

Social Enterprises and Eu Regulation

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Abstract

Social enterprises are very diverse across Europe. There is a wide range of different legislative approaches and different organisational and legal forms on the national level. In some countries, existing legal forms such as associations, foundations, cooperatives and share companies are used as social enterprises. In other countries, new legal forms are designed for social enterprises by adapting existing legal forms (companies, cooperatives), e.g. social cooperatives in Italy, cooperative collective interest companies in France, community interest companies in the UK.

The reason for the variety of approaches how to implement the idea of social enterprise, is in the lack of uniform binding rules on the level of the EU. Here, we present our views on the legal framework needed to implement the concept of social entrepreneurship in the EU in a more efficient and effective manner.

First, we present a range of definition of social entrepreneurship and enterprises, many of them not consistent and/or sufficiently elaborated. Further, some historical roots are presented on social and self-managed economy, and the concept of social enterprise is elaborated from the point of view of its eligibility. Comparative analysis aims to prove critical diversity of approaches across the EU that leads to stagnating in place and lagging behind.

Key words: Social entrepreneurship, Social enterprises, self-managed enterprise, Social economy, Social responsibility, Social objectives.

Introduction

Social entrepreneurship is **part of a wider concept of social economy**. Unlike business enterprises, which share profits, social enterprises perform not-for-profit activities, their owners / founders may not have a dominant influence in decision-making (the principle of equality of membership is not applicable) and must involve other stakeholders (the principle of stakeholder participation in management applies).

Policy documents¹ consider social entrepreneurship as an alternative form of entrepreneurship and as a market activity, taking into account the principles of social entrepreneurship with the following characteristics:

- it is an innovative form of entrepreneurship with a great sense of **responsibility for society and people** (social responsibility), where business is motivated for solving social, economic, environmental and other problems of society in an innovative way;
- it promotes **people's involvement and volunteering**; entrepreneurs have a **high sense of social responsibility** for society and people; doing business is combined with social, economic, environmental and other problems of society in an innovative way.
- It **creates new jobs for vulnerable groups** of people and performs socially useful activities. Like classical companies, social enterprises also appear on the market, with the difference that they do not usually share profit but return it back to the company.

¹ There is a number of policy documents and recommendation enacted at the EU level and in member states.

- It **strengthens social solidarity** and cohesion and encourages the participation of people and volunteering. It strengthens the company's ability to deal with innovative social, economic, environmental and other problems.
- It provides an additional **offering of products and services that are in the public interest**, developing new employment opportunities, providing additional jobs and social integration and vocational reintegration of the most vulnerable groups of people in the labour market (objectives of the social entrepreneurship).

There is no doubt that this socially responsible concept of social entrepreneurship is well defined and described. Nonetheless, there is some controversy in imposing social entrepreneurship in a competitive market; social enterprises are namely considered to be a form of entrepreneurship, which strengthens social solidarity, encourage people's involvement and volunteer work.

All above explained values and principles of social entrepreneurship are more than welcome in each socially responsible society. However, the gap between the proclaimed values and principles and the reality is very pronounced in this area too. The legal framework for social entrepreneurship is far from enforcing the wishful social solidarity ideas in reality. It seems that the holders of social power do not have a genuine interest in the development of social entrepreneurship. Or, even more obvious, social entrepreneurship simply does not interest them because social entrepreneurship, by definition, does not bring any profits to them.

Thus, social entrepreneurship's main reality is more or less a humanitarian activity of enthusiasts driven by human ethics, altruism and social responsibility, which is hardly to be found on cruel competitive markets. Therefore, in spite of the well-designed definitions, social entrepreneurship has no significant future until the systemic basis of its functioning is regulated. Namely, it cannot be developed to a relevant stage within the legal clauses laid down under private property-based corporate rights, whose iron rule is the "one share, one vote" decision-making principle, and the maximization of profit is its primary objective.

The legal elaboration of certain parts of the EU Social entrepreneurship definition is needed by legally binding provisions at the EU level to make national legislation more clear and transparent and to make SE more publicly recognized and visible at investors and consumers market.

What Is Social Entrepreneurship?

A miracle combination of 4 economic and 5 social criteria

- The Social Business Initiative (SBI)² distinguishes two types of social enterprises:
- companies providing **social services** and / or goods and services for **vulnerable persons** (access to housing, medical care, assistance for the elderly or disabled, childcare, access to employment and training, dependency management, etc.);
- companies engaged in the **production of goods or services with the social aim of social and occupational integration** through access to employment for people in disadvantage, in particular due to insufficient qualifications or social or professional problems leading to exclusion and marginalization), but whose activity can be outside the field of providing social services.

² In October 2011, the European Commission adopted the Social Business Initiative (SBI). The Communication, inter alia, provides this definition of "social enterprise"; COM(2011) 682 final - Social Business Initiative: Creating a favourable climate for social enterprises, key stakeholders in the social economy and innovation. Available at:

<http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0682:FIN:EN:PDF>

The European Economic and Social Committee (EESC)³ and the International Research Network (EMES)⁴ proposed a precise definition of a social enterprise based on four economic and five social criteria, which constitutes a useful framework for understanding the differences between social and other enterprises.

Economic criteria:

- **the secondary activity of production and / or the sale of goods and services** (and not predominantly advisory activities or the allocation of function subsidies);
- **a high degree of autonomy:** social enterprises voluntarily establish and manage groups of citizens, and not directly or indirectly public bodies or private companies, even if they are eligible for subsidies and grants. Their shareholders have the right to participate in the management (“vote”) and to leave the organization (“exit”);
- **significant economic risk:** the financial capacity of social enterprises depends on the efforts of their members who are responsible for providing adequate financial resources, unlike most public institutions;
- **activities of social enterprises "require a minimum number of paid workers,** although, as traditional non-profit organizations, social enterprises can combine both financial and non-financial sources and voluntary and paid work.

Social criteria:

- **the ultimate goal of the benefit of the community:** one of the main objectives of social enterprises is to serve a community or a particular group of people; with the same purpose, as well as to promote the sense of social responsibility at the local level;
- **citizens' rights:** social enterprises are the result of collective dynamics, involving people belonging to a community or a group that shares a particular need or goal. They must maintain this dimension in one form or another;
- **the decision is not based on ownership of capital:** this usually means that the "one member, one vote" principle applies, or at least that the voting rights are not based on equity interests. Although capital owners in social enterprises play an important role, they share decision-making rights with other stakeholders;
- **participative nature, the involvement of those affected by:** users of social enterprise services "are represented and involved in their governing bodies; in many cases one of the objectives is to strengthen democracy at local level through economic activity.

