in assessing how it delivers on its purpose.

- In California, SPCs are asked to include a management discussion and analysis of the SPC’s special purpose in their annual reporting. This includes discussion of the actions taken and the expenses incurred to achieve the SPC’s special purpose objectives. SPC directors are also asked to prepare special purpose current reports for their shareholders when specific events arise, including when the SPC makes any expenditure of corporate resources to further the SPC’s special purpose objectives.
- In Florida, SPC directors prepare an annual benefit report that describes how the SPC pursued a public benefit, the extent to which a public benefit was created and any circumstance that may have hindered this creation. The board of directors or the articles of incorporation may require that the report be prepared in accordance with a third-party standard.<sup>16</sup>
- In Washington, directors are required to provide a social purpose report to shareholders that describes the corporation’s efforts to promote its social purpose(s). This report can include discussion of the material actions taken, or expects to take, to achieve its social purpose(s) as well as how the corporation evaluates its performance.<sup>17</sup>

#### 3.1.2.2. Benefit Corporations

**Where is this available?** In 2010, the first law creating a benefit corporation was passed in Maryland. At the time of writing, 30 states and Washington, DC enable benefit corporations, and seven states are working on legislation.

**What are its key features?** Benefit corporations operate as a triple-bottom line business, which is defined to consider the business impact on the community and the environment, as well as generate profits for its shareholders. They are required to have a purpose of creating “general public benefit,” which is defined as a “material positive impact on society and the environment, taken as a whole, as assessed against a third-party standard, from the business and operations of a benefit corporation.”<sup>18</sup> Benefit corporations may in addition recognize specific public benefits, which can include “(i) providing beneficial products or services to low income or underserved individuals or communities, (ii) promoting economic opportunity beyond job creation, (iii) preserving the environment, (iv)

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<sup>13</sup> Id. at Article 607.507(1)(b).

<sup>14</sup> Washington SPC Statute at Chapter 23B.25.040.

<sup>15</sup> Id. at Chapter 23B.25.050.

<sup>16</sup> Florida SPC Statute at Article 607.512.

<sup>17</sup> Washington SPC Statute at Chapter 23B.25.150.

<sup>18</sup> B Lab, How do I Create General Public Benefit.

improving human health, (v) promoting the arts, sciences or knowledge, (vi) increasing capital flow to public benefit entities, and (vii) accomplishing other particular benefits for society or the environment (Thomas Reuters Foundation 2013).”

**What is the difference between a benefit corporation and an SPC?** The differences between the two depend on specific state legislation. For instance, the Delaware public benefit corporation is seen as more similar to the California SPC than to the California benefit corporation.<sup>19</sup> Nevertheless, the general differences are summarized in Table 3.

**Table 3. Differences between benefit corporations and SPCs**

Area	Benefit Corporations	SPC
<b>Availability</b>	A larger number of states have created benefit corporations than SPCs. California and Florida allow for both benefit corporations as well as SPCs.	
<b>Accountability</b>	Directors are required to consider the impact of decisions on <i>all stakeholders</i> . They serve a <i>general public benefit</i> (a material positive impact on society and the environment taken as a whole) and may add a specific public benefit.  The benefit corporation (itself or derivatively through a shareholder or director) can bring a “benefit enforcement proceeding” against a director or officer to ensure furtherance of the general public benefit.	Directors are asked to consider the impact of decisions with regard to the <i>specific purpose</i> described in its articles of incorporation (such as a charitable activity or benefiting the community and society).  There is no specific provision for enforcement.
<b>Transparency</b>	A public report of social and environmental performance is assessed against a third-party standard (except for Delaware benefit corporations). <sup>20</sup>	Management’s discussion and analysis discusses the corporation’s special objective, but is not typically assessed against a third-party standard.

Source: Authors’ based on Chen and SPZ 2014.

**What is the difference between a benefit corporation and a B corporation (B Corp)?**

Existing corporations can be certified as “B Corporations” by a nonprofit organization, B Labs. B Labs also played an important role in driving state adoption of benefit corporations. Both B corporations and benefit corporations provide for similar accountability (where directors are required to consider the impacts of the corporation on all stakeholders) and transparency (through public reports of social and environmental performance assessed against a third-party standard). Table 4 captures the key differences between the two.

**Table 4. Differences between benefit corporations and B corporations**

Area	Benefit Corporation	B Corporation
<b>Status</b>	Distinct corporate entity, authorized under state corporate law.	Existing corporation that is certified by a nonprofit organization, B Labs.
<b>Availability</b>	Corporations register in one of the	Available in any US state.

<sup>19</sup> Innov8 Social, CA’s Flexible Purpose Corporation Renamed to Social Purpose Corporation.

<sup>20</sup> In most states, a third-party standard is defined as "a standard for defining, reporting, and assessing overall corporate social and environmental performance" that must be comprehensive, independent, credible, and transparent." [http://benefitcorp.net/sites/default/files/Model%20Benefit%20Corp%20Legislation\\_4\\_16.pdf](http://benefitcorp.net/sites/default/files/Model%20Benefit%20Corp%20Legislation_4_16.pdf)



	states that permit benefit corporations by law.	
<b>Performance</b>	Self-reported performance that is assessed against a third-party standard.	Subject to B Lab’s private regulatory regime, including achieving a minimum verified score on a B Impact Assessment and recertification every two years.
<b>Accountability</b>	The benefit corporation can bring a “benefit enforcement proceeding” against a director or officer to ensure furtherance of general public benefit.	No specific enforcement proceeding.
<b>Cost</b>	State filing fee (from USD 70-200).	B Lab certification fee (from USD 500 to 50,000 per year, depending on revenues).

Source: Authors’ adapted from B Corporations, Certified B Corps and Benefit Corporations.

### 3.1.2.3. Low-Profit Limited Liability Companies

**Where is this available?** Vermont first allowed the Low-Profit Limited Liability Company (L3C) in 2008. Ten other states have followed (Illinois, Kansas, Louisiana, Maine, Michigan, North Dakota, Rhode Island, Utah, Vermont, and Wyoming) as well as two Native American nations (the Crow Indian Nation of Montana and the Oglala Sioux Tribe). The state of North Carolina passed its L3C statute in 2010, but then repealed it three years later.

**What are its key features?** L3Cs are LLCs that further the accomplishment of a charitable purpose. They are structured so as to have the ability to receive financing (known as Program Related Investments) from private foundations, according to the Tax Reform Act of 1969. Program Related Investments enable private foundations to invest in LLCs, in addition to investing in charities. They were permitted before the creation of L3Cs but it was difficult for foundations to determine exactly when an investment would qualify as a Program Related Investment, and when it would not (and therefore be subject to tax).

Low-profit LLCs are required by law to follow standards similar to those contained in the guidelines issued by the Internal Revenue Service in this area. This enables them to become corporate entities that can qualify for funding from private foundations (Doeringer 2010). The low-profit LLC benefits from the flexibility offered by LLCs (as compared to corporations) and can earn a profit (as opposed to non-profit entities). Further, managers of the low-profit LLC benefit from the branding associated with the name and can make decisions that prioritize their mission over profit.

At the same time, the low-profit LLC has been criticized due to a continued lack of certainty regarding which investments qualify as tax-exempt investments (Callison and Vestal 2010). Foundations still have the burden of verifying that their investment qualifies as a Program Related Investment, based on their own charitable purposes. Although some recent attempts have been made to clarify this point, there is still lack of clear regulation. Further, low-profit LLCs are seen to lack oversight and regulations, as compared to, for instance, the United Kingdom’s Community Interest Company (CIC) (Pierce and Hopkins 2014).

### 3.1.2.4. Benefit LLCs

**Where is this available?** These are allowed in Maryland and Oregon. Both of these states also allow for benefit corporations.

**What are its key features?** The purpose of the benefit LLC is to create a general public benefit. It follows a similar structure to the benefit corporation, except that the LLC form is used rather than the corporation form, so founders can benefit from the enhanced flexibility LLCs provide. Accountability of managers is not as strong as that of directors in benefit corporations.

## 3.2. United Kingdom

### 3.2.1. Definition

The U.K. government has had a working definition of social enterprise since 2002, as stated in Box 4.

