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# **A COMPARATIVE STUDY OF LEGAL FORMS FOR SOCIAL ENTERPRISES IN THE UK AND THAILAND**

by

**Prapin Nuchpiam**

## **Abstract**

This thesis studies legal forms for social enterprises in the UK and Thailand. The reason for the focus on these two countries is that the recent development of social enterprise in Thailand has been significantly influenced by the UK. I will show how a legal form specifically designed to suit the nature of social enterprise is important to its *operation* as well as the *fostering* of the social enterprise sector. Given this importance of such a legal form, and its unavailability in Thailand, a question arises: *does the country need such a specially designed legal form?* My argument in favour of its need runs as follows. Although the UK and Thailand rely on several legal forms, the Thai social enterprise sector, unlike its UK counterpart, still does not enjoy the benefits and advantages of a legal form like the Community Interest Company (CIC), which is devoted to the social enterprise by being purportedly designed specifically with its needs in mind. The Thai social enterprise sector's reliance on the existing traditional legal structures has been found to suffer from serious limits: not only do these legal forms not facilitate the functioning of social enterprises, but the unavailability of a specialised legal structure becomes a disincentive to social entrepreneurship. A legal blueprint designed to suit the nature of social enterprise has thus been proposed to meet Thailand's need. To establish its practical relevance, the blueprint has been used to evaluate the CIC and the legal forms adopted by social enterprises in Thailand. On the basis of the results of this evaluation it has been used as a model for the development of a specialised legal form for social enterprises in Thailand – which is the main purpose of my thesis.

**A COMPARATIVE STUDY OF LEGAL FORMS FOR SOCIAL  
ENTERPRISES IN THE UK AND THAILAND**

**by**

**Prapin Nuchpiam**

*Submitted in accordance with the requirements for the degree of  
Doctor of Philosophy*

Durham Law School

Durham University

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## Table of contents

<b>Table of Cases</b> .....	vi
<b>Table of Legislation</b> .....	vii
<b>Statement of Copyright</b> .....	ix
<b>Acknowledgements</b> .....	x

### **Part I Conceptual Perspective**

#### **Chapter 1 A Conceptual Framework for the Study of Legal Forms for Social Enterprises in the UK and Thailand ..... 1**

1.1 Introduction.....	1
1.2 Legal forms for social enterprises .....	3
1.3 For a legal form specially designed for social enterprises in Thailand .....	5
1.4 Research methodology .....	8
1.5 Research questions.....	10

#### **Chapter 2 Understanding Social Enterprise ..... 12**

2.1 Introduction.....	12
2.2 Concept and orientation of social enterprise .....	13
2.2.1 Dealing with conceptual confusion .....	13
2.2.1.1 The use of the terms “social enterprise” and “social entrepreneurship” .....	13
2.2.1.2 Third sector vs social economy vs non-profit sector.....	14
2.2.1.3 Social enterprise and the third sector .....	21
2.2.2 From the third sector to new entrepreneurship .....	23
2.3 Characteristics and orientations of social enterprise .....	29
2.3.1 Social enterprise: characteristic features and different orientations .	29
2.3.2 Social enterprise as identified in this study.....	33
2.4 Analysis of the social enterprise landscape of the UK.....	34
2.4.1 Origin of social enterprise in the UK.....	35
2.4.2 Emergence and development of social enterprise in the UK .....	35
2.4.2.1 1999: Emergence of social enterprise in the UK.....	36
2.4.2.2 1999-2001: The institutionalisation of social enterprise .....	38
2.4.2.3 2001-2005: Establishment of the meaning and orientation .....	39
2.4.2.4 2006-2010: Reassertion of the third sector.....	40
2.5 Understanding social enterprise in Thailand .....	42
2.5.1 Concept and meaning of social enterprise in Thailand.....	43
2.5.2 Problems and needs of social enterprise in Thailand .....	50
2.6 Conclusion.....	54

### **Part II Developing a Blueprint of a Legal Form for Social Enterprise**

#### **Chapter 3 Designing a Legal Form for Social Enterprise: Legal Forms for Organisations and Entrepreneurs’ Needs..... 56**

3.1	Introduction.....	56
3.2	Legal forms for organisations: some conceptual issues .....	57
3.2.1	The meaning of “legal form” .....	58
3.2.2	The importance of choice of legal form .....	60
3.2.3	The facilitating role of legal form.....	61
3.2.3.1	Reducing transaction costs.....	62
3.2.3.2	Imperfect information and “bounded rationality” .....	65
3.2.3.3	The dynamic quality of the law .....	66
3.2.4	Legal forms and mandatory rules.....	67
3.2.4.1	Arguments against mandatory rules.....	68
3.2.4.2	Arguments in favour of mandatory rules .....	69
3.2.5	A synoptic view of existing legal forms .....	73
3.2.5.1	Unincorporated legal forms .....	74
3.2.5.2	Incorporated legal forms (corporation) .....	75
3.2.5.3	The architecture of the legislation creating corporate legal forms.....	76
3.3	What do social entrepreneurs need from their legal form? .....	78
3.3.1	Social enterprise: similarities to, and differences from, for-profits ..	78
3.3.2	An organisation with its own legal personality.....	79
3.3.3	Protection against risk .....	82
3.3.4	The social enterprise’ need for, and sources of, finance .....	87
3.3.4.1	Equity (share) capital.....	88
3.3.4.2	Loan capital .....	90
3.4	Conclusion.....	90
<b>Chapter 4 Designing a Legal Form for Social Enterprise: Regulatory/Governance Rules in a Legal Form for Social Enterprises.....</b>		<b>92</b>
4.1	Introduction.....	92
4.2	Controlling agency costs .....	93
4.2.1	Agency costs and social enterprise.....	93
4.2.2	Strategies for reducing agency costs .....	97
4.3	Assuring accountability to stakeholders within social enterprises.....	99
4.3.1	Shareholding versus Stakeholding.....	100
4.3.1.1	Conventional concepts of shareholding and stakeholding.....	100
4.3.1.2	Shareholder vs stakeholder debate: who won? Or a move towards a new approach?.....	104
4.3.1.3	Social enterprise and its governance approach .....	106
4.3.1.4	Should the stakeholder elements of social enterprise be mandatory or default?.....	108
4.3.2	Devising efficient governance rules in a legal form for social enterprises.....	109
4.3.2.1	Asset lock and non-distribution constraint.....	110
4.3.2.2	Social benefit requirement .....	112
4.3.2.3	Stakeholder participation.....	114
4.3.2.4	Stakeholder board.....	117
4.3.2.5	Directors’ duties .....	121
4.3.2.5.1	Whose interests?.....	121

4.3.2.5.2 Competence.....	124
4.3.2.6 External regulator and public disclosure.....	126
4.5 Conclusion.....	131

### **Part III Evaluation of Existing Legal Forms for Social Enterprise in the UK and Thailand**

#### **Chapter 5 The Community Interest Company (CIC): An Evaluation of a Legal Form for Social Enterprise..... 133**

5.1 Introduction.....	133
5.2 Initiation and legislation of the CIC.....	133
5.3 The CIC start-up process.....	137
5.4 Rules facilitating the operation of CIC .....	140
5.4.1 Model constitutions.....	140
5.4.2 Legal personality and limited liability.....	141
5.4.3 Financing CICs.....	142
5.4.3.1 The CLG: Poor at raising finance .....	143
5.4.3.2 The CLS: Good enough at raising capital .....	144
5.5 Regulatory/governance rules of the CIC .....	146
5.5.1 Reducing agency costs .....	146
5.5.2 Assuring accountability to stakeholders .....	147
5.5.2.1 Asset lock and dividend cap .....	147
5.5.2.2 Community Interest Test.....	152
5.5.2.3 Stakeholder participation.....	155
5.5.2.4 Stakeholder board.....	157
5.5.2.5 Directors' duties and competence.....	158
5.5.2.5.1 Section 172.....	159
5.5.2.5.2 Duty of care and skill .....	162
5.5.2.6 CIC Regulator and public disclosure .....	165
5.6 Conclusion.....	171

#### **Chapter 6 Main Legal Forms for Social Enterprises in Thailand..... 173**

6.1 Introduction.....	173
6.2 For-profit legal forms under the Civil and Commercial Code.....	174
6.2.1 Partnership.....	175
6.2.1.1 Start-up process.....	175
6.2.1.2 Legal personality and limited liability.....	176
6.2.1.3 Raising of finance.....	179
6.2.1.4 Controlling agency costs .....	180
6.2.1.5 Asset lock and non-distribution constraint.....	182
6.2.1.6 Social benefit requirement .....	182
6.2.1.7 Stakeholder participation.....	183
6.2.1.8 Public disclosure .....	183
6.2.2 Limited company.....	184
6.2.2.1 Start-up process.....	185
6.2.2.2 Legal personality and limited liability.....	187
6.2.2.3 Raising of finance.....	187
6.2.2.4 Controlling agency costs .....	189

6.2.2.5	Asset lock and non-distribution constraint.....	191
6.2.2.6	Social benefit requirement .....	193
6.2.2.7	Directors' duties and competence.....	194
6.2.2.8	Stakeholder participation.....	194
6.2.2.9	External regulator and social disclosure .....	195
6.3	Non-profit legal forms under the Civil and Commercial Code.....	197
6.3.1	Foundation .....	197
6.3.1.1	Start-up process.....	198
6.3.1.2	Legal personality and limited liability.....	200
6.3.1.3	Raising of finance.....	200
6.3.1.4	Controlling agency costs .....	201
6.3.1.5	Asset lock and non-distribution constraint.....	202
6.3.1.6	Social benefit requirement .....	203
6.3.1.7	Directors' duties and competence.....	204
6.3.1.8	Stakeholder participation.....	205
6.3.1.9	External regulator and public disclosure.....	205
6.3.1.10	Tax incentives .....	206
6.4	Conclusion.....	208

## **Part IV Social Enterprise Landscape and Proposal for Creation of a Specially Designed Legal Form for Social Enterprises in Thailand**

<b>Chapter 7</b>	<b>The Social Enterprise Landscape in Thailand.....</b>	<b>209</b>
7.1	Introduction.....	209
7.2	Development of social enterprise in Thailand .....	210
7.3	The support by social and international networks .....	214
7.3.1	Support by social networks and activities .....	214
7.3.2	Support provided by the British Council .....	218
7.4	Policy support for social enterprise in Thailand.....	221
7.4.1	An overview of the Social Enterprise Promotion Bill .....	222
7.4.2	Development of public-policy infrastructure for social enterprise in Thailand.....	225
7.5	Conclusion.....	229
<b>Chapter 8</b>	<b>Developing a Legal Form for Thai Social Enterprises.....</b>	<b>231</b>
8.1	Introduction.....	231
8.2	For a new legal form for social enterprises in Thailand.....	232
8.2.1	Limited company form as the basis for the new legal vehicle .....	234
8.2.2	Basic components for the Social Interest Company (SIC) .....	236
8.2.2.1	Legal personality and limited liability.....	236
8.2.2.2	Raising of finance.....	236
8.2.2.3	Asset lock and non-distribution constraint.....	237
8.2.2.4	Social benefit requirement .....	240
8.2.2.5	Stakeholder participation.....	241
8.2.2.6	Stakeholder board.....	242
8.2.2.7	Directors' duties and competence.....	243
8.2.2.8	External regulator and public disclosure.....	244

8.3 Alternative legal arrangement to the SIC .....	248
8.4 Branding and the development of social enterprise in Thailand .....	252
8.5 Conclusion.....	260
<b>Chapter 9 Conclusion .....</b>	<b>262</b>
9.1 Introduction.....	262
9.2 What has been achieved? .....	263
9.2.1 Social enterprise as understood in this thesis .....	263
9.2.2 Designing a legal form for social enterprise .....	265
9.2.3 Existing legal forms for social enterprise evaluated.....	267
9.2.4 Surveying the Thai social enterprise landscape and creating a legal form for social enterprises in Thailand .....	270
9.3 Where shall we go from here? .....	273
Appendix.....	275
Bibliography .....	302



**Table of cases**

<i>Allen v Gold Reefs of West Africa</i> [1900] 1 Ch 656	51
<i>Williams v Natural Life Health Foods Ltd</i> [1998] UKHL 17, [1998] 1 WLR 830, [1998] 2 All ER 577, [1998] 1 BCLC 689	61