Social enterprise, as defined by the Social Business Initiative, is an operator in the social economy whose main objective is to have a **social impact rather than make a profit for their owners** or shareholders. It operates by providing goods and services for the market in an entrepreneurial and innovative fashion and uses its profits primarily to achieve social objectives. It is managed in an open and responsible manner and, in particular, involves **employees, consumers and stakeholders** affected by its commercial activities⁵.

A common feature of social enterprises is therefore that they:

- **contribute to more effective market competition, but they also promote and create solidarity and social cohesion.** The main purpose of social entrepreneurship is not the return on capital, but the realization of the goals **of social (inclusive, sustainable) development** that stakeholders have set.

³ The European Economic and Social Committee (EESC) is a consultative body of the European Union (EU) established in 1958. It is an advisory assembly composed of "social partners", namely: employers (employers' organizations), employees (trade unions) and representatives of various other interests. Available at: [https://www.bing.com/search?q=The+Committee+\(EESC\)&src=IE-SearchBox&FORM=IESR3S](https://www.bing.com/search?q=The+Committee+(EESC)&src=IE-SearchBox&FORM=IESR3S)

⁴ EMES is a research network of established university research centres and individual researchers dealing with “SE” concepts: social enterprise, social entrepreneurship, social economy, solidarity economy and social innovation. [Available at: https://emes.net/](https://emes.net/)

⁵ Social business initiative

- **are generally guided by the principle of solidarity and reciprocity, and members are managed based on the “one man, one vote” principle.** Social enterprises are flexible and innovative, and realize their goals based on **active membership** and commitment to voluntary cooperation (voluntary work). Social enterprises characterize **strong personal involvement** of members in managing the company's non-profit orientation and a way of doing business that connects economic performance, democratic functioning and solidarity among its members.
- **operate in almost all sectors of the economy**, such as banking, insurance, agriculture, crafts, various commercial services, health and social services, etc., however there are big differences among states. Most of these are micro, small and medium-sized enterprises.

Social enterprise as an **autonomous organization** that combines a social purpose with entrepreneurial activity. A social enterprise is a non-profit legal entity that permanently performs social business activities or other activities subject to special employment conditions by the production and sale of products or the provision of services on the market. Generating profits is not the main goal of social enterprise. The EU operational definition of social enterprise, represents the “ideal type” of social enterprise – “national families of social enterprise” generally share most, but not often all, of the criteria specified in the operational definition⁶.

Of the twenty-nine countries studied, twenty have a national definition of social enterprise, but in six of these countries, the definition does not require social enterprises to have “inclusive governance” models. Similarly, in several of the remaining nine countries that do not have a national definition, inclusive governance is not seen as a defining characteristic of social enterprise⁷.

All these definitions thus try to combine the social and entrepreneurial dimensions and emphasize a “different way of doing business” and a different way of corporate decision making (collective and participatory approach). In addition, profits are mainly reinvested with a view to achieving this social objective. Characteristics of social enterprises therefore include coexistence or even precedence of social objectives over commercial objectives. Social or societal objective of the common good is the reason for the commercial activity. This synthesis is very difficult, if not impossible, to achieve with traditional corporate legal tools; obviously, a high level of social innovation is needed. We are talking about two opposing concepts, which are contrary to each other. That is why a new original corporate entity should be designed based upon the above principles and following the described values, rather than a hardly implementable adaptation of the traditional legal tools. For this reason, an ideal type of social enterprise does not exist in real life in any of the member states.

As already pointed out, several definitions, legal frames and consequently also several types of social enterprises exist across the EU more or less successfully.

Traditional corporate legislation cannot cope with the SE principles

The above-explained SBI definition encompasses three key SE principles that are mutually conflicted, namely the entrepreneurial, social and the principle of democratic governance. The SE principles require engagement in continuous economic activity, pursuing a social aim and generating some form of self-governance. Primary and explicit social purpose and the existence of mechanisms to “lock in” the social goals, distinguishes social enterprises from mainstream (for-profit) enterprises.

The SE principles are strongly distinctive compared to the principles upon which the mainstream (traditional) for profit, capital investment based enterprise is legally organized. Distinctions are so substantial that tailor made corporate legislation only for SE is required, as follows:

⁶ A map of social enterprises and their ecosystems in Europe, European Commission, 2014

⁷ Ibidem

- **not for-profit principle** stipulates that the purpose of establishing a social enterprise is not at all return on investment or distribution of profit (surplus of revenues over expenses) and the property shall be invested back into the activity of a SE what is in fundamental conflict with the concept of the traditional for profit corporation.
- **the principle of equality** of membership determines that individual founders or owners do not have a dominant influence in decision-making, all members accept decisions on the principle of one member vote, regardless of the proportion of the invested capital; this is again in fundamental conflict with the concept of the traditional for profit corporations principle of proportionality and “one share, one vote”.

SE is, same as traditional for profit enterprise, an organization that engages in **economic activity**, however SE pursues an explicit and **primary social aim** (one that benefits society) rather than seek (struggle) for return on investment. SE must have **limits on distribution of profits** and/or assets and have to prioritize the social aim over profit making, as opposed to for profit enterprise, whose performance serves exclusively to investors of capital (shareholders). Last but not least, SE must be have **inclusive governance** (membership as opposed to “one share, one vote” principle).

Due to all these differences in the fundamental concept, traditional corporate legislation is not able to cope with SE principles based legal entity; traditional corporate legislation is simply composed of principles and mechanisms which are completely inapplicable for SE, e.g. “one share, one vote” and profit maximization, employees as rented workforce rather than members of an enterprise. In view of this, a new, social entrepreneurship corporate law is needed.

It is said in the various political declarations that the economic and social importance of social enterprises is rising, however, there is no ground for such optimism. If the objective to ensure equal legal conditions with other forms of enterprise were sincere, then the legal ground for prosperity of social enterprises would already be ready all across the EU. Unfortunately, it is not - social enterprises are confronted with regulatory discrimination without taking into account their particularities, and specificities (non-profit, solidarity, membership based management), which are elementary incompatible with the concepts of traditional forms of economic (capital based) companies).