#### **Box 4. Definition of social enterprise according to the U.K. government**

From 2002 until 2012, the U.K. government defined social enterprise as “business 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 maximize profit for shareholders and owners.”<sup>21</sup>

More recently, the Department for Business, Innovation & Skills applies the following four criteria to social enterprise. The enterprise should:

- “1 - consider itself a social enterprise
- 2 - not pay more than 50 per cent of profit or surplus to owners or shareholders
- 3 - not have less than 75 per cent of turnover from trading goods and services
- 4 - think themselves ‘a very good fit’ with the statement: ‘a business with primarily social *or environmental objectives*, whose surpluses were principally reinvested for that purpose in the business or community *rather than mainly being paid to shareholders and owners.*”<sup>22</sup>

The italicized and underlined words show the changes made to this working definition compared to the initial definition first proposed by the U.K. Department of Trade and Industry in 2002.

The key components of the U.K. government’s working definition of a social enterprise are (based on documents from BIS):

- Business that engages in economic activity (with over 75 percent of turnover from trading).
- Primarily social and/or environmental aims.
- A cap on profits—social enterprises should not pay over 50 percent of profit or surplus to shareholders.

There is no requirement in the definition that the entity use a specific legal form to be viewed as a social enterprise.

The components of this working definition are widely accepted in the United Kingdom. Organizations such as Social Enterprise United Kingdom (SEUK), the largest U.K. membership

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<sup>21</sup> UK Department of Trade and Industry, Social Enterprise: A Strategy for Success, Dep’t of Trade & Indus., Social Enterprise: A Strategy for Success 7 (2002). This definition is used by BIS in 2011: Department for Business, Innovation & Skills, A Guide to Legal Forms for Social Enterprise (November 2011).

<sup>22</sup> Department for Business, Innovation & Skills, Small Business Survey 2014: SME employers (BIS Research Paper No. 214).

body for social enterprise, and Social Enterprise Mark, which acts as an independent certification authority in the United Kingdom, have refined and added certain components to this working definition (Table 5).

**Table 5. Additional definitions of social enterprise in the United Kingdom**

Source of Definition	Definition of Social Enterprise
Social Enterprise United Kingdom (SEUK)	A “business that trades for a social and/or environmental purpose. It will have a clear sense of its ‘social mission’: which means it will know what difference it is trying to make, who it aims to help, and how it plans to do it. It will bring in most or all of its income through selling goods or services. And it will also have clear rules about what it does with its profits, reinvesting these to further the ‘social mission’. Social enterprises: (i) are businesses that aim to generate their income by selling goods and services, rather than through grants and donations, (ii) are set up to specifically make a difference and (iii) reinvest the profits they make in their social mission.” <sup>23</sup>
Social Enterprise Mark (SEM)	An “organisation driven by trade – applying profitable and sustainable principles of good business practice – but who exist for wider social benefit (which includes environmental benefit).” <sup>24</sup>

The SEUK and SEM definitions converge and differ from the BIS working definition in three ways:

- A business that engages in economic activity, with over a certain percentage of turnover from trading (75 percent for BIS and 50 percent for SEUK and SEM).
- Primarily social and/or environmental aims, with SEUK and SEM further requiring social enterprises to specify their aims in governing documents.
- A cap on profits—social enterprises should not pay over 50 percent of profit or surplus to shareholders (BIS) and over 50 percent of profits must be reinvested in the social and/or environmental mission (SEUK and SEM)

There is no definition for social and/or environmental aims. SEUK notes that “[w]e can’t prescribe what constitutes a social or environmental mission. Creating a list of ‘approved’ social missions would limit the very entrepreneurial spirit we want to encourage and make us closed off to the future.”<sup>25</sup>

Typical additional features of a social enterprise that do not explicitly feature in the government’s working definition but are recommended by SEUK and SEM (based on documents from SEUK and Social Enterprise Mark):

- An independent business from public agencies or private bodies (with some exceptions)
- Accountability for the organization’s social mission (SEUK only)
- Transparency regarding achievement of social or environmental objectives
- An asset lock (i.e., assets are legally protected and permanently retained for social or environmental benefit). In SEUK, seen as critical in some situations. In SEM, limitations on the distribution of assets is a requirement.
- The controlling stake is held in the interest of the social or environmental mission. In SEUK only, and only for social enterprises with shares.

<sup>23</sup> See Social Enterprise UK, FAQs. <http://www.socialenterprise.org.uk/about/about-social-enterprise/faqs>.

<sup>24</sup> See Social Enterprise Mark, Social Enterprise Mark Qualification Criteria (March 2015).

<http://www.socialenterprisemark.org.uk/wp-content/uploads/2016/02/SEM-Qualification-criteria-Feb-16.pdf>.

<sup>25</sup> See Social Enterprise UK, FAQs. <http://www.socialenterprise.org.uk/about/about-social-enterprise/faqs>.

Although the U.K. Parliament has not defined social enterprise, it specifically created a legal form for social enterprise in 2004, the CIC, which provides for a number of these features. Thus, the features of a CIC, further elaborated on in Section 3.2.2, demonstrate the important components of social enterprise for the U.K. Parliament.

In addition, in 2012 the U.K. Parliament approved a definition for social enterprise proposed by the Ministry of Health in the context of healthcare.<sup>26</sup> Parliament provided for the creation of local Healthwatch bodies in each local authority area in the United Kingdom with social services responsibilities. These Healthwatch bodies must be social enterprises, according to Parliament. In this context, Parliament provides that social enterprise is a body which:

- Ensures that not less than 50 percent of its profits are used for the purpose of the activities of that body.
- Carries on its activities for the benefit of the community in England.
- Contains clauses that require it to pass on its assets to another social enterprise if it dissolves or liquidates.<sup>27</sup>

Thus, any legal entity that meets these qualifications could then seek to become a local Healthwatch body.

Some of the features of the U.K. legal form for social enterprise, the CIC, have become part of the legal definition of social enterprise in the healthcare context. For instance, the definition of social enterprise for Healthwatch bodies refers to benefitting the community that is closer to the terminology for CICs than the BIS definition that references social and/or environmental aims. Some form of asset lock is explicitly required in the healthcare definition, which is similar for the CIC but which does not feature in BIS' working definition. This demonstrates the close interconnectedness between a legal definition and a legal form in a country: specific components of the definition for social enterprise will frequently be captured in a legal form specifically created for social enterprise, and vice versa, the legal form elements can over time influence the definition of social enterprise.

### **3.2.2. The United Kingdom's CIC**

As social enterprises become profitable, they can easily be converted into a for-profit entity by its shareholders.<sup>28</sup> Thus, the primary driver for the creation of a new legal form in the United Kingdom was the need to ensure that the owners could not privatize the social enterprise and gain from assets originally intended for the social purpose. In other words, there was a need to lock up the entity's assets. This was set against the backdrop of U.K. history wherein a number of building societies had been privatized to the detriment of their beneficiaries (Lloyd 2010).

Liability for directors was seen as less of an issue for social enterprise in the United Kingdom where the U.K. Companies Act allows directors to promote the success of the company in the interests of

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<sup>26</sup> This definition was developed by the Ministry of Health and is for Healthwatch bodies only. This restriction is made clear in the law and is echoed by commentators (Mair 2013).

<sup>27</sup> See Regulation 35: Criteria concerning social enterprises in The NHS Bodies and Local Authorities (Partnership Arrangements, Care Trusts, Public Health and Local Healthwatch) Regulations 2012.

<sup>28</sup> UK Department for Business Innovation & Skills (BIS), A Guide to Legal Forms for Social Enterprise (November 2011) at 3.

all of the shareholders *while taking into account* a wide group of stakeholder interests, such as employees, suppliers, local communities and the environment.<sup>29</sup>

The U.K. Parliament has reinforced the importance of this duty by requiring all listed companies to describe in their annual report how they take stakeholder interests into account.<sup>30</sup> Accordingly, the U.K. Parliament created the CIC as part of the U.K. Companies Act, in response to recommendations from the Government's Social Enterprise Unit.<sup>31</sup>

The U.K. Department for Business Innovation & Skills observes that the CIC "is a form of company specifically created for the social enterprise sector."<sup>32</sup> It is a limited company that is subject to specific restrictions to ensure that it will serve community interests.