## Tables of legislation

<i>Thailand</i>		s 1100	170
Civil and Commercial Code 1992		s 1104	171
s 110	183, 185, 188, 189	s 1105	171
s 111	184	s 1107	171
s 114	184	s 1108	171
s 115	189	s 1110	171, 175
s 122	185	s 1111/1	171
s 125	189	s 1117	170
s 128	186	s 1129	174
s 133	188	s 1134	174
s 134	188, 228	s 1135	174
s 1012	159, 170	s 1136	174
s 1015	172	s 1142	173
s 1016	161	s 1144	175, 179
s 1020	237	s 1145	175, 179
s 1025	162	s 1146	179
s 1033	165	s 1152	175
s 1034	165	s 1153	175
s 1035	166	s 1167	175, 176
s 1036	166	s 1168	176, 179, 234
s 1037	166	1168(3)	177
s 1040	164	s 1169	176
s 1041	165	s 1194	175, 179
s 1046	166	s 1196	236
s 1051	162	s 1197	236
s 1055	164	s 1199	237
s 1062	167	s 1200	177
s 1064	161, 169	s 1201	177
s 1068	162, 163	s 1202	177, 240
s 1069	164, 172	s 1203	177
s 1070	162	s 1215	181
s 1071	162, 163	s 1206	237
s 1072	162, 163	s 1213	237
s 1077	162	s 1219	181
s 1078	161, 169	s 1237	
s 1080	163, 164	1237(4)	172
s 1083	163, 165	s 1263	178
s 1084	163	s 1269	178
s 1087	163, 166	Cooperative Act 1999	
s 1088	163, 167	s 60	229
s 1091	165	Establishment of Administrative Courts and Administrative Court Procedures Act 1999	
s 1092	164	s 9	246
s 1093	165	Public Limited Company Act 1992	
s 1095	163	s 65	173
s 1096	170	Revenue Code 1938	
s 1097	159, 170		
s 1098	170, 239		

s 47(7)(b)	191	Partnership Act 1890	
Royal Decree under the Revenue Code Regarding Value Added Tax Exemption (No. 239) 1991		s 5	59
s 3(4)(b)	191		
Social Enterprise Promotion Regulations 2011			
reg 3	199		
<i>United Kingdom</i>			
Community Interest Company Regulations 2005			
reg 2	138		
reg 3	124, 137		
reg 4	124, 137		
reg 5	124, 137		
reg 6	137, 138		
reg 8	133		
reg 9	133		
reg 18 (revoked)			
18(1)	135		
reg 19	135		
reg 20			
20(2)	135		
Community Interest Company (Amendment) Regulations 2009			
reg 4	139		
Companies Act 2006			
s 7			
7(2)	97		
s 18	47		
s 21	51		
s 31	97		
s 32	123		
s 172	143, 144, 145, 146		
172(1)	144		
172(1)(a)	144		
172(1)(b)	144		
172(3)	70		
s 174	143, 148, 149		
s 175	143		
Companies (Audit, Investigations and Community Enterprise) Act 2004			
s 35	124		
35(6)	138		
Insolvency Act 1986			
s 213	70		
s 214	70		

## **Statement of Copyright**

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# **Chapter 1**

## **A Conceptual Framework for the Study of Legal Forms for Social Enterprises in the UK and Thailand**

### **1.1 Introduction**

I propose in this thesis to study the legal forms for social enterprises in the UK and Thailand. It will be shown what these legal vehicles for social enterprises are and how they are important to both the *operation* of social enterprises and the *fostering* of the social enterprise sector. The reason for focusing on these two countries is that the development of Thai social enterprise in recent years has been influenced particularly by the UK, although, unlike the latter, Thailand still does not have a legal vehicle specially designed to effectively serve the dual purpose indicated above. Hence, it is argued, it is essential that Thailand create such a legal form. For this purpose, it is also argued, the country could learn from the UK experience in developing its social enterprise legal regime.

The thesis thus centres on two main themes. The first theme involves the legal forms for social enterprise – what these are and how they are important to this type of business. The second theme is related to the need, in view of the importance of the legal forms for social enterprise, for Thailand to develop its legal infrastructure that is conducive to further growth of the social enterprise sector; and how, for this purpose, the country could learn from the UK experience.

The following objectives are set forth for the purpose of investigating the two main themes:

- 1) to establish an understanding of social enterprise in the UK and Thailand (with some references to social enterprises in other European countries and the USA);
- 2) to identify and analyse issues relating to the legal forms for social enterprise and specify certain deficiencies of social enterprise in Thailand which require the need for a legal form specially designed for social enterprises;

3) to construct a blueprint of legal forms for social enterprise (with the specified deficiencies experienced by Thai social enterprises in mind);

4) to assess, on the basis of the legal blueprint, the existing legal forms adopted by social enterprises in the UK and Thailand (in the latter case, the identification of the deficiencies of the existing legal forms used by Thai social enterprises would answer the question why the CIC, not the charity, is so desirable for Thai social enterprises; and

5) to propose a legal form specifically designed for Thai social enterprises.

Objective 4 actually requires further explanation. Therefore, before I present the organisational structure of my thesis, allow me to explain why it does not cover charities, and why I chose to study the CIC rather than, say, the new charity legal entity, the charitable incorporated organisation (CIO). In Thailand, as in the UK, social enterprises and charities have both made valuable contributions to social and economic development. Social enterprises and charities have similarities. However, they are also significantly different and have separate landscapes. Social enterprises are more enterprising than charities: the scope of charities is narrower, and social enterprises should not be restricted in the same way. Of course, the results of activities are more important than the types of activities, and there are useful things that social enterprises can learn from charities. Therefore, I shall cross-reference in certain parts but not in full detail.

The thesis comprises four parts. The **first part** provides a “conceptual perspective” for the thesis. This includes the framework for analysis (elaborated in Chapter 1) and a survey, in chapter 2, of the development of social enterprise and the social enterprise landscapes in the UK and Thailand to establish a theoretical understanding of this type of business. This part accomplishes the first objective.

**Part 2** develops a “blueprint of legal forms for social enterprises” on the basis of the theoretical understanding established in Chapter 2. Both Chapters 3 and 4 are devoted to this task and, in accomplishing it, fulfill the second and third objectives.

**Part 3** proposes an “evaluation of existing legal forms for social enterprise” on the basis of the legal blueprint designed in Chapters 3 and 4. These legal forms include the UK community interest company (CIC) and a number of Thailand’s for-profit and non-profit legal structures, which also serve as the main legal forms for social enterprises in Thailand. The evaluation of the CIC is attempted in Chapter 5, while the Thai legal forms are assessed in Chapter 6. The purpose of this evaluation is to determine the extent to which the existing legal forms for social enterprises match the ideal-type. This part fulfills the fourth objective.

The **last part** examines, in Chapter 7, the social enterprise landscape in Thailand, and, on the basis of this investigation and the evaluation of the country’s main legal forms for social enterprises attempted in Chapter 6, proposes, in Chapter 8, the creation of a legal form specifically tailored to suit Thai social enterprises. The proposed legal form is modeled upon the legal blueprint for social enterprise. This part accomplishes the last objective, and, together with Chapter 9, fulfills my purpose in undertaking this study of social enterprises in the UK and Thailand.

The proposed legal form for Thai social enterprises is designed not only on the basis of the ideal-type legal blueprint but also in reference to the *practical experience* of the UK in initiating the CIC. Before fully covering the objectives set out for this thesis in the following chapters, I would like to engage in a preliminary discussion of the two main themes in the following two sections.

## **1.2 Legal forms for social enterprises**

The problem of the legal forms for social enterprises is related to the latter’s vast and varied nature. Because it is not the legal structures, but rather their activities, that identify organisations as social enterprises, this makes it virtually impossible to rely on any single legal vehicle for the regulation of all types and forms of this type of business. Social enterprises in the UK and Thailand (and presumably other countries) assume numerous legal vehicles. In the UK the legal structures for social enterprise are, among others, the limited company (other than the CIC), the charity (especially the charitable incorporated organisation (CIO), the co-operative, the CIC, and the sole trader or business partnership. In Thailand, social enterprises also



operate in a variety of legal forms, including the partnership, the limited company, the association, the foundation and the co-operative. However, unlike its UK counterpart, the Thai social enterprise sector still does not enjoy the benefits and advantages of a specialised legal vehicle devoted to the social enterprise, and purportedly designed specifically with its needs in mind, such as the CIC. A fundamental question nevertheless arises from this comparison: *does Thailand really need a legal form for social enterprise like the CIC?* To answer this question, we need to address the broader theme of the importance of the legal forms for social enterprises. There are, of course, other legal issues relating to social enterprise, but in my view the legal forms for this type of business is the central one. As will be shown in this thesis, legal forms involve important features facilitating the operation of social enterprises, such as personal liability, ownership, funding, governance and profit distribution of the social enterprise, as well as those assuring their accountability to stakeholders.

The importance of the legal and public policy infrastructure is evident in historical experiences, especially in Western Europe, where the social enterprise sector is more developed than those in most other parts of the world. It is indeed in Western Europe that the development of social enterprise is clearly attributable to its enabling “legal environment”. I take the initiation of the CIC in 2005 as an indication of the importance of legal forms for social enterprise (though some other European countries had actually developed specific legal vehicles for social enterprises well before the UK). As we shall see in Chapters 2 and 5, the UK government wanted to support the operation of social enterprises by creating such an appropriate legal form, which was at the same time expected to help raise their profile. In my view, this means that the social enterprise sector needs such a legal form – one which would enable organisations to run most effectively *as social enterprises* and make them *formally recognisable* as such. It is such a clear *profile* of social enterprises that potentially contributes to the growth of the social enterprise sector. This latter point, which will be discussed in Chapter 8, helps us find an answer to the question whether Thailand really needs a legal form specifically designed for social enterprises. The answer is definitely in the positive.

Social enterprises are usually characterised by their hybrid nature – that is, they are understood as lying between traditional for-profit and non-profit entities. Though this understanding is fundamentally correct, we shall see in the next chapter that they have other aspects and it is more appropriate to characterise them as stakeholder business ventures. *The legal forms for such ventures should thus meet their need for rules both to facilitate their business operation and to meet their stakeholder requirements.* In other words, a legal vehicle specifically designed to provide *facilitative rules* for the business purpose and *mandatory rules* for assuring the stakeholding accountability of social enterprises is required.

In the UK it is the CIC that meets the dual purpose of providing the facilitative and mandatory rules for the running of social enterprises as stakeholding entities as well as a social enterprise “brand”. Thailand, on the other hand, lacks an equivalent of the CIC, and it is in view of this shortcoming that I propose a legal vehicle for Thai social enterprises modeled on the ideal-type legal blueprint and developed with the benefits from the UK experience in creating the CIC. Now let me present a brief preliminary discussion of this issue.

### **1.3 For a legal form specially designed for social enterprises in Thailand**

Thai social enterprises still rely on the existing legal structures, both those under the Civil and Commercial Code and other laws. Their problems and needs arising from this reliance are addressed in chapter 2. Although, as will be shown in Chapters 7-8, much progress has actually been made in the development of the public policy support and regulatory regime of social enterprises in Thailand, this still remains, in my view, inadequate, especially for the purpose of promoting further development of the social enterprise sector. To fulfill this purpose, a legal vehicle specially designed for social enterprises will be proposed.

In the UK and Thailand alike, social enterprises still need to rely on several legal forms mainly because, given the differences in their types and shapes, no “one-size-fits-all” legal form for this type of business is available, or even feasible. The crucial difference between the UK and Thailand is, of course, the existence of the CIC in

the UK. However, though the CIC is a legal form tailored to meet the facilitative and mandatory requirements of social enterprises, it has been initiated to provide a practical *addition* to the existing legal structures, which are still required to cater for the vast diversity of these organisations.

But this continued reliance on a variety of legal forms gives rise to a question: what difference can the introduction of *one* particular legal form make to the social enterprise landscape in either the UK or Thailand, if they still need a variety of legal forms to cater for the vast diversity of their social enterprises?