The required adjustment of the legislation on companies and other legal organizational forms (associations, cooperatives, mutual organization, etc.) or the adoption of a special law (a regulation, or at least a directive) governing social entrepreneurship is far from being accomplished on the EU level. We agree that the adoption of the law is far from a sufficient condition for the expansion of social entrepreneurship in the country; yet, it is a prerequisite for that.

The EU recommended social enterprise is based upon the property rights concept, however, it wrongly follows the principle that social enterprise is not a special legal form and can act, using any legal entity available in the legislation. This causes conflicts of corporate laws with the principles that social enterprises are based upon. The way, proposed by EU documents and implemented by national legislations followed, bears legislative conflict in itself and therefore is not productive and give poor results in the real life.

Not for profit organizations as social enterprises, cooperatives, disability enterprises, employment centres, non-governmental organizations (societies, institutions, foundations or foundations) are not created for the purpose of gaining profit, operate for the benefit of their members, users or a wider community and produce marketable or non-market goods and services. This is the reason why for profit business organization like entities (limit liability and public limited companies) are not appropriate legal form for social enterprise.

This conflict could be solved in the following two possible ways only:

- to inaugurate by law social enterprise as a *sui generis* legal entity, laying down the provisions on the legal structure of the social enterprise as a separate corporate legal form; or
- to introduce non-ownership concept in the social enterprise, again as a *sui generis* legal entity, laying down the provisions on the legal structure of the non-ownership social enterprise as a separate corporate legal form.

Traditional corporate legislation is not able to cope with these principles, for it is derived from completely different principles, as “one share, one vote” and maximization of profit, employees as rented workforce, rather than members of an enterprise; a new, social entrepreneurship corporate law is therefore needed.

The Past Tradition And Legacy Different Countries Different Tradition

The roots of social enterprise in EU countries are different. However, the history of social enterprises in broadest sense in post transition countries in certain way influenced the modern emergence of social enterprises. Social and cultural traditions and legacies have by no means shaped the formation, development and understanding of contemporary social enterprise⁸. **We cannot ignore this past legacy, as it affects substantially contemporary developments in this field.**

In welfare state tradition e.g. Scandinavian countries, municipalities have traditionally played (and still do) a major role in the delivery of social and welfare services. However, countries like Denmark also have a long tradition of third sector and voluntary sector involvement in the provision of social services, education, culture and sport, with economic support from municipalities⁹.

Under socialism, in today’s post socialist countries, the existence of different types of social enterprises like socially owned enterprises, cooperatives or companies for disabled, was very widespread. The social enterprise in socialism was based upon non-ownership as opposed to property rights concept and self-management as opposed to capital based corporate governance and profit distribution. Workers managed the enterprise rather than shareholders and profit was not distributed out of the company but allocated for enterprises development. **This concept resembles substantially to a modern type of social enterprise.**

The history and legacy (non-ownership concept)

Social property in former socialist Yugoslavia was an expression of socio-economic relations between people. It was the foundation for freedom of **associated labour** and the ruling position of the working class in socialism. The means of production were inalienable common base of social work and social reproduction¹⁰.

Legally social property entitled everybody to **get the right to work with the socially owned means of production** under the same conditions (the right to work with social means of production). Social property was not ownership at all (non-ownership concept); no one could have acquired ownership rights over the social means of production; neither the state, nor other socio-political community (municipality etc.) nor an organization of associated labour (legal form of socially owned enterprise). Neither a group of citizens nor an individual could have had ownership rights over the social means of production. The only right attached to social property was the right to work with social means of production.

⁸ GHK Study, 2014: Some countries (especially French speaking countries) have a rich tradition of social economy which has played a key role in supporting the emergence of social enterprise

⁹ IFC, GHK Study, 2014, A map of social enterprises and their eco-systems in Europe Country Report: Slovenia, March 2014 (hereinafter (GHK Study, 2014)

¹⁰ The Constitution of the former Socialist Republic of Slovenia, 1974

[https://sl.wikisource.org/wiki/Ustava_Socialisti%C4%8Dne_republike_Slovenije_\(1974\)](https://sl.wikisource.org/wiki/Ustava_Socialisti%C4%8Dne_republike_Slovenije_(1974))

In no way, property rights could have been imposed on social property. The foundation for appropriation rights was labour (personal income), rather than property rights. Human labour was the sole basis for the appropriation of the product of social labour and the sole basis for the management of social resources (workers self-management).

Social enterprise as a self-managed enterprise

The social ownership concept of business enterprises imposed labour-based corporate governance (self-management), with a **workers' council** in the role of a board of directors, with the power to appoint and remove managers, to monitor them and to make strategic and long-term business decisions.

The legal form of a business organization was a so-called **organization of associated labour** as opposed to public or private limited (joint stock) company, which was not capital but labour governed. At later stage (late eighties) organizations of associated labour became social enterprises, with the same (non) ownership and (self) managerial concept.

Social enterprises were **self-managed enterprises**, governed by employees through workers council workers in the position of the board and by director appointed by workers council. Supervision was conducted by workers supervisory body, appointed by workers council.

The social enterprise in socialism was based upon **non-ownership concept** as opposed to property rights concept on one hand and self-management as opposed to capital based corporate governance and profit distribution on the other. Workers managed the enterprise rather than shareholders. Profit was not distributed out of the company but allocated for enterprises' development. All this resembled substantially to a modern type of social enterprise.

However, there is an important difference between the self-managed social enterprise and the modern one in the ownership concept and managerial rights, derived from it. Namely due to non-ownership structure of the social enterprise, it was self-managed.

On the contrary, **modern social enterprise is owned by somebody** (founder or buyer) and therefore cannot be self-managed, but probably managed by the shareholders, unless property rights are transferred to somebody else (employees...). However, for the sake of becoming social enterprise, no transfer of ownership rights is needed; the only change necessary to be done is the adaptation of bylaws in the sense of aiming to societal objectives as prioritized. However, ownership interests of dissenting coo-owners could be damaged or at least hurt.

Abolishment of Self-Managed Social Enterprises

Reforms in the early nineties abolished this concept. The self-management and social-ownership concepts were abandoned and the privatization process enabled the transformation of organizations of associated labour, first to so-called enterprises with social capital (social enterprises) and later, after the adoption of the new European-patterned company law, to traditional corporate forms. However, some of that tradition, whether the self-management culture or related feelings and understanding, has remained among employees and of course in certain political and especially trade union circles.