Although primarily for social enterprise, the CIC Regulator clarifies that CICs can also be for people wishing to carry on activities for the benefit of the community that are not trading with a social purpose.<sup>33</sup> In other words, not all CICs are automatically deemed to meet the working definition of social enterprise, although there is a strong presumption that this is the case.

The key features of a U.K. CIC are:<sup>34</sup>

- A company with clear branding
- Carries on its business for the benefit of the community
- Shared duty of directors to the community purpose and investors
- Subject to an asset lock (its assets are legally protected and permanently retained for community benefit)
- Oversight by CIC Regulator to maintain confidence in CIC brand
- Transparency on how it is delivering on its community purpose

Further information on CIC features based on the U.K. Companies Act, BIS resources and guidelines from the CIC Regulator is provided in Annex 1.

Before the adoption of the CIC, most social enterprises operated as companies limited by guarantee with charitable status. This format allows social enterprises to adopt a hybrid business model because the assets are locked under the charitable status, but with trading freedoms as a company.

There has been a rapid uptake of CICs in the United Kingdom. The government originally estimated that it would register 200 CICs a year. Instead it registered its 10,000th CIC in November 2014 and 268 CICs were created in April 2016 alone.<sup>35</sup>

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<sup>29</sup> See Section 172(1), Duty to promote the success of the company, UK Companies Act 2006.

<sup>30</sup> The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013.

<sup>31</sup> Part 2 of the Companies (Audit, Investigations and Community Enterprise) Act 2004. See also The Community Interest Company Regulations, 2005, S.I. 1788 (U.K.) enacted in 2005.

<sup>32</sup> Department for Business Innovation & Skills (BIS), A Guide to Legal Forms for Social Enterprise at 3 (November 2011).

<sup>33</sup> Department for Business, Innovation & Skills, Office of the Regulator of Community Interest Companies: Information and guidance notes (May 2016) at chapter 1.

<sup>34</sup> See Department for Business, Innovation & Skills, Office of the Regulator of Community Interest Companies: Information and guidance notes (May 2016).

<sup>35</sup> Office of the Regulator of Community Interest Companies, Community interest companies: new CICs registered in April 2016. See also Regulator of Community Interest Companies, Annual Report 2014/2015 at 16.

### 3.2.3. Other Legal Forms

Although CICs have increased in popularity, a range of other legal forms continue to be used for social enterprise. According to a recent survey by SEUK, 60 percent of social enterprises in the United Kingdom are structured as regular companies, 20 percent are CICs and the remainder use other legal forms, such as co-operatives, charitable incorporated organizations or community benefit societies.<sup>36</sup>

The choice of legal forms is driven by the type of SE activities, funding and ownership structure, and partnerships. For example:

- Charitable Incorporated Organization (CIO) is registered with the Charity Commission as an incorporated form of charity which is not a company. Under the CIO form, trustees have limited liability but preserve a high degree of control over the CIO.
- Industrial and Provident Society (IPS) have two forms: Co-operative Societies and Community Benefit Societies or ‘BenComms’ whose purpose must primarily be “for the benefit of the community”.
- LLP has a separate legal personality similar to a company. The partnership has a limited liability, and is transparent for tax purposes: non-corporate partners register for self-assessment and pay income tax on their share of the profits, while profits shared by corporate partners will be liable to pay corporation tax on this income.<sup>37</sup>

## 3.3. Italy

### 3.3.1. Definition

Italy has had a legal definition for social enterprise since 2006.<sup>38</sup> The components of this legal definition (based on the Italian Law on Social Enterprises, as translated by academics) are:

- A social enterprise is a private organization—it cannot be, or controlled by, a public entity. It cannot be an individual enterprise.
- It performs an entrepreneurial activity of production of social utility goods and services. Income from this activity has to be at least 70 percent of the total income of the organization. Social utility is defined by law.
- It acts for the common interest and not for profit. Earnings cannot be distributed to owners, and have to be invested in the business or in increasing assets.

Expanding on some features of this legal definition:

- Similar to the U.K. working definition of social enterprise, Italy’s legal definition does not prescribe a certain legal form (e.g., a company, a non-profit, a cooperative) to be used for social enterprise. Rather, any legal form can be used. This includes traditional companies as well as non-profits. The restriction on the distribution of earning does not necessarily imply a non-profit legal form.
- Social utility is defined by law as encompassing one of the following two categories:

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<sup>36</sup> Note this is companies limited by guarantee (not co limited by share). Also note that the same survey finds that 21 percent of social enterprises have charitable status and most of these would be those who have the co ltd by guarantee. Source: Social Enterprise UK, State of Social Enterprise Survey 2015 at 9.

<sup>37</sup> Department for Business, Energy & Industrial Strategy, 2011. Legal forms for social enterprise: a guide.

<sup>38</sup> Legislative Decree, 24 March 2006, n° 155 (Law n° 155/2006) (putting into effect the Law of 13 June 2005, n.118).

- All goods and services related to social utility sectors. These sectors are welfare, health, welfare-health, education, instruction and professional training, environmental and eco-system protection, development of cultural heritage, social tourism, academic and post academic education, research and delivery of cultural services, extra-curricular training and support to social enterprises.
- The activity of the business is carried out by employees, of whom at least 30 percent are underprivileged or disabled. This category of social enterprise focuses on workplace integration, regardless of the sector of activity.
- According to the Italian Civil Code, Italian social enterprises are expected to be entrepreneurial, which means that an “entrepreneur professionally carries out an economic and organized activity with the aim of production or exchange of goods and services.” The activity pursued must account for over 70 percent of the entity’s income.
- At the same time, the social enterprise cannot distribute, directly or indirectly, profits or parts of the assets to its owners or members. The law seeks to ensure that this distribution does not take place. For instance, it defines indirect profits distribution as including rewarding directors more than 20 percent of the remuneration awarded in other similar entities.

The Italian law also provides rules on the structure Italian social enterprises must comply with. Although these rules are not included in the legal definition per se, they are requirements for any entity seeking to be recorded as a social enterprise in Italy’s business register. They therefore become de facto features of the legal definition.<sup>39</sup>

The typical features of Italian social enterprises (based on the Italian Law on Social Enterprises, as translated by academics) are:

- **Correct and efficient management.** The bylaws must require the consideration of reputation, professionalism, and impartiality by those governing the organization.
- **Transparency.** The bylaws are made public and an annual social balance sheet provides information on the pursuit of the common interest.
- **“Open door”.** Individuals seeking to become members of the enterprise are protected by non-discrimination. Rejected candidates can appeal to the assembly of members.
- **Participation.** The majority of those directing the organization are elected by members. Workers and customers have to be involved in the decisions of the enterprise.
- **Worker protection.** Certain minimum standards are placed on the treatment of workers.

Once an entity meets the criteria laid out in the Italian Law on Social Enterprises, it can be legally recognized as a social enterprise. Entities become social enterprise ex lege (i.e., by force of law) once they are recorded in a special section of the business register, Section L.

Academics, commentators and practitioners in Italy generally do not perceive the list of registered social enterprises as an indication of the actual number of social enterprises in Italy (European Commission 2014). In particular:

- There are entities in Italy that meet these legal requirements but are not registered as social enterprises. Iris Network, the national network of research institutes on social enterprises,

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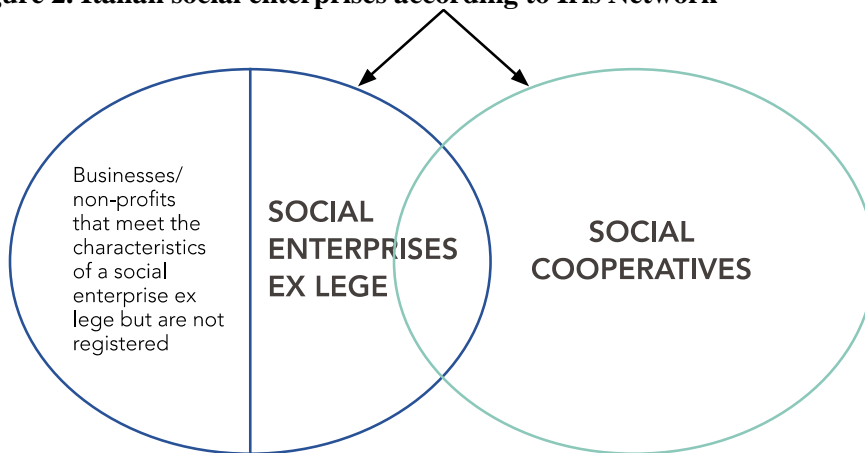
<sup>39</sup> See Antonio Fici, The New Italian Law on Social Enterprise, Seminar paper: Emerging models of social entrepreneurship: possible paths for social enterprise development in central east and south east Europe (September 2006).

finds that a number of entities include the term social enterprise in their name but are not registered, perhaps for reasons of timing or simplicity (Venturi and Zandonai 2012).