Since Thailand has not yet developed a specific legal form for social enterprises, we certainly cannot empirically show what impact such a legal form would make on the Thai social enterprise sector. All we can say at this stage is that the legal form, such as the one I am proposing in this thesis, will definitely introduce *qualitative* differences to the legal infrastructure of Thai social enterprises. We shall have, in other words, a legal form that provides proper rules governing the operation of social enterprises as *stakeholder entities*. Moreover, the British experience in deploying the CIC gives us additional clues for the answer to this question; that is, despite the continued reliance on a variety of legal vehicles, the growing popularity of this specific legal form for social enterprises means that the British social enterprise sector could be increasingly identified with the “CIC brand”.

Another question still needs to be raised: how could Thailand fulfill this requirement for a legal form specially designed for social enterprise? In view of the UK influence on the development of Thai social enterprise, one possible approach is to adopt the CIC as a model for the development of its Thai version. However, I consider this kind of “legal transplant” not particularly appropriate. Let me explain in greater detail why I decided not to rely upon this approach. As I have pointed out, my main purpose is to demonstrate that Thailand needs a legal vehicle like the CIC, which is specifically designed for social enterprise. A question might thus arise why I did not try to achieve my purpose by directly transplanting the CIC law into Thailand. There are certain reasons why I did not adopt this approach.

First, the CIC was particularly designed to meet the needs of social enterprises in the UK. That is, the initiation of the CIC had its own rationale and purpose, which might not be relevant to the Thai social enterprise sector. It can of course be said that the needs of social enterprises are in general more or less the same. However, we must recognise social and cultural differences, which are normally reflected in the legal systems of different countries. To put it more graphically, I am of the opinion that putting a square peg in a round hole will not work. Though the CIC usefully serves its purpose in the UK, it could not be expected to be similarly useful in other national or cultural contexts. Therefore, transplanting the CIC law into Thailand is not, in my view, an appropriate approach.

Second, although I recognise the usefulness of legal transplantation, it is also a very complicated matter requiring an in-depth analysis of certain related issues. Adopting a legal transplant approach would have bloated the scope and framework of my thesis. For example, I might have to look into Thai legal history regarding the introduction of foreign law or legal ideas into Thailand. A case in point is the Civil and Commercial Code, whose development could be traced back to the colonial era.

In view of these considerations, I shall opt for another approach – i.e. to construct a blueprint for designing a specific legal form for Thai social enterprises. To construct such a blueprint, we need first to understand the nature of this type of business. As I have already indicated, Chapter 2 is devoted to establishing this understanding. Admittedly, my understanding is significantly based upon social enterprise as it has been conceived and developed in Europe and North America. My reliance on the Atlantic context (particularly in the UK and the US) should nevertheless be acceptable, because it is mainly in these areas where both the concept and practical forms of social enterprise have been most clearly developed.

With such understanding as established in Chapter 2, I am able to construct the legal blueprint for social enterprises in Chapters 3-4. Chapter 3 explores the role of legal forms for organisations and social entrepreneurs' needs from the legal forms they opt for. The focus is on how the legal blueprint meets these needs, i.e. especially by providing *facilitative* rules for the running of social enterprises. Chapter 4 expands

the regulatory function of the legal blueprint to cover the stakeholding requirements of social enterprises. The rules proposed and developed for the blueprint are mainly *mandatory* in character. The purpose is to assure accountability of social enterprises to their stakeholders.

The usefulness of the legal blueprint lies in its capacity to serve as a model against which to assess actual legal structures adopted by social enterprises – to what extent these legal structures meet the normative requirements in the form of both facilitative and mandatory rules incorporated in the model – and on which to construct a specific legal form for Thai social enterprises. I attempt such an evaluative exercise in Chapters 5 and 6: the CIC and the main legal forms used by social enterprises in Thailand are evaluated on the basis of the legal blueprint. The purpose is not merely to assess how much all these legal forms satisfy the requirements of the blueprint. In view of the UK influence on the development of Thai social enterprise, how the CIC is measured against the model legal form, offers significant *practical guidelines* for designing the required legal vehicle for social enterprises in Thailand.

As is examined in greater detail in a sub-section in Chapter 7, the UK has, during the past several years, provided both expertise and guidance for the development of Thai social enterprise. In the UK social enterprise has thrived since at least the late 1990s. Social enterprises are not new in Thailand; they have been in existence for sometime in various forms. However, it is only recently that the concept “social enterprise” was introduced to this country. For this reason understanding of its nature and implications is not particularly widespread. Most importantly, the sector is much less developed than its British counterpart. The UK’s practical experience in developing its legal regime for social enterprise, especially with the initiation of the CIC, is of practical value to Thailand, particularly in *confirming* the benefits and advantages of having a legal structure specially designed for social enterprises.

## **1.4 Research methodology**

This study of social enterprises in the UK and Thailand is comparative in orientation. The need for a comparative study is almost self-evident. For a country

like Thailand, where the social enterprise sector is relatively underdeveloped, learning from other countries, especially those whose social enterprise sectors are more developed, seems advisable – if not imperative. But experiences just cannot be directly transferred, and learning only occurs in specific national contexts. Therefore, learning from the UK experience is not a matter of constructing a Thai legal infrastructure by taking some bits from the UK's legal forms or provisions as its components.

Clearly, this comparative study is not exactly within the domain of “comparative law” whose main purpose is to study or compare the legal systems of different countries to establish their similarities and differences. It is “comparative” mainly in the sense that in the present era characterised by growing internationalism, economic globalisation, and democratisation, cross-cultural experiences are often relevant, and learning from one another is sometimes even imperative. As should have become clear, my intention in engaging in this “comparative” study of social enterprises in the UK and Thailand is to establish how much the latter can learn from the UK to further develop its social enterprise sector.

The study relies almost entirely on documentary research. I engaged in only limited “fieldwork” by interviewing a number of social enterprise operators in Thailand with a view mainly to confirming my understanding about the problems and difficulties they are encountering in operating within the existing traditional legal forms. There are clearly not enough hard quantitative data that I can manipulate statistically, and, despite my best efforts, those from the interviews have many sidetracks with some replies being irrelevant. However, given that mine is a legal study requiring an in-depth exploration of the development and nature of social enterprise and other related issues together with a normative analysis, especially of what components an optimal legal form for social enterprise should be composed of, I am confident that I can downplay the fieldwork.

The documentary research examines the social enterprise landscapes in the UK and Thailand and their respective social enterprise legal regimes. The survey of the social enterprise landscapes covers the origins and development of social enterprise as a *concept* and as a *business activity*. The main bulk of the study is nevertheless

on the development of the legal blueprint and its use as a model for the assessment of the existing legal forms for social enterprises in the UK (the CIC) and Thailand as well as the construction of a specific legal structure for Thai social enterprises.

The research follows the line of enquiry embodied in the objectives set out in section 1.1. My primary goal in undertaking this doctoral research is to reaffirm that an enabling public-policy framework well equipped with *proper legal forms* is required to promote the growth of the social enterprise sector. In this respect, the crucial issue for Thailand is whether its existing legal regime is adequate for this purpose; if not, we should determine whether, or to what extent, it is profitable to learn from the UK experience in developing its own legal regime for social enterprise through the initiation of the CIC.

## **1.5 Research questions**

The central issue, which is formulated as the main research question for my thesis, is: *does Thailand need a legal form for social enterprise?* I shall argue that Thailand does need a legal form specially designed for social enterprises. The purpose of such a legal form has been only briefly discussed in this chapter. I shall further elaborate it as an answer to my main research question in relation to other relevant issues, which are set out below.

1) What is the nature and role of social enterprise, and how shall we account for its development? This issue will be discussed with special reference to social enterprise in the UK. The discussion will be found in Chapter 2, where we analyse the nature of social enterprise in the Atlantic context and trace its specific development in the UK.

2) What principles should be adopted to design an optimal legal vehicle for social enterprise? The answer is provided in Chapters 3-4, where a legal blueprint for social enterprise will be developed on the basis of our understanding of the nature and role of social enterprise as settled in Chapter 2.

3) How are existing legal forms for social enterprises performing, and to what extent are they “successful” in meeting the requirements set out in the legal blueprint? Given our focus on social enterprise in the UK, the CIC will be measured against the legal blueprint in Chapter 5. How the CIC matches the ideal-type legal form will be taken as being of practical value for Thai social enterprise.

4) How has Thai social enterprise developed, and what is the current state of the Thai social enterprise sector? I shall explore the social enterprise landscape in Thailand in Chapter 7 as part of an attempt to reaffirm that Thailand *needs* a legal form for social enterprise.

5) What are the legal forms currently used by Thai social enterprises, and what are their advantages and shortcomings as measured against our legal blueprint? I shall evaluate the main legal forms currently relied upon by Thai social enterprises in Chapter 6. The evaluation represents a further attempt to reaffirm the need for a legal structure specially designed for Thai social enterprises.

6) What would a legal form specially designed for Thai social enterprises look like? That is, given the specific conditions of the Thai social enterprise context, what would be the configuration of a possible legal vehicle for social enterprises in Thailand? A legal vehicle for Thai social enterprises will be proposed in Chapter 8, together with an alternative arrangement to more or less the same effect based on an existing legal form. This completes my attempt to answer the main research question.



## Chapter 2

# Understanding Social Enterprise

### 2.1 Introduction

The term “social enterprise” may still be unfamiliar to many people, though the “triple bottom line” concept of social enterprise having financial, social and environmental goals is not new.<sup>1</sup> Unfortunately, the term ‘means different things to different people across different contexts and at different points in time’;<sup>2</sup> it remains ‘a contested concept constructed by different actors around competing discourses,’<sup>3</sup> without any ‘consistently applied definition of social enterprise’.<sup>4</sup> Recent attempts to define social enterprise have encountered both linguistic and practical problems, and ‘any fixed definition tends to privilege one group of social enterprises over others’.<sup>5</sup> Part of the difficulty in conceptualising social enterprise involves its varied nature. Social enterprises come in many forms and sizes, ranging from small community-owned village shops to large charities delivering public services, and from individual social entrepreneurs to national businesses. Several organisations have had the label attached to them or have tried to claim the label for themselves.

Though causing conceptual confusion, this situation is not hopeless. It is possible to make sense of the movement by identifying some common threads that most social enterprises share, no matter what legal or organisational form they take. That is, ‘Whilst we may not have a “universal” definition of a social enterprise, we do have a number that are frequently cited and which capture the ethos of the relevant sector. They are broadly similar.’<sup>6</sup> Moreover, a concept often comes with practice;

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<sup>1</sup> A social audit framework for worker co-operatives developed at Beechwood College in Leeds, West Yorkshire, in the 1970s already mentioned “the emphasis on social, environmental and financial benefit”. Rory Ridley-Duff and Cliff Southcombe, ‘The Social Enterprise Mark: A Critical Review of Its Conceptual Dimensions’ (2012) 8(3) *Social Enterprise Journal* 178, 182.

<sup>2</sup> Simon Teasdale, ‘What’s in a Name? The Construction of Social Enterprise’ (2010) *Third Sector Research Centre Working Paper* 46, 4  
<[www.birmingham.ac.uk/generic/tsrc/documents/tsrc/working-papers/working-paper-46.pdf](http://www.birmingham.ac.uk/generic/tsrc/documents/tsrc/working-papers/working-paper-46.pdf)>  
accessed 8 October 2011

<sup>3</sup> *ibid* 3.

<sup>4</sup> *ibid*.

<sup>5</sup> Ridley-Duff and Southcombe (n 1) 179.

<sup>6</sup> John L Thompson, ‘Social Enterprise and Social Entrepreneurship: Where Have We Reached? A summary of issues and discussion points’ (2008) 4(2) *Social Enterprise Journal* 149, 150.

therefore, one way of understanding social enterprise is to see how it has emerged and evolved in a particular national or cultural context. I shall try to come to grips with social enterprise in *both* respects. This chapter deals with how social enterprise is conceived and how it has developed in two national contexts, namely the United Kingdom and Thailand. As we shall see, my understanding of social enterprise is mainly based upon how it has developed in the Atlantic world. Social enterprise in the UK, which is part of this world, essentially embodies social enterprise as it has thus developed. However, Thai social enterprise, though belonging to a different culture, shares many of the central features of social enterprise as will be highlighted in this chapter.

## **2.2 Concept and orientation of social enterprise**

In view of the confusion surrounding the concept of social enterprise, I propose to begin this section with an attempt to clarify the concept. Then, I shall consider the emergence of social enterprise as a type of business.