Some 20 years after abolition of socially owned companies through different kinds of privatization processes new law on social entrepreneurship was enacted in Slovenia (2011) following totally different concept. There is no tradition and little experience under new concept.

We can easily say that there is a long rich and diverse tradition social entrepreneurship in the EU. As a matter of fact, the previous self-management system that ultimately turned out to be economically inefficient, and as such politically unsustainable, was based on a social ownership, contractual economy as opposed to a market economy, and labour rights as opposed to the property rights concept. These concepts were abandoned; however, a variety of new social enterprises forms emerged in the contemporary EU member states.

In Slovenia, the new Law on social entrepreneurship (LSE, 2011) introduced completely different concept, which has nothing to do with the previous socially owned system. Nevertheless, experience and tradition of social ownership and self-management left tracks in peoples' feelings and understanding of human society (solidarity, equality, mutuality...) and therefore affected and influenced the developments of social ideas in capital based economy, including of course the re-emerging of social forms of enterprises.

Social Enterprises in The Eu Member States Legislation

Legislation and legal forms of social enterprises

Rather than uniform EU regulation referring to social enterprises, there are numerous political documents and expertise on the EU level. On the other hand, there is a variety of laws in different states, approaching to social entrepreneurship very differently. Laws on social entrepreneurship and so the progress, vary significantly; however some classification is possible; for example, there are countries (concepts, classification) with laws on social entrepreneurship, then countries with laws implementing social entrepreneurship through other legal forms (social cooperatives) and finally countries with laws on SE as special legal entity.

In the **United Kingdom**¹¹, there is **no specific legislation** for social enterprises. Social enterprises can take one of the legal forms of Limited Liability Company, Company Limited by Guarantee or Joint Stock Company, and also Craft and Support Society or Cooperatives.

UK has developed its own legal form of social entrepreneurship, as it is **Community Interest Company**, as a limited liability company governed by UK Companies act. The **Community Interest Company** was introduced in 2005, although the concept of social entrepreneurship in the UK, based on the Companies Act and the Law on the Craft and Supporting Society Act, existed earlier. Most of these companies decide on the form of, rather than a joint stock company.

In **Italy**, the prevailing legal form of social enterprise is **social co-operative**, but other non-profit entities as voluntary associations, funds, social and cultural associations and non-governmental organizations are also appear as social enterprises.¹²

The Social Entrepreneurship Act does **not introduce a new legal form**, but existing legal forms such as, for example, Limited Liability Company (Societá a responsabilitá limitata - S.r.l.) or a public limited company (Societá per Azioni - S.p.A.) allows the legal recognition of the status of a social enterprise and the related tax and institutional benefits, just like in cooperatives. Also in Italy, social enterprises operate in a wide range of activities, which typically relate to social/humanitarian services, education, health care, culture, recreation, interest associations, tourist activities, etc.

In Italy, two laws directly relate to social entrepreneurship, namely the **Social Cooperatives Act no. 381/1991 of 1991** and the **Social Business Act no. 155/2006**. In Italy, the law provides for two types of social cooperatives:

-the first type (type A) providing services to the environment that are not sufficiently provided by the market, educational services, health services or social services,

¹¹ Since in 2017 this industry employed more than 1.44 million people with approximately 471,000 registered social enterprises (Government of UK, 2017). The advancement of social entrepreneurship in the UK needs to be attributed to the strategic approach taken by the government, which has established a number of support activities, organs and programs to promote this sector. With this approach, social entrepreneurship gained momentum and began to develop in a direction that ranks UK among European countries with the most developed social entrepreneurship.

¹² About a third of social enterprises are registered as cooperatives (cooperativa sociale), about a quarter are a limited liability company (societá a responsabilita limitata) and only four companies are registered as a public limited company (societá per azioni).

-the second type (type B) of social cooperatives differs from the usual ones by employing socially disadvantaged people in the labour market of a vulnerable group of people, such as disabled. The three basic conditions for the status of the social co-operative are private ownership, the supply of services, the production of products with a wider social benefit and the reinvestment of profits in achieving social benefits, whereby profits between owners and / founders cannot share¹³.

In Germany, there is no single law, neither uniform legislation regulating the field of social entrepreneurship. The legal and organizational form in which organizations, corresponding to what is understood as social enterprise, are partnerships, a society, a foundation (Stiftung), a registered association / society (Eingetragener Verein, e.V.). Already under the statutory arrangement, it is common for all of the aforementioned forms that the distribution of profits is limited.

Denmark in 2014, adopted the **Law on Registered Social Enterprises (L 148)** in order to create the basis for a common identity for companies operating in the field of social economy. Through the registration, companies that fulfil the conditions of the law can start using the term registered social enterprise. Such a company must operate in a social and moral sense, but it is limited in terms of profit sharing.

The so-called social enterprise networks play an important role in social enterprises. For example, the role of such networks may be a mutual support mechanism offering guidance and advice, acting as a sector advocate, negotiating contracts, exchanging good practices and collaborating with public authorities in creating specific public programs. Such networks, with the exception of a couple of countries, are known throughout Europe.

In Slovenia, the Law on social entrepreneurship (LSE, 2011) introduced social enterprises as registered social undertaking, taking one of the existing legal forms (companies, societies, foundations, cooperatives). Social entrepreneurship are activities that serve the public interest by offering additional products and services to increase the quality of life or living environment, strengthen social solidarity and cohesion, etc.¹⁴

The law (LSE, 2011) lays down the definition, objectives and principles of social entrepreneurship, the activities of social entrepreneurship, the conditions under which legal entities acquire the status of a social enterprise, the method of acquiring the status of a social enterprise and its withdrawal, specific operating conditions of social enterprises, the records kept regarding social entrepreneurship and its supervision.

The existing concept social entrepreneurship (LSE, 2011) emerged recently, almost 30 years after abolition of social ownership and social ownership based economy. The predominant driving force was the prevailing disappointment of Slovene population with the economic efficiency and social injustice of the new privatized and capital based concept of economy and related economic crisis and lack of social and mutual and solidarity based ways of entrepreneurship.