- Italy offers a specific legal form, social cooperatives, which are viewed by commentators as being social enterprises even though they do not meet the requirements of this legal definition. Iris Network states that social cooperatives are “the most popular and consolidated legal and organizational model for social enterprises”; they “best represent[] the characteristics referred to by the legislator in the most recent regulations and therefore they can be considered social enterprises to all intents and purposes.”
- Accordingly, the components of a social cooperative could be seen to complement the legal definition of social enterprise in Italy. These will be described further in Section 3.3.2. Only a small number of social cooperatives are registered as social enterprises ex lege.

Figure 2 depicts the working definition of social enterprise by Iris Network.

**Figure 2. Italian social enterprises according to Iris Network**



Source: Authors’ depiction of Iris Network research (Venturi and Zandonai 2012)

### 3.3.2. Italy’s Social Cooperative

In 1991, Italy introduced the social cooperative form because of the acute need for social services and employment. This form enabled individuals to use entrepreneurial initiatives to tackle issues faced by the state relating to welfare and development. The typical key features of an Italian social cooperative (based on Italian law translated by academics) are:

- A company (public or private) with clear branding
- Pursues the general interest
- Provides social, health and educational services or produces goods and services through activities that further the work integration of defined disadvantaged groups
- Ultimate control rests with the members
- Limited dividends can be distributed (calculated with reference to the maximum interest of postal bonds)
- Transparency on how its activities have been of benefit to the community

An Italian social cooperative can register as a social enterprise if it meets the components of the legal definition. Some social cooperatives have registered to become social enterprises, while others have not. There are more than 11,000 social cooperatives in Italy and 365 entities that meet the legal



definition of social enterprise and have registered as a social enterprise with the state. Of those 365 entities, 43 (just over 10 percent) are social cooperatives (Venturi and Zandonai 2012).

Table 6 lists the key differences between the Italian legal definition of social enterprise and social cooperative, according to the European Commission (2014).

**Table 6. Key differences between Italian social cooperatives and social enterprises**

Area	Social Cooperative	Social Enterprise Ex Lege
Status	A legal form that relies on the company form (public or private).	A legal status that can be applied to any legal form. Those that meet the legal requirements for a social enterprise can register as a social enterprise ex lege, regardless of their legal form. Legal forms include non-profits, which is not possible for a social cooperative.
Purpose	Provides social, health and educational services or produces goods and services through activities that further the work integration of defined disadvantaged groups.	Provides goods and services related to social utility sectors defined by law, or, the activity of the business is carried out by employees, of whom at least 30 percent are underprivileged or disabled.
Distribution of dividends	Distribution of dividends is allowed, with a cap on the maximum amount of dividends payable.	Dividends cannot be distributed. Profit is used to either further the activity of the social enterprise or to increase its capital. This places restrictions on equity financing.
Inclusion	Workers who are also members of the cooperative are involved in decision-making.	Social enterprises ex lege are required to consider forms of inclusion for workers and beneficiaries of the activities.
Asset lock	Conversion to a regular company is possible.  If the social cooperative is dissolved, the surplus is provided to the government to promote and develop other cooperatives.	If converting to an organization that is not a social enterprise ex lege, the members are not allowed to receive any distribution of the assets on this conversion.  If the social enterprise is dissolved, the surplus is distributed to non-profit organizations of social utility, associations, committees, foundations, and ecclesiastical organizations.

In Italy, a social enterprise is only considered as such if it reinvests all of its profits into its mission. It is their non-profit orientation that enables them to qualify for social enterprise status. This may help explain why Italian social cooperatives, which allow for limited profits to be distributed, have continued to remain the primary feature of Italian social enterprise, as defined by practitioners.

### 3.4. South Korea

#### 3.4.1. Definition

South Korea has had a legal definition of social enterprise since 2007, under the Social Enterprise Promotion Act (SEPA). This is the first and only legal definition for social enterprise in Asia (Defourny and Kim 2011).

Article 2 of SEPA defines social enterprise as “an enterprise certified in accordance with Article 7 as one that pursues a social objective, such as raising local residents' quality of life, etc., by providing vulnerable groups with social services or jobs while conducting business activities, such as the production and sale of goods and services, etc.” The law provides definitions for a number of the terms used in this definition.

Article 7 of SEPA provides that a social enterprise must (i) satisfy the requirements for certification and (ii) obtain certification from the Ministry of Employment and Labor. Article 8 provides a list of requirements for certification. When looking at the law on social enterprise as a whole, the key components of a South Korean social enterprise are (based on the ILO translation of the 2006 Social Enterprise Promotion Act):

- Pursues a social objective (e.g., raising local resident’s way of life)
- Provides vulnerable groups with social services or jobs or contributes to local communities. Vulnerable groups are defined as people who have difficulties in purchasing the social services they need at the market price or are particularly hard to be employed. Social service refers to service in the areas of education, health, social welfare, the environment and culture, and other equivalent services.
- Employs paid workers and conducts business activities (e.g., the production and sale of goods and services)
- Ensures that two-thirds of distributable profits are spent on social objectives (33 percent of the profits can be distributed, with 66 percent to be spent on social objectives). The law states that this is only if the social enterprise is of a form that already allows distributable profits (for instance, a company or a limited partnership rather than a non-profit).
- Uses a participatory decision-making structure
- Meets specific requirements for minimum revenue, content of articles of incorporation, reporting, and asset distribution
- Is certified as a social enterprise by the Ministry of Employment and Labor

Expanding on some key features of this legal definition:

- The social enterprise must take on a specific legal form. However, the organizations allowed are very broad and include a range of profit and non-profit forms. Therefore, similar to the practice in other countries, the social enterprise can choose a range of legal forms.
- According to the Korea Social Enterprise Promotion Agency, set up by the Ministry of Employment and Labor to foster and promote social enterprises, social enterprises can be classified as one of the following five types:
  1. Job-Creation Type: The main purpose is to offer jobs to vulnerable social groups.
  2. Social Service Provision Type: The main purpose is to provide vulnerable social groups with social services.
  3. Mixed Type: Job-Creation Type plus Social Service Provision Type.
  4. Other Types: A social enterprise of which realization of social purposes is difficult to judge on the basis of the ratio of employment or provision of social service.
  5. Local Community Contribution Type: An enterprise that helps improve the quality of life of the local community.
- There is an asset lock provision in the form of a restriction on where the entity’s assets can be distributed if the enterprise dissolves.
- The term social enterprise is legally protected. An entity has to meet these requirements and be certified to use the term social enterprise. This is in contrast to Italy, where some entities use the term social enterprise but are not registered as such, although the Iris Network

stipulates that these entities are those who will in due course register as social enterprises *ex lege*.

There has been a rapid increase in legal social enterprises in South Korea, from 55 in 2007 to more than 1,000 in 2014 (Bidet and Eum 2015). In addition, the South Korean Ministry of Labour adopted a system of “pre-certification” in 2011 to assist social enterprises that meet some, but not all, of the legal conditions for social enterprise.

One of the key drivers for companies registering as social enterprise under the law relates to the extensive support provided by regional organizations (coordinated by the Korean Social Enterprise Promotion Agency) to registered social enterprises. Financial support includes subsidies to the labor cost of workers, subsidies for social insurance fees and project funding for business development, and tax exemptions and tax rebates linked to donations to social enterprises. Non-financial support includes support in consulting services, marketing, and advertising.