### **2.2.1 Dealing with conceptual confusion**

Social enterprise as a concept has been fraught with confusion and ambiguities. This problem has arisen partly from its association with terms whose meanings are similar to it, or which are related to it in some way or another. Even though I cannot hope to dispel all or even part of the confusion or ambiguities, this sub-section attempts some clarification.

#### **2.2.1.1 The use of the terms “Social Enterprise” and “Social Entrepreneurship”**

I deem it imperative to make clear the way I use the terms “social enterprise” and “social entrepreneurship”; ‘whilst there are links between them they are not bound together in a seamless manner’.<sup>7</sup> “Social enterprise” will be used in this study simply as a type of business with social mission, whose characteristics and orientation will later become clear. A social enterprise may or may not be innovative and entrepreneurial – characteristics normally associated with the term

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<sup>7</sup> *ibid.*

“entrepreneurship” – but those who engage in this business will be referred to as “social entrepreneurs”.

“Social entrepreneurship” is more problematic. Although the term cannot be used interchangeably with social enterprise, I find it not very helpful to confine it to the fundamental meaning of “entrepreneurship” as ‘a way of thinking and behaving that has opportunity at its heart. Creativity and innovation are typically in evidence’.<sup>8</sup> A problem is that not all social enterprises are “entrepreneurial” in this sense; so if we make a distinction between those which are entrepreneurial (and therefore entitled to the term “entrepreneurship”) and those which are not (and, hence, qualified only as “social enterprises” in general), the attributes they share (and which are to me more important) will be lost.

For this reason, when I use the term “entrepreneurship”, I generally mean a business-oriented venture. This sense of the term is embodied in the word “enterprise”. In this sense, a venture such as a voluntary organisation, even when it is “enterprising” or “entrepreneurial” (that is, innovative and creative), does not represent an “enterprise” – that is, it is not a business venture.

#### 2.2.1.2 Third Sector vs Social Economy vs Non-Profit Sector

Another source of confusion surrounding social enterprise is its association with the “third sector”, the “social economy” and the “non-profit sector”. We generally know that the sector variously identified by these terms occupies the intermediate space between the private and public sectors (the market and the state). But how is social enterprise, which also belongs to neither the market nor the state, related to them?

Historically, the social enterprise concept in Europe made its first appearance in Italy in the early 1990s closely linked with the co-operative movement.<sup>9</sup> The report

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<sup>8</sup> *ibid* 153. See also J Gregory Dees, ‘The Meaning of Social Entrepreneurship’ (*Duke Innovation & Entrepreneurship*, 30 May 2001) <<https://entrepreneurship.duke.edu/news-item/the-meaning-of-social-entrepreneurship/>> accessed 11 February 2012; Samer Abu-Saifan, ‘Social Entrepreneurship: Definition and Boundaries’ (2012) *Technology Innovation Management Review* 22.

<sup>9</sup> In 1991, the Italian parliament introduced a specially-designed legal form called “social co-operatives” in support of social public services provided by the state aiming to integrate disadvantaged people. Carlo Borzaga and Monica Loss, ‘Multiple Goals and Multi-Stakeholder

on a seminar on “Reviewing OECD Experience in the Social Enterprise Sector” in 2006 has indicated that ‘social enterprises have developed from within the “social economy” sector, which lies between the market and the State’.<sup>10</sup> Likewise, Pearce has introduced the idea of a “three-sector economy” consisting of the first system or the private sector, the second system or the public sector, and the third system or the third sector. He defines the social economy as part of the third system, functioning as the latter’s “trading side”. In his view, the social economy sector comprises all those community and voluntary organisations, which are involved in trading and social activities.<sup>11</sup> Finally, Ridley-Duff and Bull introduce nuanced differences, stressing that the social economy and the third sector are not the same:

[T]he social economy and third sector are not the same thing. At the EU level, third sector organisations that do not produce any goods or services for household or business use are excluded from the definition of the social economy. Moreover, definitions of social economy are more explicit about the ‘social’ aspects of organisation. While third sector organisations may have a social purpose, social economy organisations value ‘social’ rather than ‘private’ ownership and control (e.g. democratic member control and/or decision-making power not based on capital ownership).<sup>12</sup>

The confusion that is evident in the above examples may be said to have arisen from different ways of theorising the relationship between the third sector, the social economy, and social enterprise. Differences in this respect have resulted in different understandings or definitions of social enterprise itself. I see social enterprise as being closely associated with the “new entrepreneurship” that has developed in the third sector. However, given the confusion we have seen above, we need to be clear about what the third sector, the social economy and the non-profit sector are. I shall begin with Pearce’s idea of the three-sector economy.<sup>13</sup>

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Management in Italian Social Enterprises’, in Marthe Nyssens (ed), *Social Enterprise at the Crossroads of Market, Public and Civil Society* (Routledge 2006) 72.

<sup>10</sup> OECD, ‘Reviewing OECD Experience in the Social Enterprise Sector’, the DECIM Final Report (Seminar held by the OECD LEED Centre for Local Development and the Third DECIM Roundtable, Trento, November 2006) 3 (emphasis added)

<[www.oecd.org/cfe/leed/seminaronreviewingoecdexperienceinthesocialenterprisesectortrentoitaly15-18november2006.htm](http://www.oecd.org/cfe/leed/seminaronreviewingoecdexperienceinthesocialenterprisesectortrentoitaly15-18november2006.htm)> accessed 20 January 2012

<sup>11</sup> John Pearce, *Social Enterprise in Anytown* (Calouste Gulbenkian Foundation 2003) 28.

<sup>12</sup> Rory Ridley-Duff and Mike Bull, *Understanding Social Enterprise Theory & Practice* (Sage 2011) 34.

<sup>13</sup> Pearce (n 11) 24-28.

The first system is generally known as the private sector. Rooted in the principles of maximising return for investors or shareholders, the private sector is naturally profit-driven. Apart from the focus on individual gain and profit maximising above all else, this sector is also characterised by competition among enterprises.

The second system or the public sector is involved with redistribution and planning. In this system, which is based on the principle of public services being provided by democratically elected institutions, the state and local districts assume responsibility, which consists not only in providing services for the people but also in managing aspects of the economy to that end.

Finally, the third system relies on participation and collaboration of citizens to meet and satisfy their own needs. Unlike the private sector, in particular, it relies on the principles of self-help and mutuality and care for others, and of meeting social needs instead of maximising profit. The problem it is still facing is that its value and contributions are still not as widely recognised as those of the other two systems.

Theorists have proposed some theoretical approaches to our understanding of a set of organisations and initiatives that are neither in the public nor private for-profit sector – the so-called third sector. As Teasdale notes, ‘the different theories are often used to explain different phenomena...[They] are not incompatible. It is conceivable that each explains the emergence of different forms and aspects of social enterprise’.<sup>14</sup> Two approaches have been internationally recognised.<sup>15</sup>

Influenced by the North American perspective, the *first approach* is the “non-profit” one, according to which the third sector comprises “all non-profit organisations”.<sup>16</sup> These entities are taken as representing this sector because they tend to be perceived as complementing the main pillars of society – ‘the market and

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<sup>14</sup> Teasdale (n 2) 6.

<sup>15</sup> Jacques Defourny and Marthe Nyssens, ‘Defining Social Enterprise’, in Marthe Nyssen (ed), *Social Enterprise: At the Crossroads of Market, Public Policies and Civil Society* (Routledge 2006) 7-9.

<sup>16</sup> Jean-Louis Laville, ‘What is the Third Sector? From the Non-Profit Sector to the Social and Solidarity Economy Theoretical Debate and European Reality’ (2011) EMES European Research Network Working Paper 11/01, 4 <[www.emes.net/site/wp-content/uploads/EMES-WP-11-01\\_Jean-Louis-Laville.pdf](http://www.emes.net/site/wp-content/uploads/EMES-WP-11-01_Jean-Louis-Laville.pdf)> accessed 2 May 2012

the state [that] represent the normal way to circulate goods and services'.<sup>17</sup> The role of the third sector in society is therefore conceived as coming in to fill the gaps if the market and the state fail in their tasks. According to Defourny and Nyssens, the social enterprise in the United States is viewed as 'an innovative response to the funding problems of non-profit organizations, which are finding it increasingly difficult to solicit private donations and governments and foundation grants.'<sup>18</sup> As Ridley-Duff and Bull have stated, 'Typically, TSOs [third sector organisations] deliver goods and services that are not available through the state or market; offer an alternative to the private sector; and extend or replace services offered through the state'.<sup>19</sup>

In sum, dominating the North American thinking, the third sector-based analysis of non-profit organisations is founded on the neo-classical economic perspective, which conceives of their role in terms of the market's failures in the provision of individual services and the state's failures in the provision of collective services. The approach focuses on the separation and the hierarchy between the two mainstays of society – the public and private sectors – and the so-called third sector. In this conception, the non-profit sector represents 'a second-rank or third-rank option, when the solutions provided by the market and the state prove inadequate'.<sup>20</sup>

According to Laville, this conception of the third or non-profit sector coming in to fill the gaps left by the private or public sectors is invalidated by history, and particularly by "European reality", which confirms that "associationism", for example, came before public intervention.<sup>21</sup> Because of this weakness of the non-profit analysis, in Europe the *second approach* comes in, which defines the third sector as the "social economy". Unlike the non-profit approach, the social economy perspective covers a wide set of organisations such as co-operatives, mutual societies, and associations. The criterion for distinguishing these entities is not the

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<sup>17</sup> *ibid* 5, citing J-T Godbout, *Le don, la dette et l'identité. Homo donator vs homo economicus* (Paris: La Découverte 2000) 98.

<sup>18</sup> Defourny and Nyssens (n 15) 4.

<sup>19</sup> Ridley-Duff and Bull (n 12) 17.

<sup>20</sup> Laville (n 16) 4.

<sup>21</sup> *ibid* 5. See also Ridley-Duff and Bull (n 12) 22-28 for the evolution of third sector organisations including trusts and charities, and co-operatives and mutual societies.

non-distribution constraint but rather the *limits* on the distribution of profits to investors.

The border is thus not the one drawn between for-profit and non-profit organisations but rather between “profit-driven” and “social economy” organisations. For Laville, the latter are characterised by what he calls ‘a collective patrimony over the return on individual investment’.<sup>22</sup>

Generally speaking, therefore, in the North American view, the third sector mainly involves non-profit organisations, whose counterparts in the UK are the “voluntary sector” organisations. However, the so-called third sector in the UK, which is more influenced by the social economy tradition, covers a wider range of organisations. To understand this situation, we also need to go into some more detail about the idea of the non-profit sector.

Salamon and Anheier have proposed a set of definitions of the non-profit sector. They nevertheless find the structural and operational definition ‘relatively economical and significant, and [having] considerable combinatorial richness and organizing power’,<sup>23</sup> as it defines a broad range of organisations with just five basic, but considered most compelling, characteristics, which are still in use today. Using these key features, we can define the non-profit sector as comprising organisations that are formal, i.e. having a certain degree of institutionalisation; private, i.e. institutionally separate from government; non-profit distributing to their owners or directors; self-governing, i.e. having their own internal procedures for governance or decision-making process; and voluntary, i.e. involving some level of voluntary participation. To be considered part of the non-profit sector under this definition, an organisation must make an attempt to show that it satisfies all these criteria.<sup>24</sup>

This approach holds that because there are failures in the private and public sectors, people tend to turn their attention to an alternative – the so-called third sector or non-profit sector. The first crisis is the failure of the state-run social welfare system.

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<sup>22</sup> Laville (n 16) 6.

<sup>23</sup> Lester M Salamon and Helmut K Anheier, ‘In Search of the Nonprofit Sector I: The Question of Definitions’ (1992) The Johns Hopkins Comparative Nonprofit Sector Project Working Paper 2, 15.

<sup>24</sup> *ibid* 10-12.