The Law (LSE, 2011) was therefore a big hope to overcome this gap, but unfortunately already is a big disappointment. The development of new forms of social enterprises has so far been slow and not very promising. The amendments of the Law (LSE, 2011) were already enacted. Social entrepreneurship legislation, strategies, and subsidies on this field were also driven by the pressure of on non-profit organizations and movements to meet their social objectives developing their commercial revenue generating activities. And also the rise of socially conscious consumers, ethical business, social

¹³ According to data from 2011, 11,264 social cooperatives were registered in Italy, while in 2013 1,348 social enterprises were ex-lege. Together with other de-facto social enterprises (eg foundations, societies, conventional cooperatives, and companies where the "social enterprise" is only in the name), the total number was estimated at 34,840. On average, 12 individuals are employed in a single social enterprise in Italy, and such companies ranked on average as a category of those with founding capital between EUR 10 and 50 thousand. There are only nine large companies employing 250 or more employees. Equally, with regard to capital only nine companies are classified as companies with EUR 250,000 or more.

¹⁴ From 2011 until November 2018, 259 social enterprises were registred, most of them societies, private institutions, cooperatives, foundations and private limited companies.

entrepreneurship movement, etc. Finally yet importantly, new social needs, arising from then increasing economic crisis, pressed the government to reduce the level of the welfare state and to run more efficiency drive economic policy, which has partly included outsourcing of public services. There is no tradition and little experience under new concept.

Standard business legal forms are not applicable

In the compared countries, standard business legal forms (limited liability and joint stock companies) are too much dependent on the return on investment interests of shareholders to be able to enter into social entrepreneurship. On the other hand, charities are subject to stricter regulation to meet the needs of social entrepreneurship.

Sui generis legal form is therefore invented in some countries (like UK Community Interest Company or Italian social cooperative) to enable social entrepreneurs to establish legal entities that are not charities, while at the same time protecting the social purpose and not just maximizing company profit for shareholders and governed by “one share, one vote” principle.

Such entities are **legally prohibited to sell its assets** (except to another such entity) or pay dividends (alt. above a certain threshold). In some cases (Boeger, Burgess and Ellsion, 2018, 347-349) only restrictions are imposed to distribution of profit (dividends can be paid only for social purposes, the amount of dividends is limited). Profits must either be re-invested into the entity or be used for social purposes.

There are also legal forms of a public limited company that has a dual purpose: it is to create profit for shareholders and to pursue social purposes or goals (Sørensen and Neville, 2014, 271). In such cases, the introduction of a ceiling for the payment of dividends is legally required. The purpose of this is to ensure a balance between providing an attractive investment opportunity and ensure that most of the generated profits are used to benefit the community. **However, these two incompatible objectives is hard to be balanced in a way that both achieve satisfactory results.**

There is also a restriction on registered associations, societies (Eingetragener Verein), which are the most common form of legal and organizational arrangements for organizations that function in the general interest. Registered associations (Eingetragener Verein, e.V.) may not engage in commercial activities.

The German Foundation, which is an extremely appropriate organizational form for charitable activities, is on the other hand a very limited one in particular; the objection to the choice (appropriateness) of this organizational form is a **legal prohibition on engaging in commercial activity.**

The common legal and organizational form is a limited liability company (Gesellschaft mit beschränkter Haftung, GmbH). In addition to the limited liability company, a new form was introduced, i.e. a **general-benefit company (Gemeinnützige GmbH, gGmbH)**, in which many associations and / societies that have encountered an increase in commercial activities with which, in other legal and organizational forms, it should not be dealt with.¹⁵

Registration and governmental supervision is needed

Regulators supervision and powers to impose sanctions for the violation of declared (registered) social purpose is the one of the crucial distinctive feature of social enterprises compared to traditional companies. If a company is registered additionally as social enterprise, it is not anymore the same legal status as traditional companies. Additional legislation applies and not all company law rules are longer applicable for social enterprises. Better to say, company registered as social enterprise is no longer company under companies law.

¹⁵ European Commission, 2015; Bundesrepublik Deutschland, 2017; Birkhölzer, 2017

Registration of the social enterprise as a special legal entity in the compared countries includes for example the submission of a **social purpose statement** (community interest statement in the case of UK Community Interest Company) proving that the social enterprise will pursue the activities to the benefit of the community. The regulator (competent ministry), to which the social enterprise belongs, examines whether the declaration meets the definition of social purpose (submission of annual plans and reports).

The regulator has powers to publicly monitor the social enterprise activity including powers to investigate and take action, including a decision on an independent audit at its own expense. The regulator also has the power to initiate legal proceedings against the social enterprise and the power to intervene in the internal affairs of the company and to remove and appoint directors (for Community Interest Company see: Office of the Regulator of Community Interest Companies, 2017).

Such rules are inapplicable to companies under traditional company law what presents another important argument for social enterprise as *sui generis* legal entity not being ruled under company law.

Tax incentives

There are enormous differences in tax law in relation to social enterprises - due to total autonomy that EU member states have in this field. UK for example, has no special tax relief for social enterprises, but numerous tax reliefs on donations and funds for establishing charitable funds have been introduced. Nevertheless, there are various forms of support for social enterprises from the state, especially from the funds (for Community Interest Company see: Office of the Regulators of Community Interest Companies, 2013).

The UK government has also launched a **Social Investment Tax Relief program**, which encourages individuals to support or invest in social enterprises, with individuals receiving a 30% tax deduction in investing in an eligible organization. The investor then gets his investment reimbursed in the form of interest or, with his investment, helps to create a positive social effect.

Italian Law on social enterprises, 381/91, provides **tax relief for social associations**. Concerning the benefits, social co-operatives benefit from exemptions or reductions in corporation tax, and the services of social cooperatives of Type A are subject to the lowest value added tax (IVA), which is four percent. Social co-operatives also benefit from public tenders, in agreement with the European Commission, local communities and social cooperatives can directly conclude a contract of up to EUR 300,000.00 (European Commission, 2014).

The supportive environment for social entrepreneurship in Italy, due to the organization itself, consists of national, regional and local levels. Special instruments for promoting social entrepreneurship include specialist or t. i. ethical banks that are dedicated to dealing with social enterprises and their financing (European Commission, 2014).

The **status of *Gemeinnützigkeit*** is the basic status that enables non-profit organizations' in Germany to apply **tax incentives**, with the exception of partnership, which makes partnership as an organizational form of what is understood as a social enterprise less desirable and hence less common.

Critical Overview On The Eu Social Enterprises Principles

Social enterprise brings more questions than answers

Brief comparative analysis opens numerous questions with the common characteristic: how to implement the values and principles of social entrepreneurship into real life, and in the best possible way. There were so many positive attempts, unfortunately rare of them succeeded.