Differences on what constitutes a social enterprise remain in South Korea. What people perceive as social enterprise can be divided into three categories (Bidet and Eum 2011):

- Social enterprises that meet the legal requirements and are certified.
- Entities that are viewed as social enterprise based on their function and role (even if they do not recognize themselves as social enterprise). These include certified self-sufficiency enterprises (some of which are certified social enterprises).
- Entities that follow a social purpose and involve social innovation.

### **3.4.2. South Korea’s Social Cooperative**

A wide range of legal forms can qualify a social enterprise in South Korea. They can be for-profit or non-profit forms. The legal form is irrelevant, as long as they are structured to meet the requirements for the legal definition of social enterprise.

As in Italy, there is one form that can help in the creation of a social enterprise: the social cooperative. The social cooperative was created in 2012 to encourage the use of entrepreneurial activities to tackle issues of unemployment and community welfare. It is a cooperative that carries out business activities related to the enhancement of welfare of local residents or provides social services or jobs to disadvantaged people (Jang 2013).

While traditional cooperatives are business organizations that carry out the purchase of goods or services, production, sales or distribution among their members, social cooperatives are non-profit organizations intended to improve the welfare of local residents or provide the disadvantaged with jobs and/or social services (Lee and Kim 2013).

When this law was passed, the presidential decree which listed the legal forms allowed to qualify as a social enterprise was amended to include social cooperatives. Therefore, similarly to in Italy, not all social cooperatives qualify as social enterprises under the law, although they can choose to register if they meet the requirements of the definition. The social cooperative provides one clear advantage to founders of social enterprise which relates to participative governance. The legal definition of social enterprise requires stakeholders to participate in the social enterprise’s governance. The social cooperative is the only legal form which specifically addresses this requirement of participatory governance (Bidet and Eum 2015).

Table 7 lists the main distinctions between the South Korean definition of social enterprise and the social cooperative legal form.

**Table 7. Distinctions between South Korean social cooperatives and social enterprises**

Area	Social Cooperative	Social Enterprise Ex Lege
Structure	Non-profit form.	A legal status. Can be a range of legal forms, including for-profit or non-profit forms.
Government support	Some grounds for government support, but relies less on government support.	Benefits from a large number of government support measures (such as subsidy to wage for employment of disadvantaged people).
Purpose	Engaged in one or more business activities among the following: (i) programs for contributing to the renewal of local communities, the invigoration of the local economy, the enhancement of rights, interests, and welfare of local residents, and the resolution of other problems that local communities face, (ii) programs for providing disadvantaged people with social services or jobs in the aspects of welfare, medical services, or environment, (iii) projects entrusted by the central government or a local government, and (iv) other projects for enhancing the public interest.	(i) To provide vulnerable groups with social services or jobs, or (ii) to contribute to local communities.
Approval	Ministry of Strategy and Finance (or related agencies).	Ministry of Employment and Labor.
Dividend distribution	Not allowed to distribute surplus to members.	Distribution of profits up to 1/3 total surplus, if a for-profit form is chosen.

Source: Adapted from Jongick Jang, Emerging Dual Legal Frameworks of Social Enterprise in South Korea: Backgrounds and Prospects, EMES-SOCENT Conference Selected Papers, no. LG13-10 (2013) at 8.

### 3.5. Malaysia

#### 3.5.1. Definition

Malaysia has neither a legal nor a working definition for social enterprise. Practitioners and consultancies have stepped in to define social enterprise. The Malaysian Global Innovation and Creativity Centre (MaGIC), which receives funding from the government to promote social enterprise, proposes the following working definition: “social enterprise is an entity that achieves a social mission by using a business model. Social enterprises combine elements of NGOs and for-profit companies.”<sup>40</sup>

According to MaGIC, a social enterprise combines two elements:

- (i) **A social mission**, which is the social or environmental issue the organization wishes to solve. This enterprise’s mission responds to a legitimate issue that has been neglected by the private and public sectors. It has a specific target group of beneficiaries (e.g.,

<sup>40</sup> See The Malaysian Global Innovation and Creativity Centre (MaGIC), Social Enterprise 101 at 4.

individuals who are underserved by the market). This extends beyond access to employment.

- (ii) **A business model**, which generates income and profit. The entity sells products or services in demand by the market. Malaysian social enterprises are entitled to pay dividends to investors “after reinvesting a certain portion back into the business.”<sup>41</sup>

MaGIC adds that social enterprises have the following secondary characteristics: fair compensation and returns, responsible and transparent, inclusive equity and just governance.

A consultant in this field, Tandemic, also makes clear that social enterprises combine both a social cause with the use of a private sector business model.<sup>42</sup> In their proposed definition, however, “there are no limitations on the dividends issued to investors in a social enterprise.” There remains a lack of clarity in Malaysia on some of the key features of social enterprise.

### 3.5.2. Legal Form

Malaysia does not have a specific legal structure for social enterprise. Founders of social enterprise will typically resort to one of the traditional legal forms already provided for, including private limited companies and associations. They will typically make changes to the legal form so that it enables social enterprise.

Since there is no legal or working definition of social enterprise provided by the government, founders rely on components of social enterprise that they believe are important to qualify as a social enterprise. In particular, there is a strong influence from the United Kingdom, with a range of social enterprise founders returning from studying and working in the United Kingdom (Grave 2014). Accordingly, some legal forms in Malaysia have been adapted by the founders to follow the U.K. CIC. This includes opting for a business that can be measured against its social objective (the U.K. community interest test), which benefits from an asset lock and restricts the payment of dividends. These restrictions can be built into the Malaysian company form (Arkitek 2014).

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<sup>41</sup> See The Malaysian Global Innovation and Creativity Centre (MaGIC), Social Enterprise 101 at 7.

<sup>42</sup> See Tandemic, What is social enterprise? <http://www.socialenterprise.org.my/what-is-social-enterprise/>.

# 4. LESSONS LEARNED ACROSS COUNTRIES

## 4.1. Common Features in Definitions of Social Enterprise

Table 8 lists the common features when comparing the three countries where the governments adopted either a legal (Italy and South Korea) or working (United Kingdom) definition of social enterprise.

**Table 8. Common features when comparing definitions across Italy, South Korea, and the United Kingdom**

Feature of the definition	Italy	South Korea	United Kingdom
Any legal form	✓	✓ There is a broad pre-defined list of forms	✓
Enterprise is to fulfill a specific purpose	✓ Specifically defines the activities to be covered, unless the social enterprise employs a certain percentage of underprivileged workers	✓ Provides vulnerable groups with social services or jobs or contributes to local communities	✓ Benefits social and/or environmental aims
Restriction on distribution of profits	✓ Restriction of 0 percent: no distribution possible	✓ Restriction of 33 percent	✓ Restriction of 50 percent
Economic activity	✓ 70 percent turnover from activity	✓ Employs paid workers and conducts business activities	✓ 75 percent turnover from activity
Stakeholder participation in governance	✓	✓	X Absent from the working definition but features in the CIC legal form
Some form of asset lock (which seeks to ensure enterprise assets are used for its specific purpose)	✓	✓	
Transparency of activities	✓	✓	

Of particular note:

- Where the U.K.'s working definition lacks components that feature in the Italian and South Korean definitions, these components feature in U.K.'s legal form, the CIC.
- The Italian definition is fundamentally different to the South Korean and U.K. definition since it does not allow for the distribution of profits.

## 4.2. Lessons Learned on the Merits of Adopting a Legal or Working Definition of Social Enterprise

In this research, two countries have adopted a legal definition of social enterprise (Italy and South Korea), one country has adopted a governmental working definition of social enterprise (United Kingdom), two countries do not have a legal or working definition of social enterprise (United States and Malaysia), of which one has created legal forms for social enterprise (United States). Each approach carries some advantages and disadvantages.