In this view, the state is considered overloaded and over-bureaucratized. The second problem involves the crisis of development, which has caused severe poverty in developing countries, where, in order to survive poverty, people have degraded their surroundings. This situation has led to a global environmental crisis and thereby stimulated greater private initiatives. Indeed, in the developed and developing countries alike, people have grown increasingly frustrated with the government and become eager to take up the challenges themselves. Moreover, the decline of welfare state system has also resulted in the rise of the third or non-profit sector. People have been in a search for new ways to satisfy their social and economic needs. As a result of these problems, people have widely and enthusiastically been involved in non-governmental organisations.<sup>25</sup>

Nevertheless, some criticisms have been raised against such a view. One is that it is one-sided, i.e. focusing only on “interest-oriented individual choices”, and seeing individuals “only as consumers”.<sup>26</sup> ‘The role of organisations is thus only perceived through their function of production of services; other dimensions are not taken into account. Social integration and democratic participation are overlooked issues.’<sup>27</sup>

Another criticism involves the implicit hierarchisation. As has been indicated, the non-profit sector approach views the private and public sectors as the main pillars of society while the third sector is seen only as a complement. As we have noted already, Laville believes that such a view is not supported by historical evidence; what he calls “associationism” came before “public intervention”.<sup>28</sup> Moreover, according to Ridley-Duff and Bull, ‘There is a narrow, perhaps misleading, definition that the third sector is ‘non-profit’ in its outlook. This obscures both the

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<sup>25</sup> Lester M Salamon, ‘The Rise of the Nonprofit Sector’ (1994) 73(4) *Foreign Affairs* 109, 115-18. For more understanding of the social welfare system and its decline, see Bernard Harris, *The Origins of the British Welfare State: Society, State and Social Welfare in England and Wales, 1800-1945* (Palgrave Macmillan 2004); Gosta Esping-Anderson, *The Three Worlds of Welfare Capitalism* (Polity Press 1990); Asa Briggs, ‘The Welfare State in Historical Perspective’ (1961) 2(2) *European Journal of Sociology* 221; Howard Glennerster, ‘The Sustainability of Western Welfare States’, CASE Seminar at London School of Economics and Political Science (November 2007) <[http://eprints.lse.ac.uk/3989/1/The\\_sustainability\\_of\\_western\\_welfare\\_states\\_\(LSERO\).pdf](http://eprints.lse.ac.uk/3989/1/The_sustainability_of_western_welfare_states_(LSERO).pdf)> accessed 25 August 2016

<sup>26</sup> Laville (n 16) 5.

<sup>27</sup> *ibid.*

<sup>28</sup> *ibid.*



notion of ‘not for private profit’ and a century of history and knowledge about the effectiveness of co-operatives and mutual societies.’<sup>29</sup>

Still another criticism of the third- or non-profit approach is related to its emphasis on non-distribution of profits. Defining the third sector as a non-profit sector comprising non-profit organisations, the North American approach places an emphasis on the *non-distribution constraint*. Its focus is thus on foundations, with co-operatives and mutual societies being excluded on the ground that these organisations can distribute part of profits to their members.

However, this is not true in the European context, where some co-operatives, such as building co-operatives in Sweden, have never distributed any profit, and where distribution of profits in all cases are limited.<sup>30</sup> This is because, in Europe, co-operatives and mutual societies follow the same principles as those of associations (non-profit organisations), the latter being created not for the purpose of obtaining return on investment but rather for meeting general or mutual interests or contributing to public welfare.<sup>31</sup>

The non-profit approach thus ‘... does not capture the essence of co-operative and fair trade networks’.<sup>32</sup> On the contrary, the “social economy”, which is more dominant in Europe, covers the set of organisations such as co-operatives, mutual societies, and associations that tend to be left out by the non-profit analysis. Moreover, it is perhaps too simple to conclude that the third sector has emerged from debates about the limitations of the private and public sectors. As we have seen, what Laville has called “associationism” actually predated public intervention. This approach is thus unable to embrace the whole reality of the so-called non-profit or third sector.

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<sup>29</sup> Ridley-Duff and Bull (n 12) 12.

<sup>30</sup> Yohanan Stryjan, ‘Social Cooperatives in Sweden. Etudes in Entrepreneurship’ (2003) 50(1) Meiji Business Review 209; and Yohanan Stryjan and Filip Wijkström, ‘Co-operatives and Non-Profit Organisations in Swedish Social Welfare’ (1996) 67(1) Annals of Public and Co-operative Economics 5.

<sup>31</sup> Laville (n 16) 5-6.

<sup>32</sup> Ridley-Duff and Bull (n 12) 66.

We need therefore to find some other more profitable way of looking at the different sectors of the economy. Following Pearce, the point is that instead of focusing on the first and second systems, we attach greater importance to the third sector as ‘another way of doing things’.<sup>33</sup> ‘An argument can be made that public and private organisations have advanced economic efficiency. More recent analyses question whether they are *socially* efficient due to increasing rates of suicide, a widening gap between rich and poor, community breakdown and endemic health issues, even in the most “developed” nations...’<sup>34</sup>

In the UK, as we shall see in section 2.4, the third sector has gained greater attention when questions were raised whether the public and private sectors were socially efficient in solving social issues such as increasing rates of suicide, a widening gap between rich and poor, community breakdown, and endemic health problems.<sup>35</sup> The New Labour Government, in particular, saw the social enterprise concept as a “third way” of solving many social problems.<sup>36</sup>

### 2.2.1.3 Social enterprise and the third sector

For my practical purpose, with a focus on the third sector, I propose to see it simply as the sector that occupies the *intermediate* space between the private and public sector, that is, between the market and the state. While recognising the nuanced differences between the third or non-profit sector and the social economy, I believe that this focus is helpful to our understanding of the emergence of social enterprise, which is the subject of the next section. However, taking this position requires further clarification.

To begin with, I shall follow the European, with a focus on the UK social enterprise, not the North American, perspective, that is, focusing on the *limits* on the distribution of profits rather than the *ban* on profit appropriation. In this sense,

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<sup>33</sup> Pearce (n 11) 26.

<sup>34</sup> Ridley-Duff and Bull (n 12) 13.

<sup>35</sup> *ibid.*

<sup>36</sup> Anthony Giddens, *The Third Way: The Renewal of Social Democracy* (Polity Press 1998); Stephen Driver and Luke Martell, ‘Left, Right and the Third Way’ (2000) 28(2) *Policy & Politics* 147; Alibeth Somers, ‘The Emergence of Social Enterprise Policy in New Labour’s Second Term’ (DPhil thesis, Goldsmiths College University of London 2013).

organisations like co-operatives and mutual societies come under the umbrella of the third sector.

Moreover, I shall take differences between the third sector and the social economy earlier identified by Ridley-Duff and Bull as representing different traditions within the third sector, particularly differences between the more *traditional* third sector organisations, such as charities and voluntary associations, and those of the more *radical tradition of social economy* with its focus on economic democracy and social ownership.

Finally, given my focus on the UK context, I attach particular importance to the third sector generally understood in this context as comprising the range of entities that include community-based and voluntary organisations; charities; self-help, family and informal economies; and, of course, social enterprises.<sup>37</sup>

It must also be pointed out that in the UK different views exist on the third sector's relationship to social enterprise. On the one hand, social enterprises are differently perceived as "outsiders" to the third sector; as building "links" between traditional organisations and the trading cultures and markets; and as "potent organisational devices" to be employed in tackling social problems and needs in a business-like manner, that is, in ways which are efficient and financially viable, and in which traditional voluntary and third sector organisations are often deficient.<sup>38</sup> On the other hand, there exist views that social enterprise is a "particular organisational form", which is part of the third sector, but is at the same time different from other third sector organisations, such as voluntary and community organisations; that all third sector organisations are social enterprises; and that social enterprise is "a form of activity". This latter view is one which avoids linking it to a particular organisational form, seeing it as applicable to any third sector organisation, as long as the latter is at least partially dependent on earned revenue.<sup>39</sup>

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<sup>37</sup> Leandro Sepulveda, 'Outsider, Missing Link or Panacea? Some Reflections About the Place of Social Enterprise (With)in and in Relation to the Third Sector' (2009) Third Sector Research Centre Working Paper 15, 2 <[www.birmingham.ac.uk/generic/tsrc/documents/tsrc/working-papers/working-paper-15.pdf](http://www.birmingham.ac.uk/generic/tsrc/documents/tsrc/working-papers/working-paper-15.pdf)> accessed 3 May 2012

<sup>38</sup> *ibid* 3.

<sup>39</sup> *ibid*.

My particular position in this study is that I see social enterprise as a type of business that is part of the third sector, belonging to neither the private nor public sector. As such, this business does not belong to the for-profit type. Like a traditional business, it remains financially viable through revenue generated by commercial activities, but unlike a traditional for-profit organisation, it is not oriented towards private profit-sharing. For me social enterprise can be distinguished from other third sector organisations such as community and voluntary organisations. Even though these organisations also engage in trading like social enterprises, they are *unlike* social enterprises in that they remain substantially dependent upon grants and donations.

Many third sector organisations (voluntary associations, charities and co-operatives) have claimed to be “social enterprise”. But whether or not they are social enterprises depends on the extent to which they are market or community oriented. ‘The more market oriented they are, and the more they are oriented towards public and community benefit, the more they are accepted as part of the social enterprise mainstream.’<sup>40</sup> That is, only the third sector organisations that are more market and community oriented could have a claim on the term “social enterprise”.

### **2.2.2 From the third sector to new entrepreneurship**

As we have seen, social enterprise as a concept seems to have developed on both sides of the Atlantic. For my practical purpose, to understand the concept and orientation of social enterprise, at least two aspects of its development need to be considered.

First, we need to understand the conditions under which social enterprise emerged in the past two or three decades. Focusing on the “Atlantic” experience, I consider the development of “new entrepreneurship” from within the so-called third sector as most relevant to our understanding of the emergence of social enterprise. Second, we need to recognise the existence of different perspectives on the third sector as

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<sup>40</sup> Ridley-Duff and Bull (n 12) 34.

well as social enterprise – which are often seen as reflecting differences in orientation that exist on the different sides of the Atlantic.

I propose here to deal with both aspects of the development of social enterprise; that is, to trace how a “new entrepreneurship” developing in the third sector has spawned “social enterprise”, and to touch upon the different perspectives on this new sector – those that will be later seen as influencing the development of social enterprise in the UK in the late 1990s.

Occupying the intermediate space between the traditional private and public sectors, the third sector has assumed increasing economic roles, especially in allocating resources through the production of quasi-public goods and services – those in the areas of health, culture, education, social action, proximity services, sport, leisure, and the environment, among others. It has also been involved in providing a wide range of free or virtually free services to deprived people through voluntary contributions (in money or through voluntary work), as well as in regulating economic life, as in cases of associations or social co-operatives serving as partners of the public sector in bringing back to work low qualified unemployed people who risk being permanently excluded from the labour market.<sup>41</sup>

As the third sector has assumed a larger profile, it has experienced change in recent decades in its nature. For example, volunteering has profoundly changed. Voluntary workers have been increasingly involved in “entrepreneurial” activities. Paid work has also undergone important change. Many third sector organisations have created new types of employment by hiring salaried workers under unemployment reduction programmes or developing semi-voluntary formulas or part-time work. Moreover, employees have found themselves in a new status – as members of the governing bodies of their organisations with the resultant control and decision-making powers that such a status entails.<sup>42</sup>

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<sup>41</sup> Jacques Defourny, ‘From Third Sector to Social Enterprise: A European Research Trajectory’, in Jacques Defourny, Lars Hulgård and Victor Pestoff (eds), *Social Enterprise and the Third Sector: Changing European Landscapes in a Comparative Perspective* (Routledge 2014) 19-20.

<sup>42</sup> *ibid* 22.

Another significant “new” movement, which is particularly relevant to this thesis, is the creation of new legal forms especially designed to suit this new social entrepreneurship trend of reflecting the more entrepreneurial element as well as ensuring social objectives.<sup>43</sup> As Defourny notes, ‘The recent introduction of new legal frameworks in the national legislation of various European states tends to confirm that we are dealing with a *somewhat original kind of entrepreneurship*.’<sup>44</sup>

This new entrepreneurship was viewed, especially in the United States during the early 1990s, as an innovative response to the funding problem being experienced by non-profit organisations.<sup>45</sup> In other words, finding it increasingly difficult to raise funds from private donations and state or foundation grants, these organisations had to become more entrepreneurial in their orientation.