What needs to be done at the EU level is to transform the specific values and principles of social entrepreneurship, to legal rules. For example, the principle of **equality of membership and stakeholder involvement** in the management must become legal rule, as to make sure, all social enterprises will follow

this concept. It cannot be simply left to, or depend on the good will of individual shareholders and their real power.

The same is true with the principle that **assets, profits and revenues in excess of expenses shall be used for the purpose of social entrepreneurship** and other non-profit purposes and that distribution of profits or surpluses of revenue is not permitted or restricted. If this essential component of social enterprise were left to be implemented depending to respective understanding and mood of the actual stakeholders, we would have very diverse, black and white picture on that in real life.

Financial transparency and internal supervision of the material and financial operations could only be achieved in an effective way when everyone follows the same strict legal rules on that, not through voluntary applicable recommendations.

The same is true for the rest of the principle, like continuous operation for the benefit of its members, users and the wider community, or job creation for vulnerable groups of people, and the pursuit of socially useful activities.

The question arises **who are legally the members of a social enterprise?** Are the members people who are the founders or who become owners of the social enterprise, or the members are supposed also to be other stakeholders (workers who are employed in the SE, volunteers in the SE engaged in volunteer work, and persons who are users of the products or services of social enterprise)?

If yes, this needs then to be precisely legally regulated including on what basis and to what extent they bear managerial right in competition to owners and founders. For there is no doubt about that management rights are property rights, it is necessary to regulate on what legal basis the stakeholders who are not owners or founders carry management rights. To shorten, the managerial and appropriation legal structure of a social enterprise need to be amended to the extent where it differs from traditional property based rules. It is simply not feasible to leave all these opened issues to by laws of the individual social enterprise.

The managerial and other rights of stakeholders (employees, volunteers, users) should be set out legally and not just left founders or owners to voluntary enact rules as a basis for their position.

The same as it was said for governance issues is true for **appropriation issue**. Any deviation from traditional rules regulating distribution of profits or surplus (in non-profit organizations) should be set out separately by *lex specialis* legal rules.

“One man, one vote” rather “one share, one vote”

Fundamental principle of social entrepreneurship is equality of membership, what obviously refer to the concept of “one man, one vote”, rather than “one share, one vote”. It is not quite clear and there are differences in legislations in stipulating governance rights in the social enterprise. As it is generally explained, social enterprise management rights are attached the members of a social enterprise (the founders and later owners and also those who joined the membership in a way defined by the social enterprises articles of incorporation (employees).

Rather on the level of principles, than in the legislation, it is explained that stakeholders are also involved in the management, however it is not quite clear who exactly stakeholders could be (in addition of employees) and how they acquire membership status in the social enterprise (becoming the founder or simply on contractual basis). Stakeholders are supposed to be employees, volunteers and persons who are users of the products or services of SE.

Founders or owners should not have a predominant influence on decisions made by all members on the principle of “one member, one vote”, irrespective of the share capital (equality of membership). In the management of the SE members are autonomous (independent). In decision-making stakeholders shall be

included (stakeholder involvement in management). These are general principles, however, understanding and the implementation vary among countries. **There are several reasons for that: first of all the concept is not clear at the level of implementation and second, countries have different traditions and the governments have different political backgrounds.**

The issues related to members and stakeholders are rather complicated, but unfortunately left to the more or less creative solutions in different countries in the absence of transparent and binding EU rules; this is by no means a weak point of social enterprises regulation.

Non-profit nature of social enterprises

A SE is an undertaking that uses its profits to achieve its primary objective; profits are distributed to shareholders, only when it is ensured that distribution of profits does not undermine the primary objective. There is also generally accepted principle that assets, profits and surpluses of income over expenses are used for the purposes of social entrepreneurship and other non-commercial purposes; profit-sharing or revenue gain is not possible or limited.

Distribution of profits is one of the fundamental rights of the shareholders as far as profit-making entities is concerned. However, the shareholders themselves can decide not to distribute the profit in a certain year, to leave it undistributed or to put the profit into reserves. **But amending for ex. the joint stock companies by laws in order to make provisions that would prevent shareholders to distribute the profits at all, would have changed the concept of a joint stock company as a for profit entity to the not for profit entity. Transforming joint stock company to a non-profit organization would change it so substantially that this is no longer joint stock company. For this reason, a joint stock company which embodies profit distribution as the basic principle is not an appropriate legal form for social enterprise at all. This is true for other capital-based companies as well.**

Only private non-profit legal persons can become social enterprises; a legal form for non-profit entity could be **an association, institution, organization, company, cooperative, European cooperative** or other legal entity of private law, which is not formed solely for the purpose of profit.

The purpose of the establishment of the SE rather to satisfy social needs, than to make profit (non-profit purpose of the establishment). One of the fundamental principles of social entrepreneurship is also that assets, profits and revenues in excess of expenses, shall be used for the purpose of social needs and other non-profit purposes, nevertheless there are different legislative approaches regarding the issue, whether this principle is recommended only, or an exclusive and strict rule. Some of the compared legislations permit members to distribute a part of the profit, imposing the limitation in percentage, while others would strictly forbid any profit distribution to members.

General principle is that distribution of profits or surpluses of revenue of social enterprises is not permitted, however, it is also allowed that it is restricted or limited only. To what extent restricted and how, it is mostly not stipulated and rather left to the bylaws of the social enterprise. That causes a lack of transparency as well as an inconsistency in the implementation of this principle.

Continuous operation for the social benefit

Next SE principle is continuous operation **for the benefit of its members, users and the wider community**, while again it is not clearly defined who the members are, how they become members and who exactly is wider community (municipality, state, or other).

Operation for the benefit of its members, users and the wider community are mostly job creation for vulnerable groups, and the pursuit of other socially useful activities. SE are established primarily for the purpose of social entrepreneurship activities or other activities for the purpose of employment the most vulnerable groups in the labour market, thereby achieving the public interest (acting in the public interest).

Creation of jobs for vulnerable groups is obviously a prerequisite, in addition to other socially useful activities; but again not in all legislations and that shows the difference in basic understanding of the concept of the SE.

SE manufactures and sales products or services on the market and mainly operates on market principles (market orientation). Market orientation and non-profit purpose do not oppose to each other, however traditional corporation and non-profit purpose does.