### 4.2.1. Adopting a legal definition for social enterprise (Italy and South Korea)

#### *Advantages:*

- **Government focus:** The process that underpins the consensus for the legal definition signals that social enterprise is an area of importance for the government and the country.
- **Clarity in definition:** It is clear for founders of social enterprise what is expected for them to qualify as social enterprises. This can help spur movement in the country by entrepreneurs seeking to move closer to the legal definition.
- **Enshrined definition:** A definition approved at the parliamentary level carries an authority that working definitions lack. It cannot be easily revised in the event of a political change: the approval process will follow that of other laws, typically requiring bipartisan support for any legislative approval.
- **Support:** Once entities become social enterprise by operation of the law, they can qualify for support.
- **Clear labeling:** There is clear labeling for entities operating as social enterprises. This can provide comfort to stakeholders, including investors, of the entity's social mission.
- **Learning from international practices:** The adoption of a legal definition for social enterprise in South Korea allowed for a dynamic discussion on the elements to draw from in the United States, United Kingdom, and continental European approaches to social enterprise. The result is a model that is heavily influenced by the United Kingdom and Italy, but with some elements from the U.S. approach (Bidet and Eum 2010).

#### *Disadvantages:*

- **Administrative layer of formality:** Entities seeking to qualify as social enterprise are required to register with the relevant government authority. This adds a layer of formality and administration that may hinder social enterprise.
- **Not a catch-all definition:** In the two countries analyzed, the legal definition was not seen by external commentators and practitioners as a catch-all for social enterprise. Rather, those entities certified as social enterprise *ex lege* were seen by commentators as included within a broader category of social enterprise. For instance, in Italy, social cooperatives are viewed by commentators as social enterprise even when they do not meet the legal definition. Accordingly, the legal definition can confuse academic research and practitioner analysis by providing the assumption that the number of registered social enterprises represents the number of social enterprises in that country.
- **Hinders support:** If an entity is pursuing a worthwhile activity, which could meet a broader definition of social enterprise while not meeting the exact components of the legal definition (or while meeting them but not registering with the government), it can miss out on valuable support.

- **Lack of flexibility:** If there are changes in understanding what constitutes a social enterprise, a legislative revision process can be burdensome and time-consuming. For instance, the South Korean legislature needed to revise its law in 2011 to provide that social enterprise encompassed activities contributing to local communities. South Korea has sought to minimize these legislative revision processes by providing for a legislative decree that provides further detail on the law. For instance, when social cooperatives were added as an entity that could be a social enterprise, a legislative revision was not needed; a change to the presidential decree sufficed.

**Box 5. Conclusion on the merits of adopting a legal definition for social enterprise**

- Adoption of a legal definition can play a positive signaling effect for the private sector and impact investors, by providing a predictable framework for public and private investments and support to social enterprises.
- A legal definition alone appears insufficient to boost the social enterprise sector: offering a legal definition for social enterprise has not yielded sustained social and economic benefits. For example, in South Korea, although social enterprises certified as such benefit from extensive support from the government, the sector has slow growth rates and limited financial sustainability.
- The legal definition should be complemented by a more flexible working definition, otherwise it could provide a restrictive view of the social enterprise sector. For instance, in Italy, social cooperatives, which do not all meet the legal definition for social enterprise, remain significantly more popular than social enterprises ex lege.

#### 4.2.2. Adopting a working definition for social enterprise (United Kingdom)

*Advantages:*

- **Government focus:** As with a legal definition, the process that underpins the development of a working definition signals that social enterprise is an area of importance for the government and the country. The fact that various ministries can be involved in its definition can help increase ownership of the definition. For instance, in the United Kingdom, this has included BIS, the U.K. Department of Trade and Industry, and the Ministry of Health. In addition, it helps the government in its work on social enterprise. For instance, BIS uses the working definition in its small and medium enterprises survey in order to monitor social enterprises in the United Kingdom.
- **Clarity in definition:** As with a legal definition, it is clear for founders of social enterprise what is expected of them to qualify as social enterprises. The U.K. working definition helped to promote debate and reach cohesion over the definition and approaches to social enterprises in the country.
- **Flexibility:** The working definition can evolve over time to encompass additional features that were not envisioned at the outset. For instance, BIS has made some changes over time to the initially proposed 2002 working definition. A social enterprise now includes a business with primarily environmental objectives, in addition to those with primarily social objectives. In addition, when reviewing the working definition used over the years, one notices a change in the extent to which the business must engage in economic activity. The 2010 working definition provided for a requirement that 25 percent or more of turnover of social enterprises was derived from trading, whereas it is now 75 percent in the BIS definition.



### *Disadvantages:*

- **No protection on use of the term social enterprise:** Since this is a working definition with no certification process, it is not possible to restrict those that use the term social enterprise. The label could therefore be used by businesses that are not legitimate social enterprises but that are seeking to benefit from an enhanced reputation and from investment by socially minded investors.
- **Subject to change:** A working definition may reflect the views of a ministry, various ministries, or the cabinet as a whole. However, these views can change, especially when political changes occur. This can create uncertainty for social enterprise if the working definition is changed too frequently.
- **Can be trumped by a legal definition:** Parliament can choose to approve a definition for social enterprise that differs from the working definition. For instance, in the United Kingdom, there was debate regarding whether the parliamentary approval of the Ministry of Health's definition of social enterprise, which varies from the general working definition, had trumped the working definition used by BIS.

#### **Box 6. Conclusion on the merits of adopting a working definition for social enterprise**

- Offering a working definition provides a number of the same advantages as offering a legal definition. It signals that government is focused on social enterprise. It helps entities determine whether or not they should be viewed as social enterprise, which in turn will help them attract public recognition and relevant financing sources.
- When combined with a legal form specifically for social enterprise, and measures intended to stimulate financing for social enterprise, this working definition can play an important role in promoting the sector.
- The working definition is an important coordination mechanism for cross-sectoral agendas. When adopted at the highest level of the government, it provides an anchoring point for cross-ministerial collaboration.

### **4.2.3. Providing legal forms for social enterprise with no legal or working definition (United States)**

#### *Advantages:*

- **Allows for the forging of a consensus:** Where no legal or working definition exists, a range of commentators will attempt to fill the vacuum and provide views on what constitutes social enterprise. This allows for a rigorous debate on the required components of social enterprise. For instance, the fact that the U.S. government had not defined social enterprise permitted a non-profit organization, B Labs, to engage in extensive work to define a consensus around what would constitute a B corporation, which in turn fed into legislative debates at the state level on the creation of benefit corporations.
- **Stimulates entrepreneurial spirit:** Founders of social enterprise can engage in it, regardless of whether they would meet specific components of social enterprise. This provides a dynamic approach. For instance, in the United States the focus has been to harness the potential of enterprise to tackle major development challenges, regardless of whether the specific entities meet features such as providing for an asset lock.
- **De facto legal definition:** Although not a legal definition of social enterprise, the components of a legal form created to enable social enterprise demonstrate what is viewed as important for that state's legislature. For instance, benefit corporations and SPCs

emphasize the ability to prioritize the social mission over shareholder wealth as well as enhanced transparency regarding the social form.

- **Clear labeling:** Meeting the qualifications to become a specific legal form can provide a certain comfort to investors and other stakeholders regarding the nature of the business. Entities that register as benefit corporations or SPCs benefit from a presumption that they are social enterprises.

***Disadvantages:***

- **Focus on the components of legal structures:** The components for the legal form may not capture the overarching view of social enterprise. They are intended as requirements to qualify for a specific legal form. However, as experiences in Italy, the United Kingdom, and South Korea demonstrate, even when countries have a legal form, not all social enterprises will register as that legal form. Without a definition, there is no clear way of determining which other entities are social enterprises that have not used one of these legal forms.
- **Lack of coordination at the national level:** The requirements for a legal form vary on a state-by-state basis and there is no nationwide approach to social enterprise.

**Box 7. Conclusion on the merits of focusing on legal forms to define social enterprise**

- By offering new legal forms, US states are seeking to stimulate social enterprise by protecting their status and making them attractive investments for socially minded investors.
- Some of the disadvantages of not having a legal or working definition, such as confusion on what constitutes social enterprise, can be countered by the creation of these legal forms for social enterprise.
- Cultural specificities are important when deciding whether or not to pursue a legal or working definition. The approach taken in the United States seeks to provide flexibility to federal states and social entrepreneurs to define and enable social enterprise. A legally defined certification approach similar to the one offered in Italy or South Korea would not be considered appropriate for the cultural specificities of the United States.