We must also note that other important changes in the wider socio-economic contexts in the OECD countries were also relevant. The seminar report referred to in sub-section 2.2.1.2 above succinctly summarises these changes:

The demographic and fiscal pressures for welfare state reforms during the 1980s resulted in a shift from the traditional advocacy role of the non-profit sector towards the development of activities aimed at responding to new social needs through the autonomous production of social and community-driven public goods and services. Governments meanwhile sought to decentralise the provision of services in both labour and social policy areas, paving the way for outsourcing public services.<sup>46</sup>

Other explanations for the increased tendency of third sector organisations to engage in commercial activities have also been proposed. To take but one example, the “institutional” theory focuses on the influence of “market disciplines”. That is, the language and practices of the market, which influenced the state sector through

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<sup>43</sup> Examples of these new legal forms for social enterprises are such as Italy’s social co-operatives, France’s Société Co-opératif d’Intérêt Collectif (Scic), the UK’s Community Interest Company (CIC), Belgium’s social finality companies, and Finland’s Social Enterprise Law. Frabrizio Cafaggi and Paola Iamiceli, ‘New Frontiers in the Legal Structure and Legislation of Social Enterprises in Europe: A Comparative Analysis’ (2008) European University Institute Working Papers Law 2008/16, 31

<[http://cadmus.eui.eu/bitstream/handle/1814/8927/LAW\\_2008\\_16.pdf?sequence=3&isAllowed=>](http://cadmus.eui.eu/bitstream/handle/1814/8927/LAW_2008_16.pdf?sequence=3&isAllowed=>) accessed 12 February 2015

<sup>44</sup> Ibid 23-24 (emphasis added).

<sup>45</sup> Dees, ‘The Meaning of Social Entrepreneurship’ (n 8).

<sup>46</sup> OECD (n 10) 3.

“new public management” (NPM),<sup>47</sup> have also permeated civil society and come to be accepted by third sector organisations as a preferred way of “doing things”.<sup>48</sup> The result is the increased reliance on revenue generated through trading.

One important result of these developments is that third sector organisations have increasingly assumed an *entrepreneurial* character. That is, they have come to possess an increasing number of features in common with traditional companies. They have nevertheless not been transformed into such entities. One central aspect of this new entrepreneurship is ‘the requirement (absolute or in part) for the production surplus to be ‘socialised’, that is to be reinvested in the development of the activity or to be used for the benefit of people other than those who control the organisation’.<sup>49</sup> Moreover, its organisational methods also help to preclude such a transformation.

Here we see the influence of the social economy orientation with its emphasis on the “social” aspects of the organisation. As we shall see, the *private/entrepreneurial* as against *social* tendencies would always be present in the development of social enterprise. Defourny succinctly describes this “social” aspect of organisation,

The two concepts [non-profit and social economy approaches] embody the view that a third sector organisation should be autonomous or even independent, with its own decision-making bodies. The social economy approach also stresses that there should be a democratic decision-making process. Such features are often found in social enterprises since they are generally founded on a participatory dynamic which involves their members (paid workers, volunteers, users and/or other partners representing for instance the local community) in management and controlling bodies and since members’ power is generally not proportional to any capital stake they may hold. So we clearly have here characteristics which may be classified as *social*.<sup>50</sup>

Of course, we can trace the development of social enterprise in other ways. Ridley-Duff and Bull have explored the definitions of social enterprise that appeared in (1) a Social Audit Toolkit for worker and community co-operatives; (2) the EMES European Research Network; (3) consultation by the UK government on the CIC;

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<sup>47</sup> On this issue, see Ridley-Duff and Bull (n 12) 38-53.

<sup>48</sup> Simon Teasdale, ‘A Comparative Study of Changes in Earned Income Among Third Sector Organisations in England, Wales, and the United States’ (2010) Third Sector Research Centre Briefing Paper 47, 6-8 <[www.birmingham.ac.uk/generic/tsrc/documents/tsrc/working-papers/briefing-paper-47.pdf](http://www.birmingham.ac.uk/generic/tsrc/documents/tsrc/working-papers/briefing-paper-47.pdf)> accessed 10 July 2011

<sup>49</sup> Jacques Defourny, ‘From Third Sector to Social Enterprise’ (n 41) 15.

<sup>50</sup> *ibid* 16 (emphasis added).

and (4) a report for the Inter-American Development Bank. Their purpose was to see if all these definitions display common threads. They have found that ‘In all cases, social enterprises are seen as socially driven organisations with social and/or environmental objectives combined with a strategy for economic sustainability’.<sup>51</sup>

What I nevertheless see in the effort to identify such definitions is that all of them have their origins. For instance, the definition that first appeared in the 1979 edition of Spreckley’s *Social Audit Toolkit* had adopted the language characteristic of the co-operative movement.<sup>52</sup> Moreover, a definition, once adopted (as in the case of social enterprise in the UK), would much influence the development of social enterprise in a particular country or society.

However, without denying the validity of other explanations for the development of social enterprise, for me seeing it as having developed from within the third sector is more helpful. For one thing, there exist within this sector the “social” traditions, either in its more “traditional” form or the more “radical” orientation of the social economy, which today represent a *central* aspect of social enterprise. Moreover, this conception of social enterprise as having developed from within the third sector has both historical and spatial dimensions; that is, covering a time frame (the past two or three decades) and at least both sides of the Atlantic.

The emergence of social enterprise as the development of a new entrepreneurship from within the third sector has had the important effect of *expanding* the latter’s field, thereby resulting in the blurring of sector boundaries. As Dees has pointed out, even though the movement is not a new phenomenon, its new name implies a new development, that is, the blurring of sector boundaries.

In addition to innovative not-for-profit ventures, social entrepreneurship can include social purpose business ventures, such as for-profit community development banks, and hybrid organizations mixing not-for-profit and for-

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<sup>51</sup> Ridley-Duff and Bull (n 12) 61.

<sup>52</sup> Social enterprise was defined as ‘[a]n enterprise that is owned by those who work in it and/or reside in a given locality, is governed by registered social as well as commercial aims and objectives and run cooperatively may be termed a social enterprise. Traditionally, “capital hires labour” with the overriding emphasis on making a “profit” over and above any benefit either to the business itself or the workforce. Contrasted to this is the social enterprise where “labour hires capital” with the emphasis on personal, environmental and social benefit’. *ibid* 62, citing Freer Spreckley, *Social Audit Toolkit* (4<sup>th</sup> edn, Local Livelihoods 2008).



profit elements, such as homeless shelters that start businesses to train and employ their residents. This new language helps broaden the playing field.<sup>53</sup>

Apart from broadening the playing field, this new term has also caused a conceptual confusion of what is or is not subsumed under it. It is largely in view of this situation that I have decided to go without a rigorous definition of social enterprise. A major benefit of adopting this approach is that it does not exclude organisations that do not neatly fit in with a rigorous definition: social enterprise is so diverse that such a definition would not do justice to its diversity. I thus opt for a *deeper* understanding of the concept in its various dimensions including its development in particular national contexts (the subject of sections 2.4 and 2.5).

I fully recognise the intellectual as well as practical drawbacks of having to dispense with a rigorous definition.<sup>54</sup> But such deeper understanding provides us with at least some idea of what we are dealing with – and, in so far as my research interest is concerned, how it has been *legally* regulated.

In fact, the inclusiveness of the social enterprise concept still serves some practical purposes. Given the evolving roles of social enterprises, it is impossible to stick to any particular model of this movement. In the UK, as we shall see, its meanings have evolved and expanded considerably during the past decade or so. In the wider OECD context, the fundamental “triple bottom line” goal seems to have been superseded by a multiple bottom line orientation. Many social businesses are already going ‘one step further to include governance as an objective to be met, adding democratic decision making processes to social, economic and environmental objectives pursued’.<sup>55</sup>

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<sup>53</sup> Dees, ‘The Meaning of Social Entrepreneurship’ (n 8).

<sup>54</sup> As Martin and Osberg have pointed out, ‘...we need a much sharper definition of social entrepreneurship, one that enables us to determine the extent to which an activity is and is not “in the tent”...If we can achieve a rigorous definition, then those who support social entrepreneurship can focus their resources on building and strengthening a concrete and identifiable field. Absent that discipline, proponents of social entrepreneurship run the risk of giving the skeptics an ever-expanding target to shoot at and the cynics even more reason to discount social innovation and those who drive it.’ Roger L Martin and Sally Osberg, ‘Social Entrepreneurship: The Case for Definition’ (Spring 2007) 5(2) Stanford Social Innovation Review 29, 30.

<sup>55</sup> Marguerite Mendell and Rocío Nogales, ‘Social Enterprises in OECD Member Countries: What are the Financial Streams?’, in Antonella Noya (ed), *The Changing Boundaries of Social Enterprises* (OECD 2009) 89, 91.

## 2.3 Characteristics and orientations of social enterprises

If, as I have argued, it is more useful to identify the characteristics and orientations of social enterprises than fix on a specific definition, what are these characteristics and orientations?

### 2.3.1 Social enterprise: Characteristic features and different orientations

Inherent in the discussion so far are two different orientations. According to Ridley-Duff and Southcombe, one involves the move towards businesses with a social purpose, called a *social purpose* perspective on social enterprise. This perspective emphasises the social objectives of the entrepreneurs and the social purposes of the enterprises they have created. The other is a *socialisation* perspective on social enterprise, which is ‘based on advocacy of mutualism in worker co-operatives, employee-ownership and other societies and associations in the social economy ...’<sup>56</sup> The social purpose perspective is rooted in writings on social entrepreneurship that have been influenced by US thinking on business with a social mission,<sup>57</sup> whereas the socialisation perspective is more dominant on the other side of the Atlantic.

Equally important, the discussion of the change in the third sector has also helped us identify some *central features* of social enterprise. It has become apparent from this discussion that social enterprise, either in the traditional third-sector organisational form or as a new entrepreneurship, is most notable for its “social orientation”. That is, ‘the ultimate goal of an entrepreneur is to create economic

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<sup>56</sup> Ridley-Duff and Southcombe (n 1) 181.

<sup>57</sup> Dees, ‘The Meaning of Social Entrepreneurship’ (n 8); Abu-Saifan, ‘Social Entrepreneurship: Definition and Boundaries’ (n 8); and Martin and Osberg, ‘Social Entrepreneurship: The Case for Definition’ (n 54). See also, Jacques Defourny and Marthe Nyssens, ‘Conceptions of Social Enterprise in Europe: A Comparative Perspective with the United States’ in Benjamin Gidron and Yeheskel Hasenfeld (eds), *Social Enterprises: An Organizational Perspective* (Palgrave Macmillan 2012); David Bornstein, *How to Change the World: Social Entrepreneurs and the Power of New Ideas* (OUP 2004); J Gregory Dees and Beth Battle Anderson, ‘Framing a Theory of Social Entrepreneurship: Building on Two Schools of Practice and Thoughts (2006) 1(3) Research on Social Entrepreneurship 39; Janelle A Kerlin, ‘Social Enterprise in the United States and Europe: Understanding and Learning from the Differences’ (2006) 17(3) *Voluntas* 247; and Alex Nicholls (ed), *Social Entrepreneurship: New Models of Sustainable Social Change* (OUP 2006).

wealth whereas, for a social entrepreneur, the priority is to fulfill their social mission'.<sup>58</sup>

Practically, the concept of social enterprise is often associated with the idea of social entrepreneurs assuming the role of *social change agents*. 'Social entrepreneurship signals the imperative to drive social change, and it is that potential pay-off, with its lasting, transformational benefit to society, that sets the field and its practitioners apart.'<sup>59</sup> This idea is echoed in all definitions and understandings of social enterprise. As Ashoka puts it,

Just as entrepreneurs change the face of business, social entrepreneurs act as the change agents for society, seizing opportunities others miss and improving systems, inventing new approaches and creating solutions to change society for the better. While a business entrepreneur might create entirely new industries, a social entrepreneur comes with new solutions to social problems and then implements them on a large scale.<sup>60</sup>

According to Dees, social entrepreneurs take up this challenge in various ways. These include adopting a mission to create and sustain social value (not just private value); recognising and relentlessly pursuing new opportunities with a view to serving that mission; engaging in a process of continuous innovation, adaptation, and learning; acting boldly without being limited by resources currently in hand; and exhibiting heightened accountability to the constituencies served and for the outcomes created.<sup>61</sup>

It is the primacy of this social aim that significantly marks social entrepreneurs off from their for-profit cousins. I would like to round off the discussion of this aspect of social enterprise by quoting Martin and Osberg, who clearly explain the general orientation of social entrepreneurs as follows:

The social entrepreneur...neither anticipates nor creates substantial financial profit for his or her investors...or for himself or herself. Instead, the social entrepreneur aims for value in the form of large-scale transformational benefit that accrues either to a significant segment of society or to society at large...[T]he social entrepreneur...targets on underserved, neglected, or highly

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<sup>58</sup> Abu-Saifan, 'Social Entrepreneurship: Definition and Boundaries' (n 8) 24.