SE activities are far from being limited to local and economic integration of the disadvantaged and excluded (work integration, sheltered employment). Today, social services of general interest like long term care for the elderly and for people with disabilities, education and child care, employment and training services, social housing; health care and medical services are of growing importance. Also public services such as community transport, maintenance of public spaces, are more and more performed by SE. Likewise, there are more and more SE, engaged on strengthening democracy, civil rights and digital participation and also on environmental activities such as reducing emissions and waste, renewable energy, practicing solidarity with developing countries (such as promoting fair trade).

The question arises, why at all to list the admissible SE activities in legislation, or why restrict SE when registering its activities. The same rule should apply as when performing other business activities, namely: the company may carry out any authorized activity. Differences between the SE and profit-oriented companies are therefore not in the types of activities that they are allowed to perform, but in the way of performing these activities and in their effects on society. In the SE, these effects must be not only a business but also a social one.

The EU harmonization of this area should therefore eliminate restrictions on activities for social enterprises and enforce the principle that social enterprises can be established in all activities; only the way of doing business would be different from that which characterizes general business activity.

An Undertaking, Regardless of its Legal Form

Crucial misunderstanding is the standpoint definition that SE is an undertaking, regardless of its legal form. The method of organization or ownership system, according to EU concept, reflects SE mission using democratic or participatory principles or focusing on social justice leaving all the implementation to SE internal rules, conflicting substantially with traditional corporate legislation. The EU Program for Employment and Social Innovation (EaSI)¹⁶ defines a social enterprise as an undertaking, regardless of its legal form, which in accordance with its Articles of Association, Statutes or with any other legal document by which it is established, has as its primary objective the achievement of measurable, positive social impacts rather than generating profit for its owners, members and shareholders.

It is therefore left to by laws of the legal entity to define itself as SE. Any legal entity, profit or non for profit, public or private, corporation or foundation, could declare itself as social enterprise, provided it sets out in its bylaws and performs positive social impacts. The problem that we see here is that internal legal relations between owners (shareholders) and managers are normally defined by corporate or other entity law, following the principles of property rights, protecting outstanding (minority) shareholders and creditors. Internal regulation of distribution of profit or decision-making, irrespective to property rights principles, could harm the interests of dissenting members of the social enterprise.

For this reason, legal form is a primary issue to be respected in deciding upon establishing social enterprise. Even more, social enterprise should have legal form per se (as its own). Legal structure of

¹⁶ Article 2 of Regulation (EU) No 1296/2013 of the European Parliament and of the Council of 11 December 2013 on a European Union Programme for Employment and Social Innovation ("EaSI") and amending Decision No 283/2010/EU establishing a European Progress Microfinance Facility for employment and social inclusion. Available at:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:347:0238:0252:EN:PDF>

the social enterprise should have been defined by law on social enterprises. Otherwise, the shareholders of the legal form transforming itself to social enterprise by the bylaws decision might violate the law on the respective legal entity.

Social enterprise is, in majority of countries, not a special type of a company, as we think, it should be, but could be any legal entity, additionally registered as entrepreneurial entity with a special (social) purpose, aiming to accomplish social objectives by selling its products or services on the market. Not being a special legal form with the legal structure referring to special attitude towards profit distribution, governance and employment, enterprise, not being a special corporate legal form may also fall into conflict of laws with the company legislation laying down the rights and duties of shareholders, directors and employees and referring to property right issues.

The method of organization or ownership system, according to EU countries concepts, reflects their mission using democratic or participatory principles or focusing on social justice.

It is there left to by laws of the legal entity to define itself as social enterprises internal relations and governances structure. Any legal entity, profit or non for profit, public or private, corporation or foundation, could declare itself as social enterprise, provided it sets out in its bylaws and performs positive social impacts.

This is wrong approach that causes variety of different kind of understanding, what social enterprise is. Legal uncertainty based on lack of transparency is the basic reason for the fact that social enterprises stay small in size and not develop to bigger corporation. The number of social enterprises in the EU is high, but the number of employees and capitalisation is small. The relation among members, investors, employees and other stakeholders and directors, shall be crystal clear in order to ensure legal certainty and reduce risk for each of the partners.

The problem that we see here is that corporate or other entity law following the principles of property rights normally defines internal legal relations between owners (shareholders) and managers, protecting outstanding (minority) stockholders and creditors. Internal regulation of distribution of profit or decision making, irrespective to of property rights principles, could harm the interests of dissenting members of the social enterprise.

For this reason, legal form is a primary issue to be respected in deciding upon establishing SE. Even more SE should have legal form per se (as its own). Legal structure of the SE should have been defined by law on SE or company legislation at EU level for all EU countries. Otherwise, the shareholders of the legal form transforming itself to social enterprise by the bylaws decision might violate the corporate law on the respective legal entity.

No uniform EU legal structure for social enterprises

As already said, there is no uniform EU regulation referring to SE. There is a variety of laws in different states, approaching to social entrepreneurship very differently. Though laws on SE in the EU vary significantly, some classification is possible, for example: there are countries (concepts, classification) with **laws on social entrepreneurship**, then countries with **laws implementing SE through other legal forms** (social cooperatives) and finally countries with **laws on SE as special (*sui generis*) legal entity**.

Countries with SE laws, narrowly referring to work integration are for ex. Finland, Lithuania and Slovakia). As example, a country, with both: law on social cooperatives (legal form) as well as a law on SE (legal status) is Italy. A specific legal form for SE (social cooperatives) and a specific law creating a social enterprise legal status is in Poland and specific registration of SE, taking other traditional (established) legal forms is Slovenia.

Variety of forms makes it difficult to compare and seriously analyse the performance and impacts of social entrepreneurship in the EU. Legal forms of SE are not comparable to each other, therefore, the

social effects that are essential for stakeholders of SE (purpose) and for society's progress are not measurable and not at all in a uniform way. Therefore, it would be necessary to start by harmonizing the basic rules for the establishment, operation, governance and relations between the members (owners / employees) of the EU (EU Directive on SE). Methodology for measurement of the implementation of social or societal goals (the purpose of the SE) is here essential; because it substitutes the profit as an expectation of stakeholders it have to be as precise as the regulation on profit distribution are.

As long as the legal framework for SE is left to the good will of each political option and not to the long-term systemically regulated backbone of social development, much progress cannot be expected – similarly to what we found out for employee stock ownership and employee profit sharing. Moreover, the same goes for the social economy in general.