**4.2.4. No legal or working definition and no legal form for social enterprise (Malaysia)**

***Advantages:***

- **Allows for the forging of a consensus:** Similar to the situation of the United States, where no legal or working definition exists, a range of commentators will attempt to fill the vacuum and provide views on what social enterprise is. This allows for debate on the required components of social enterprise, which is particularly important where there is a lack of consensus. For instance, in Malaysia, there is no generally accepted consensus on the extent to which dividends can be distributed to investors, and since the government has not pronounced it, allows for a range of views to be considered.
- **Stimulates entrepreneurial spirit:** Similar to the situation of the United States, founders of social enterprise can engage in it regardless of whether they would meet specific components of social enterprise. This provides a dynamic approach. This can also help founders benefit from support, regardless of whether or not they would meet specific requirements. For instance, the entity that supports social enterprise in Malaysia, MaGIC, notes that the lack of a definition enables them to support all registered entities with a social or environmental mission (Zweynert 2015).

***Disadvantages:***

- **Confusion on social enterprise:** Where there is no clear definition for social enterprise, it can be difficult for social enterprise founders to describe what they are seeking to achieve. In Malaysia, social enterprises report significant confusion on the term, with a range of individuals assuming this is referring to work in social services, non-profit, or social media.
- **Limits support to social enterprise:** Lack of clarity on the term social enterprise hinders support. Financial institutions will typically lack awareness of what social enterprises seek to achieve, thereby subjecting them to the same standards as for-profit entities. Government bodies will be unable to specifically support social enterprise since they cannot determine the entities that should qualify for support. According to MaGIC, this phenomenon has been reported in Malaysia, where social enterprises find it difficult to obtain assistance.
- **Strong influence by other countries that may or may not be appropriate for that country:** Where there is no legal or working definition, and no legal form for social enterprise, founders of social enterprise will seek inspiration elsewhere. This is the case for social enterprise in Malaysia, where founders are influenced by the United Kingdom, both in terms of determining what constitutes social enterprise (the U.K. working definition) as well as the necessary features of a legal form for social enterprise (the U.K. CIC). This may or may not be suited to the specificities of Malaysia.

**Box 8. Conclusion on the merits of not adopting a legal or working definition of social enterprise**

- Not adopting a definition of social enterprise at the government level (whether cabinet or legislature) enables academics, practitioners, and the government to engage in a meaningful discussion regarding the components of social enterprise that would meet the specificities of that country.
- At the same time, as the situation in Malaysia demonstrates, the lack of recognition of social enterprise, whether in the form of a legal definition or legal form for social enterprise, will prevent government institutions and market regulatory agencies from effectively supporting social enterprise. In this case, founders of social enterprise might choose to adopt models from other countries.

#### 4.3. Lessons Learned on Legal Forms of Social Enterprise

Creating a legal form for social enterprise has clear advantages:

- **Ease for founders:** Legal forms help founders of social enterprise to start their ventures and removes the complexity of seeking to adapt existing forms. It further reassures founders that they will be seen as social enterprises if they fulfill the requirements for that legal form. This thinking is demonstrated by the uptake in these legal forms in the United Kingdom and Italy. The U.K. government registered its 10,000th CIC in November 2014, and there were over 11,000 Italian social cooperatives in 2012 (Venturi and Zandonai 2012).
- **Tailored to country challenges:** The country can tailor its existing legal forms to the specific challenges faced by social enterprise in that country. For instance, the US legal forms helped comfort those governing social enterprises that they would not be held liable for putting the social mission ahead of profit-making. The U.K. legal form provided comfort to stakeholders that they could support social enterprise, whether as a founder, government agency, investor, or worker, and know that this support would continue over time to benefit the community. In South Korea and Italy, social cooperatives enabled flexibility to tackle social issues. In South Korea, in particular, the new legal form helped respond to the requirement of participatory governance in social enterprise.
- **Tailored to view of social enterprise:** The country can tailor a legal form to the way it views social enterprise. For instance, US legal forms are structured differently than those for

the U.K. CIC. Further, social enterprise in the United States and the United Kingdom seeks to rely primarily on market or quasi-market mechanisms, while social enterprise in Italy and South Korea is more influenced by state policy and encompasses civil society more broadly.

- **Improve access to financing:** Financing appears to be a concern for social enterprise, wherever they are located. Consultations around the CIC form highlighted issues related to attracting investment, which spurred the removal of caps placed on dividends paid to investors. CICs are no longer limited in the amount they pay to investors, as long as they only distribute up to 35 percent of that company’s distributable profits. These financing difficulties appear to be more significant for social enterprises that rely heavily on state support and public contracts. For instance, commentators point to the unsustainability of the social enterprise sector in South Korea and Malaysia in the long term. By providing a legal form that is able to attract a range of financing, the government can further stimulate the sector’s sustainability.

Country experience shows that the legal form must fit the specific needs of social enterprise in that country to generate uptake. For instance, in the United States, the creation of specific legal forms started in 2008 with the formation of low-profit LLCs intended to attract financing from foundations. These entities have been viewed as insufficient to stimulate social enterprise and have rapidly been replaced by the newer legal forms of benefit corporations and SPCs (Stanford Social Innovation Review 2014). These latter legal forms benefit from attracting socially minded investors who recognize the corporate form that a corporation provides, welcome the social enterprise’s mission, and acknowledge that shareholder wealth is not the primary consideration.

Further, it is helpful (but not essential) if the country has a working or legal definition for social enterprise that the legal form can build upon. For instance, in the United States, some debate remains regarding whether benefit corporations and SPCs qualify as social enterprise, triggered in part by the lack of a commonly accepted definition for social enterprise. These forms would not have been suitable in the United Kingdom for social enterprise since they do not contain some of the components of social enterprise featured in the U.K.’s working definition.

Table 9 lists questions that can be helpful for governments to consider when creating new legal forms for social enterprise.

**Table 9. Questions to consider when creating legal forms for social enterprises**

Questions to Consider	Comments
Do we need a legal form?	In the United Kingdom, the legal form (CIC) aligns with the working definition of social enterprise adopted by the government and shared by stakeholders and was created to help protect the mission of social enterprise. In South Korea, the discussion about legal forms stimulated public debate and learning from international lessons. Adopting a specific legal form can have advantages (e.g., sectoral stimulation and consolidation, better targeting of government programs) and disadvantages (e.g., social enterprise operating outside of the legal form may not be so easily recognized as social enterprise).
Which form should this legal form follow?	Most legal forms are companies. For instance, the U.K. CIC has to be a company limited by shares or a company limited by guarantee and the Italian social cooperative relies on the company form, whether public or private. In contrast, the South Korean legal form is a non-profit form.

Should this legal form clarify the responsibilities of those governing the entity?	This has proven particularly helpful where social enterprises have faced threats of shareholder derivative lawsuits, for instance in the United States. In the United Kingdom, the CIC Regulator is ultimately empowered to act where he/she deems that the CIC has not adequately prioritized community interests.
Should this legal form allow for specific accountability provisions in the event the social mission is not prioritized?	Legal forms based on company forms tend not to provide direct recourse to stakeholders who may wish to contest director decisions. The benefit corporation can bring a “benefit enforcement proceeding” against a director or officer to further general public benefit. By contrast, the SPC has no comparable statutory provisions to enforce its special purpose, which leaves the corporation and its shareholders with no internal recourse to compel directors and officers to carry out the entity’s special purpose.
Should this legal form require specific participatory governance?	The South Korean social cooperative provides for participatory governance. In the other forms, participatory governance tends to be encouraged, although not technically required.
Should this legal form have a specific oversight mechanism?	The U.K. CIC Regulator oversees CICs to maintain integrity in the CIC brand. This has been deemed helpful since the Regulator provides guidance and support to CICs to help promote the sector’s growth. The CIC Regulator sits within the U.K. ministry that oversees all companies (BIS), thereby ensuring coordination with that ministry. Alternatively, the legal form can be subject to the authority of the relevant business authority as for any other company, as is the case for benefit corporations in the United States. Nonetheless, the performance of benefit corporations needs to be assessed against a third-party standard.
Should the purpose for the legal form be clearly defined or left open?	Governments can decide to clearly define the categories within which this legal form can operate (as in South Korea and Italy) or provide for a more general purpose.
Should the distribution of dividends be restricted and if so, how?	Governments may or may not choose to cap the dividends that can be transferred to shareholders. This is the case in Italy. This was the case in the United Kingdom before 2014 (although the maximum aggregate dividend cap remains).
What kind of transparency with regard to the entity’s mission should be prescribed?	Governments typically require some form of transparency with regard to the social mission involved. For instance, the US benefit corporation has to produce a report of social and environmental performance assessed against a third-party standard while information produced by SPCs is not typically assessed against a third-party standard.