<sup>59</sup> Martin and Osberg (n 54) 30.

<sup>60</sup> Ashoka, 'What is a Social Entrepreneur?' <[www.ashoka.org/social\\_entrepreneur](http://www.ashoka.org/social_entrepreneur)> accessed 30 August 2011

<sup>61</sup> Dees, 'The Meaning of Social Entrepreneurship' (n 8).

disadvantaged population that lacks the financial means or political clout to achieve the transformative benefit on its own.<sup>62</sup>

Another important aspect of social enterprise that has emerged from our discussion thus far is its increasingly *economic* or *entrepreneurial* orientation. As we have seen, the efforts of non-profit organisations to achieve their social objectives by engaging (at least in part) in commercial activities have produced the new entrepreneurship. It is this entrepreneurial orientation that marks social enterprise off from its traditional non-profit counterpart, and that has already become one of its defining features.

The idea of social enterprise as a *business enterprise* rather than a charity or other related entities is thus now inherent in all its definitions. As has been pointed out earlier, social enterprise as a business enterprise is not for-profit in orientation. To be financially viable, it needs to generate revenue through trading, but the revenue thus generated is principally used for social and community purposes rather than as private profits. In the UK, in particular, social enterprise has become well established as a *business* that trades for a social and/or environmental purpose.<sup>63</sup> Conceptualising social enterprise in this way at the very least has the important effect of distinguishing it from other socially oriented activities such as philanthropy, social activism or voluntarism, traditional companies with charitable foundations, or CSR activities of corporations. Moreover, it is worth re-emphasising that it is in this respect that social enterprises can be distinguished from other third sector entities, such as voluntary and community organisations, which also engage in trading. That is, whereas social enterprises are mainly business-oriented (with a social purpose), the other third sector organisations still considerably rely on grants and donations.

Apart from the features of social enterprise that have emerged from our discussion of the changing nature of the third sector, we may add the environmental concern as another one of its central features (though this feature now tends to be regarded

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<sup>62</sup> Martin and Osberg (n 54) 34-35.

<sup>63</sup> Social enterprises are 'businesses that are changing the world for the better...trade to tackle social problems, improve communities, people's life chances, or the environment'. Social Enterprise UK, 'About Social Enterprise' <[www.socialenterprise.org.uk/about/about-social-enterprise](http://www.socialenterprise.org.uk/about/about-social-enterprise)> accessed 2 January 2016

as part of the “social” objective). This aspect of social enterprise reflects worldwide concerns about the global environmental situation rather than changes in the nature of third-sector organisations that have led to their new orientations and forms.

The relevance of environmental concerns to social enterprises lies in the opportunities social entrepreneurs are now offered to take up these challenges by filling the gaps in the public services in this area which, like many others in the social sector, have been left by public authorities. Indeed, ‘the opportunities for social enterprises have increased in recent decades in parallel with the growth of national and international policy towards sustainable development, regeneration policy and specific areas of environment-related regulation and fiscal incentives, public sector reforms and the outsourcing of public services’.<sup>64</sup>

With the growing importance of environmental concerns all over the world, it is not surprising that we have witnessed in recent years the growth of entrepreneurship motivated by environmental values. Social enterprise activity in this area has been known by various names, including environmental or green entrepreneurship, eco-preneurship or enviropreneurship, and sustainable and sustainability entrepreneurship. ‘Entrepreneurial actors, with their propensity for innovation, experimentation and risk taking, are seen by some authors as the driving force of a sustainable society.’<sup>65</sup>

This environmental goal has now become an important aspect of social enterprise. It forms part of the movement’s “triple bottom line” orientation. But as I have pointed out, this orientation might have been superseded by a new multi-bottom line one that also stresses the importance of the independent or democratic governance of social enterprise. Actually, as has also been made clear earlier, this specific aspect of social enterprise may be regarded as part of its “social” orientation. However, given the importance given to it by many quarters in the UK,

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<sup>64</sup> Ian Vickers, ‘Social Enterprise and the Environment: A Review of the Literature’ (2010) Third Sector Research Centre Working Paper 22, 3

<[www.birmingham.ac.uk/generic/tsrc/documents/tsrc/working-papers/working-paper-22.pdf](http://www.birmingham.ac.uk/generic/tsrc/documents/tsrc/working-papers/working-paper-22.pdf)>  
accessed 24 January 2016

<sup>65</sup> *ibid* 26.

I consider it appropriate to mark it off as a separate defining characteristic of social enterprise.

### **2.3.2 Social enterprise as identified in this study**

I am now in a position to broadly characterise social enterprise as possessing three central features that mark it off from other socially beneficial activities, namely, *entrepreneurial (economic) orientation*, *social objectives*, and *social control* over its assets and activities.

As in the case of tracing its development, it is certainly possible to characterise social enterprise in other ways. Pearce has proposed six “defining characteristics” of social enterprise, namely: ‘(1) having a social purpose or purposes; (2) achieving the social purposes by, at least in part, engaging in trade in the marketplace; (3) not distributing to individuals; (4) holding assets and wealth in trust for community benefit; (5) democratically involving members of its constituency in the governance of the organisation; and (6) being independent organisations accountable to a defined constituency and to the wider community’.<sup>66</sup>

Pearce’s characterisation of social enterprise is in essence close to the one I have proposed. However, he has helped us to see the nature of this business in finer detail. Moreover, the explanation he offers for each of these characteristics is also helpful to our understanding of social enterprise. Therefore, I would like to take a look at his idea in some more detail.

For Pearce, having social purpose is the most important feature of social enterprise, since this means that it aims to benefit the community or a specific beneficiary group. The “social” is taken to include environmental concerns. Engaging in commercial activity is secondary in importance, because, as a main source of revenue, this is the means to achieving the social purpose. When social enterprises generate profits, these are not to be distributed to their owners or shareholders but reinvested in the business or for the benefit of the community. Moreover, the assets of a social enterprise may not be sold off and divided among members, directors or

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<sup>66</sup> Pearce (n 11) 31-32.

other group of stakeholders. Finally, social enterprise governance should involve participation of stakeholders.<sup>67</sup>

In essence seeing no difference between Pearce's characterisation of social enterprise and mine, I shall focus on the three defining characteristics of social enterprise rather than six as proposed by him. However, I would like to add a final note to the way I have characterised social enterprise.

As already pointed out, the emergence of the new entrepreneurship does not signal the transformation of non-profit organisations or other socially beneficial activities into traditional companies (and nor does this amount to the privatisation of public services).<sup>68</sup> Apart from its clear "social" purpose, this new entrepreneurship is subject to social and legal mechanisms that impose control over both its assets and activities. Equally important, this "economic" orientation also sets it apart from a traditional non-profit organisation that mainly depends on donations and grants. It is in these terms that social enterprise can, from my point of view and for my practical purpose, be sufficiently characterised.

The practical utility of this way of conceptualising social enterprise may be seen from the characteristics and orientation of social enterprise in the UK today. The following section has been included partially for this purpose.

## **2.4 Analysis of the social enterprise landscape of the UK**

This section offers a historical analysis of the social enterprise movement in the UK with a view to illustrating how the movement emerged and developed in a national context. The UK social enterprise movement is very much part of the "Atlantic landscape" I have presented in sections 2.2 and 2.3, and the three aspects of social enterprise I have identified (entrepreneurial orientation, social objectives, and social control) are very much relevant to UK social enterprise. A fuller understanding of

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<sup>67</sup> *ibid* 33.

<sup>68</sup> A point made by Ridley-Duff and Bull might be relevant here: '...social enterprise is the product of the tension between attempts to reform the *public* sector through the introduction of private sector management rhetoric, and radical responses to those attempts by local politicians and community entrepreneurs with socialist sympathies'. Ridley-Duff and Bull (n 12) 39.

social enterprise in this country nevertheless requires tracing both its origin and development especially from the late 1990s.

#### **2.4.1 Origin of social enterprise in the UK**

Social enterprise in the UK can be traced very far into the past – to at least the 19<sup>th</sup> century, and its modern form began to take shape as late as the 1970s (the case of the social audit toolkit in sub-section 2.2.2). As we shall see, the emergence of social enterprise in this country, as in most other OECD countries, is the result of the *institutionalisation* of this movement, especially within the non-profit sector.<sup>69</sup>

The UK social enterprise is a diverse movement: it comprises ventures such as co-operatives, credit unions, housing associations, community development trusts, social firms, and community businesses. The main principle fueling the movement during this period was that of a “third way”, focusing on the ideas of stakeholding, social inclusion and community. According to this principle, responsible citizens need to have a sense of shared purposes. They should not simply claim rights from the state but should also accept their individual responsibilities and duties as citizens, parents and members of communities. Therefore, a third way should promote the value of community by supporting the structures and institutions of civil society, such as the family and voluntary organisations.<sup>70</sup> Social enterprises driven by economic and social goals represent an organisational exemplar of the third way. In tracing the origin of social enterprise in the UK, this is where we may start.

#### **2.4.2 Emergence and development of social enterprise in the UK**

Teasdale has already mapped out a chronological path of the development of social enterprise policy and discourse in the UK.<sup>71</sup> However, whilst drawing upon this, I propose a *different interpretation* of the trends in the development of social enterprise in this country, one which seeks to understand this development in line with the concept and orientation of social enterprise presented above.

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<sup>69</sup> OECD (n 10) 12.

<sup>70</sup> Driver and Martell, ‘Left, Right and the Third Way’ (n 36) 151.

<sup>71</sup> Teasdale, ‘What’s in a Name?’ (n 2) 8-14.



Prior to the emergence of social enterprise in the UK, there had already existed, apart from traditional third sector organisations, a strong social economy tradition, most notably in the form of worker co-operatives and community enterprises, which placed strong emphasis on economic democracy and social ownership. As I see it, social enterprise emerged not only as a result of the New Labour Government's policy to use it, initially, as a tool for regeneration of deprived areas but also, eventually, as the success of what has been referred to as the "social purpose" perspective on social enterprise in gaining growing recognition within the third sector. Even so, however, we shall see that the influence of both traditional third sector organisations and the social economy tradition is still there.

#### 2.4.2.1 1999: Emergence of social enterprise in the UK

The term "social enterprise" first officially appeared in the UK with the launch of the HM Treasury's *Enterprise and Exclusion* in November 1999.<sup>72</sup> This report appeared just after the setting up of Social Enterprise London (SEL) in the previous year, and these two events may be taken as signaling the emergence of the social enterprise movement in this country.

It is significant that SEL came into being not only with a label attached to it – in the name of the new organisation, which is now the largest social enterprise network in the UK with over 2,400 members, linking and inspiring social enterprises in the country and beyond – but also with its first tentative definition:

Social enterprises are businesses that do more than make money; they have social as well as economic aims and form the heart of what is now coming to be known as the "Social Economy". Aims include the creation of employment, stable jobs, access to work for disadvantaged groups, the provision of locally based services and training and personal development opportunities.<sup>73</sup>

With the creation of an organisation with a "social enterprise" label and a proposed tentative definition, the social enterprise movement in the UK tangibly took shape.

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<sup>72</sup> HM Treasury, *Enterprise and Social Exclusion* (National Strategy for Neighbourhood Renewal: Policy Action Team 3 1999) 14.

<sup>73</sup> Jim Brown, 'Defining Social Enterprise' (Small Business and Entrepreneurship Development Conference, Surrey University, April 2003) 3 <[www.huckfield.com/wp-content/uploads/2014/05/02-Brown-Defining-Social-Enterprise.pdf](http://www.huckfield.com/wp-content/uploads/2014/05/02-Brown-Defining-Social-Enterprise.pdf)> accessed 6 April 2013, citing Social Enterprise London, 'Social Enterprise, Social Inclusion' (Inaugural conference report, London, 1999)

The definition clearly shows that SEL at that time had a strong focus on employment opportunities and democratic ownership. This orientation was probably influenced by the worker co-operative elements in the network, and reflected what has been called the socialisation perspective on social enterprise.