Having no uniform EU regulation (directive) on social enterprises, we are confronted with a mess of different legislative approaches and therefore legal forms and types of social enterprises. Different organizational and legal forms and statuses of SE are thus registered and operating across Europe, offering much less of the progress as could be expected in more orderly circumstances in the EU.

Operations and financing of social enterprises

Nowadays, social services of general interest like long term care for the elderly and for people with disabilities, education and childcare, employment and training services, social housing, health care and medical services are of growing importance. In addition, other public services such as community transport, maintenance of public spaces, are more and more performed by social enterprises. Likewise, there are more and more social enterprises, engaged on strengthening democracy, civil rights and digital participation and also on environmental activities such as reducing emissions and waste, renewable energy, practicing solidarity with developing countries (such as promoting fair trade).

The question arises, why at all, to list the admissible social activities in legislation, or why restrict social enterprises when registering its activities. The same rule should applies as when performing other business activities, namely: the company may carry out any authorized activity. Differences between the SE and profit-oriented companies are therefore not in the types of activities that they are allowed to perform, but in the way of performing these activities and in their effects on society. In the social enterprises, these effects must be not only a business but also a social one, or even better, social ones should prevail.

The EU harmonization of this area should therefore eliminate restrictions on activities for social enterprises and enforce the principle that social enterprises can be established in all activities; only the way of doing business would be different from that which characterizes general business activity.

SE is a hybrid' business model, when talking about their revenues. SE derives the revenues from a combination of market (the sale of goods and services to the public or private sector) and non-market sources, like government subsidies and grants, private donations, non-monetary or in-kind contributions such as voluntary work etc.

SE contract with public authorities and agencies to receive fees for defined services (quasi-markets, direct payment, social security, voucher systems). SE also acquires direct grants and subsidies, provided to SE by public authorities (for specific project based activity, employment subsidies and compensations).

SE might get membership fees, donations and sponsorship. Other forms of revenue (renting assets, such as property), penalty payments, prize money or income from endowed assets, in-kind donations, volunteering time are also permissible.

Financing of SE comprises of a variety of possibilities and forms, which are not all applicable neither at traditional corporations nor all in the case of charity organizations. Financing issues appear again

as relevant specificity that require specific uniform legal regulation for the SE as a *sui generis* legal entity.

Shareholders Rights, when Company becomes SE

Nothing is wrong with the orientation or even the rule that SE provides services or goods, which generate a social return, and/or other ways pursues social objective. In market economy, rational expectations of the investors are that the sale of services or goods ensures return on investment (the higher the better). This is what shareholders require from their agents (directors) in a joint stock company.

In order to make a company to become SE, shareholders should amend articles of incorporation and declare its company activities as not necessarily profitable, as long as it provides some social return as opposed to return on investment. This is the approximately same approach as to declare the company as not for profit, unless the company provides for social return through profitable activity.

It is important in the previous and this case that each individual shareholder agrees and give written consent on such an amendment of articles of incorporation. If not, the shareholder is considered dissenting (minority) outstanding shareholder, having the right to step out of the company and be repaid for his investment under current market value.

SE, is managed in an entrepreneurial, but in particular, as opposed to traditional enterprises by involving workers, customers and/or other stakeholders affected by its business activities.

Property rights' corporate governance, based on the principle "one share, one vote" is the concept relevant for decision-making in the traditional joint stock company. Any other way of making decisions should be based upon amendments of the Articles of incorporation, or if it is the corporation from scratch in the founding act. Again, consent of each shareholder would be needed for such an amendment of the Articles or such a provision in the funding act that would deny or abandon the principle of "one share, one vote" in any possible manner. Again, for the dissenting shareholders a way to step out has to be commonly agreed or (even better) legally guaranteed.

Nothing is wrong with the orientation or even the rule that SE provides services or goods that generate a social return however the investors of capital need to agree or to have legally guaranteed rights to be protected when the corporation seizes to follow their for profit expectations. In addition, stakeholders that accept to substitute return on investment with social return should be guaranteed that such a return is measurable and allocated to users fair and equitable.

In market economy, rational expectations of the investors are that the sale of services or goods ensures return on investment (the higher the better). This is what shareholders require from their directors in a joint stock company. If the case of social enterprise in a certain company, shareholders might amend articles of incorporation and declare its company activities as not necessarily profitable, as long as it provides some social return as opposed to profit as a return on investment. This is the approximately same approach as to declare the company as not for profit, unless the company provides for social return through profitable activity. However, to protect shareholders property rights, it is important that each individual shareholder previously agrees and give written consent on such an amendment of articles of incorporation. If not, shareholder is considered dissenting (minority) outstanding shareholder, having the right to step out of the company and be repaid for his or her investment under current market value.

So the expectations of the shareholders of a company that declared itself as a social enterprise might be above activities and measurable objectives achieved in certain period, rather than distribution of profit. However, for the sake of transparency and legal certainty, which is the prerequisite for social investments, it is urgent to define outcomes as precisely as the profit is defined. Otherwise, why would anybody invest his or her brains, skills or money for the activities whose outcomes are not clearly defined?

Conclusions

The legal elaboration of certain parts of the EU SE definition is needed by legally binding provisions at the EU level to make national legislation more clear and transparent and to make SE more publicly recognized and visible at investors and consumers market. It should be legally clear, how positive social returns and impacts are measurable (methodological inputs), and what are the legal consequences, and stakeholders protective measures, if such impact are not achieved to the foreseen extent? The definition and the methodology for measurement of the term "social return" and the definition and the list (exemplificative) of the methods of production of goods or services that embodies its social objective should be legally precise and though transparent to the extent that motivates potential investors.

The rules on profit distribution should be strict rather than just recommendation or optional and left shareholders to decide on the extent of restrictions or lock in. Predefined procedures and rules for any circumstances in which profits are distributed to shareholders and owners should be precisely stipulated in the legislation and not just left to articles of incorporation. If general laws on profit distribution are not excluded by *lex specialis* (legislation on SE) general corporate legislation on profit distribution to shareholders shall apply.

And finally, the following question should be defined more precisely by legislation: what exactly is democratic participative governance, which includes all stakeholders (employees, customers and users) and what is the relation towards capital investors in governance; in order to avoid improvisation, left to the political attitude and social sensitivity of shareholders.

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