## 5. CONCLUSION

There is no one-size-fits-all approach when it comes to appropriate legal frameworks for social enterprise. A range of factors influence the preferred approach for a specific country, including the extent to which social entrepreneurs emanate from the non-profit or for-profit sectors, the objectives they seek to meet with social enterprise and views on the appropriate balance between protection of the social enterprise's mission and attracting "patient capital" (whereby shareholders are rewarded for investing in social enterprise with some limited dividends). The entry point relates to defining the role of social enterprise in a particular country and determining the type of support that will likely be available to guarantee an enterprise's long-term sustainability. Legal frameworks can then provide a supporting role to help fulfill this vision of social enterprise in a particular country.

Commentators diverge on the need to reach a commonly accepted definition for social enterprise. Some argue that the lack of a definition hinders research and analysis and dilutes the social enterprise brand. Others note that divisions are understandable in light of the range of diversity included in social enterprise and that not defining social enterprise in specific terms provides flexibility and enables innovation (Lyon 2009; Martin & Osberg 2007; SEUK 2012). Country experience highlights that crafting a working definition that is generally accepted by government helps forge a consensus around the components of social enterprise, while ensuring that the legal certification approach that often accompanies a legal definition does not deter the creation of social enterprise.

This working definition approach can be particularly helpful for the sector when combined with a legal form that seeks to respond to the specific challenges faced by social enterprise in that country. This requires a baseline assessment of existing social enterprise to determine the constraints faced by its founders, to be better equipped to propose a suitable legal form.

Ultimately, there is a close relationship between definitions and structures for social enterprise, and they work together to create a conducive environment to social enterprise. Where a country creates a legal form for social enterprise, this could be viewed as forming a key part of that country's definition of social enterprise. Indeed, these are the components an entity must meet in the government's view for that entity to qualify as a social enterprise. At the same time, not all legal forms are created for social enterprise solely.

Although this paper focused on defining and structuring social enterprise, these are not the sole elements of importance in a legal framework for social enterprise. In particular, governmental support to facilitate the financial sustainability of social enterprise is important and has ranged from tax breaks to encourage investors to finance social enterprise in the United Kingdom, to wage subsidies and tax exemptions in South Korea. Furthermore, a legal framework for social enterprise sits within a broader legal framework for a country, which is equally important to consider. For instance, a legal definition for social enterprise that enables enterprises to register as social enterprises with the state will be unhelpful in a country characterized by weak governance and high corruption. Equally, a new legal form for social enterprise that uses the company form will be unhelpful in a country that imposes significant barriers for creating companies and doing business. A review of broader legal frameworks is therefore paramount to the creation and promotion of social enterprise.

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# ANNEX. KEY FEATURES OF UNITED KINGDOM COMMUNITY INTEREST COMPANIES

Feature	Description
Requirement to meet the “community interest test” which seeks to ensure that the activities are for the benefit of the community	The community interest test is defined in law and is met when a reasonable person might consider that the activities being carried on are for the benefit of the community. The community can include the population as a whole or a section of the community (e.g., residents of a particular area, a group of people suffering from a particular disadvantage). It does not include the company’s directors, employees or service providers. The CIC Regulator decides whether an organization meets the community interest test based on a community interest statement the company provides, and may take enforcement action against a CIC if he/she forms the view that it no longer satisfies the test.
Directors have a shared duty, both to the community purpose as well as to their investors	Directors of CICs “are under a stronger obligation to have regard to the wider community which the company serves and involve stakeholders in its activities than” in traditional companies. <sup>43</sup>
The social purpose of the CIC is enshrined in the form of an asset lock	<p>The asset lock “is the name given to the set of rules designed to ensure that the CIC’s assets are used for the benefit of the community.”<sup>44</sup> In short:</p> <ul style="list-style-type: none"> <li>• Assets cannot be transferred out of the CIC, unless the directors obtain fair market value (or unless the transfer is to another asset-locked entity or for the benefit of the community);</li> <li>• In the event of dissolution, the assets must be to another entity whose assets are “locked” into community benefits (a charity or another CIC but not a limited company);</li> <li>• There is a cap on the maximum dividend the CIC can make so as to strike a balance between ensuring that the CIC’s assets are used to benefit the community and encouraging investments in CICs. The dividend cap was changed in 2014: there is no longer a cap on the maximum dividend that CICs can pay out on each share. The maximum aggregate dividend cap remains at 35%, ensuring that 65% of the profits are reinvested back into the community or used for the community it is serving;</li> <li>• There is a cap on performance related interest (where a CIC borrows money with the interest payable linked to the performance of the CIC); and</li> <li>• There are restrictions on how CICs with share capital may redeem shares, purchase its own shares or reduce its share capital.</li> </ul>
Oversight by a CIC regulator	A CIC Regulator works to maintain confidence in CICs and can appoint auditors to examine the accounts of a CIC. The Regulator has wide enforcement powers which can be used for instance if a CIC is not satisfying the community interest test or there is misconduct, or mismanagement, in the administration of the company. These powers include the ability to bring civil proceedings in the name of a CIC (for instance, for breach of duty against the directors), to appoint or remove directors, to appoint a manager to take control of the business, and to present a petition to the Court for the winding up of a CIC.

<sup>43</sup> Id. at Chapter 1, p. 11.

<sup>44</sup> Id. at Chapter 7.

Transparency	A CIC is required to prepare a Community Interest Statement as part of its annual reporting which shows how it is intending to deliver on its community purpose. This statement would also include information on directors' salaries, dividends and the extent to which the community has been involved in the company's activities.
Clear branding	A CIC's name must end in either CIC or Community Interest Company. Criminal penalties apply for companies that misuse these name endings so as to maintain trust in the brand.
CICs are not tax-exempt but can benefit from a range of financing options	<p>A CIC can be structured as a company limited by guarantee (without a share capital) if it seeks to rely primarily on grants or donations. Alternatively, it can be structured as a company limited by shares (which can be private or public) if it seeks to rely on equity. The use of the company structure is intended to provide confidence to banks financing the entity. CICs limited by guarantee have been more popular, but the creation of CICs limited by shares has been on the increase since recent changes to the dividend cap.<sup>45</sup></p> <p>CICs are not provided any special tax status. They do benefit however from a new system designed to incentivize financing in CICs. The Social Investment Tax Relief enacted in 2014 provides some tax relief for investors investing in a CIC (as well as in some other entities, including community benefit societies with an asset lock or a charity). CICs can also benefit from the Public Services (Social Value) Act which came into force in 2013 and requires commissioners of public services (such as local authorities) to consider how their services can benefit people living in the local community. The government states that one of the key drivers for the law was "to make it easier for Social Enterprises to deliver public services."<sup>46</sup></p>
Stakeholder governance is recommended (but not required)	CICs are asked to consider how they will involve the relevant community stakeholders in their projects. The CIC Regulator encourages a number of techniques that CICs can use to integrate stakeholders more fully into the CIC (such as holding stakeholder meetings or requiring that certain stakeholder groups be consulted before specific decisions are made). The community interest company report must include information on the extent to which the CIC has involved its community in its activities. Nonetheless, unlike a number of social cooperatives, stakeholder governance requirements in CICs are not a requirement.

<sup>45</sup> Regulator of Community Interest Companies, Annual Report 2014/2015, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/445334/cic-15-15-annual-report-14-15.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/445334/cic-15-15-annual-report-14-15.pdf).

<sup>46</sup> Cabinet office press release, Significant boost to social enterprises as the Social Value Act comes into force (January 2013), available at <https://www.gov.uk/government/news/significant-boost-to-social-enterprises-as-the-social-value-act-comes-into-force>.