However, apart from the influence of co-operatives, community enterprises led in part by the Development Trusts Association were also trying to claim being part of the social enterprise movement. Their aim was to keep wealth in local communities and to establish social ownership of local assets.<sup>74</sup>

The main difference between co-operative and community enterprise proponents lies in the extent to which the social enterprise to be established is financially sustainable through trading. Many community enterprises during that time relied primarily on trading for their income, but they were financially viable only to the extent of their success in attracting grants and donations.

The significance of the year 1999 lies in the fact that it marks the expansion of the meaning of social enterprise as closely affiliated with the co-operative movement to incorporate community enterprises. For a small group of people closely related to, or affiliated with SEL, and adhering to the co-operative discourse influenced by the social economy tradition, social enterprise did not involve local regeneration. However, social enterprise was then portrayed by the government as a policy tool to tackle market failure and regenerate deprived areas, and the meaning of the “social” shifted its focus from economic democracy based on democratic ownership to what some describe as ‘a regenerative tonic’ for ‘hard pressed areas’.<sup>75</sup> This new orientation is inherent in what may be regarded as a provisional definition of social enterprise in *Enterprise and Exclusion*:

Social enterprises, which together make up the social economy, are in most ways like any other private sector businesses, but they are geared towards social regeneration and help, rather than simply the generation of profits. As such social enterprises do not fall within the standard definitions of private or public sector enterprises.<sup>76</sup>

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<sup>74</sup> Teasdale, ‘What’s in a Name?’ (n 2) 10.

<sup>75</sup> *ibid*, citing Ash Amin, ‘Local Community on Trial’ (2005) 34(4) *Economy and Society* 612.

<sup>76</sup> HM Treasury (n 72) 105.

#### 2.4.2.2 1999-2001: The Institutionalisation of social enterprise

The second phase in the development of social enterprise in the UK may be taken to represent what I would term the *institutionalisation* of the movement. This happened in 1999-2001, when the Social Enterprise Unit was established within the Department of Trade and Industry (DTI). Its initiation was announced by Douglas Alexander, minister for e-commerce at that time, in October 2001. This move should be regarded as a groundbreaking development. The Unit was an important focal point during this time as it established the government's definition of social enterprise and served to coordinate the government, the third sector and funding agencies. During this time, however, there were regular clashes among differing ideological interests.

On the one hand, more traditional third sector organisations were unhappy with the placement of the Social Enterprise Unit within the DTI, which was mainly responsible for promoting trade and industry. For them the focus should rather have been placed on community cohesion or inclusion through the placement of the Unit within a different government department.<sup>77</sup> They were keen to demonstrate that charities and other non-profit organisations had a long tradition of trading for a social purpose. Moreover, those from the co-operative movement, which represents another tradition in the third sector, were committed to promoting economic democracy and collective ownership as defining characteristics of social enterprise, having commitment to the socialisation perspective on social enterprise.

However, the social business representatives attempted to convince the government of the need to promote what was practically effective rather than focus on the process as advocated by community enterprises and co-operatives. In particular, they attacked the latter's focus on democratic control and the limits on non-distribution of profits which, they argued, would exclude private entrepreneurs who also create social values. They were, from my point of view, committed to the social purpose perspective on social enterprise.

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<sup>77</sup> This misplacement was a reason for the Unit being later replaced in 2006 by the Office of the Third Sector (OTS).

Despite the clashes of these different perspectives, the period 1999-2001 marks the initial movement of social businesses into the social enterprise sector. An important consequence of this development was the widening of the social enterprise concept to incorporate the notion of *businesses operating in the social sector*. This clearly points to the growing influence of the “social purpose” orientation in the third sector.

Though the period was notable for the clashes of competing ideas and interests and intensive lobbying by representatives of co-operatives, community enterprises, and social businesses, *I see this period as the time when social enterprise in the form of “new entrepreneurship” (described in sub-section 2.2.2) became institutionalised on the social enterprise landscape in the UK*. As Teasdale has noted, the ‘...positioning of social enterprise within the DTI was seen by some commentators as prioritising a social business discourse over and above those for whom the process was as important as outcome’.<sup>78</sup>

#### 2.4.2.3 2001-2005: Establishment of the meaning and orientation of social enterprise

The early work of the Social Enterprise Unit focused upon defining the term social enterprise. The definition was kept deliberately vague so as to permit the inclusion of as wide a range of forms as possible. The official definition of social enterprise contained in *Social Enterprise: A Strategy for Success* (used until May 2010) was as follows:

A social enterprise is a 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 maximise profit for shareholders or owners.<sup>79</sup>

In reaffirming that social enterprise is a business, this definition reflected a dominant discourse within the DTI at that time, which was pushed strongly by

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<sup>78</sup> Teasdale, ‘What’s in a Name?’ (n 2) 11.

<sup>79</sup> Department of Trade and Industry (DTI), *Social Enterprise: A Strategy for Success* (DTI 2002) 13.

social business representatives. We can therefore conclude that *the years 2001-2005 witnessed the incorporation of social enterprises as social businesses.*

On the other hand, from my point of view, this development actually represents a shift in the direction described above – that is, from the third sector or social economy (as the sector lying between the traditional public and private sectors and including co-operatives, mutual societies, associations, and foundations) to what has been referred to as “new entrepreneurship”.

This was evident in the inclusion of for-profit organisations with a social mission, as well as co-operatives and community enterprises, in the meaning of social enterprise. The significance of the inclusion of such for-profit entities lies in the fact that, *though charities and other non-profit organisations had a long tradition of trading for a social purpose, it was the for-profit organisations with social objectives that primarily relied on earned income.* The shift to social business is also inherent in Teasdale’s observation that ‘The assimilation of social businesses necessarily diluted the influence of the co-operative movement and community enterprises’.<sup>80</sup>

#### 2.4.2.4 2006-2010: Reassertion of the third sector

Given the long tradition of charities and non-profit organisations engaging in trading as a source of their income, it was natural for the voluntary and community sector in the UK to be interested in the potential utility of social enterprise as an “activity” (not as an organisational type) being carried out by a variety of entities in this sector. The purpose was to increase the role of voluntary organisations, in particular, in delivering public services. I shall not elaborate on this concept of social enterprise as an activity. So suffice it just to point out “the fatal flaw” of this idea.

...activities [frequently] evolve into institutional forms. Whatever they do, questions arise regarding governance, liability, power, ownership, control and managerial authority that have to be resolved both on paper and in practice. Social enterprise therefore may be an activity and a process, but it is also has to decide upon form.<sup>81</sup>

<sup>80</sup> Teasdale, ‘What’s in a Name?’ (n 2) 13.

<sup>81</sup> Ridley-Duff and Bull (n 12) 78.

We should note in this connection that the chief concern of organisations such as the Association of Chief Executives of Voluntary Organisations (ACVO) was to enhance the role of non-profits in delivering public services. As a result of intense lobbying by the strategic alliances of voluntary organisations, the official responsibility for social enterprise was moved from the DTI to the Cabinet Office, where the Office of the Third Sector (OTS), which replaced the Social Enterprise Unit in 2006, was located. This Office came into being with a new policy priority:

Social enterprises are part of the ‘third sector’, which encompasses all organisations which are non-governmental, principally reinvest surpluses in the community or organisation and seek to deliver social or environmental benefits.<sup>82</sup>

However, though this period may be said to have witnessed the reassertion of the third sector, I tend to see the thrust of social businesses or for-profits with social objectives as more dominant, as evident in the re-labeling of voluntary organisations delivering public services as “social enterprises”. The first national survey of social enterprise found that almost half of third sector organisations identified themselves as social enterprises. Moreover, a large number of private businesses also adopted this label.<sup>83</sup>

Of course, social enterprise as a label can be attached to non-profits relying at least in part on earned income as well as for-profits with social objectives. *But the trend was unmistakable that social enterprises increasingly relied on earned income.* The period was characterised not so much by the return of the third sector as the effort to promote the “business model” within this sector.<sup>84</sup> This is because ‘Earned income is likely to remain the most important source of revenue for many charities. Certainly it is unlikely that government grants to charities will increase significantly in the near future’.<sup>85</sup>

Significantly, though in 2010 the Office of the Third Sector was renamed the Office for Civil Society, no single actor has so far managed to capture social enterprise for

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<sup>82</sup> Office of the Third Sector (OTS), *Social Enterprise Action Plan: Scaling New Heights* (Cabinet Office 2006) 10.

<sup>83</sup> IFF Research, *A Survey of Social Enterprise across the UK* (Small Business Service 2005).

<sup>84</sup> Sepulveda (n 37) 5.

<sup>85</sup> Teasdale, ‘What’s in a Name?’ (n 2) 16.

itself. This was partly because the government chose to keep the movement loosely defined to permit its inclusion of as wide a range of forms as possible.<sup>86</sup> We may expect that, in the future, some other entities, in addition to co-operatives, community enterprises, social businesses, and not-for-profit and voluntary organisations, might feel the need to describe themselves as social enterprises.

We have clearly seen how the development of social enterprise in the UK was shaped by the country's traditional third sector or social economy as well as the influence of what has been term "new entrepreneurship". Let us now consider social enterprise in another national context – one which is not culturally part of, and lying far away from, the Atlantic world. The following section focuses upon recent efforts in Thailand to come to grips with the meaning and concept of social enterprise – how this has been influenced by the global trends in the development of this type of business – as well as the problems and needs of social enterprise in Thailand. Chapter 7 provides a fuller account of how social enterprise in this country has developed – with emphasis on the national and international influences relevant to its emergence and growth.

## **2.5 Understanding social enterprise in Thailand**

The development of social enterprise in Thailand is very recent, although, as we shall later see in Chapter 7, social enterprises may be said to have been in existence in this country since at least the 1970s. The development of social enterprise in Thailand has been profoundly influenced by ideas and initiatives that have emerged elsewhere, particularly in the Atlantic world. However, as in the case of the UK social enterprise, Thai social enterprise must be understood in its specific national context. As indicated above, this section focuses on the concept and meaning of Thai social enterprise as well as a brief overview of its problems and needs.

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<sup>86</sup> *ibid* 15.

### 2.5.1 Concept and meaning of social enterprise in Thailand

The concept and meaning of Thai social enterprise have been profoundly influenced by the development of social enterprise in other countries. In view of the extensive global social enterprise networks today, this is understandable. Even though social enterprises of one form or another have been in existence in Thailand for some time, the concept of social enterprise is quite new. This section explores the development of concept of social enterprise in this country and how its meaning has been *formalised*.

As we have seen in sections 2.2 and 2.3 above, social enterprise in Europe and the United States, in particular, has developed from within the third sector. Thailand may be said to have its own “third sector”, but it is difficult to determine how extensive its coverage is. Apart from its two main types of non-profit organisations, associations and foundations, the country has many other social or public-oriented entities in the form such as community enterprises, co-operatives, NGOs, and state enterprises. Moreover, organisations playing a crucial role in “filling the gaps” left by the state and the market include Buddhist monasteries and other religious institutions. All these organisations have their own specific purposes and orientations, but they may be regarded as providing the *social foundation* for the development of Thai social enterprise. This means that while the concept and even some forms of “practice” of social enterprise have been imported, it is the domestic social ground that has in no small way contributed to the growth of this “new” business model in Thailand.

Academic literature on social enterprise in Thailand is still very limited. In my search I have come across only a few articles, theses, and research works. The articles mainly provide basic understanding of social enterprise,<sup>87</sup> and those of

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<sup>87</sup> Examples of articles of this type are Sagol Jariyavidyanont, ‘Social Entrepreneurship: Principles and Basic Concepts’ (2010) 12(1) *Journal of Social Development* 456; Chayuth Chamnanlertkij, ‘Social Enterprise: A New Discourse on Social Responsibility’ (2012) IX (101) *Southeast Asia Current* 20; Sanit Noonin, ‘Organizational Analysis: Social Enterprise’ (2014) 17 *Journal of Social Sciences Srinakharinwirot University* 358; Kewalin Mali, ‘Social Enterprise in Thailand’ (2014) 1(2) *Journal of Economics and Management Strategy* 104; Sakda Siripatrasophon, ‘A Conceptual Study of Social Enterprise Development in Thailand’ (2015) 20(2) *Journal of the Association of Researchers* 30.



critical nature are hardly available,<sup>88</sup> as are those addressing the legal aspects of social enterprise.<sup>89</sup> A few theses which are available are naturally more focused in their scope,<sup>90</sup> and one of them deals with the legal forms for social enterprise.<sup>91</sup> Existing research works are also limited in number;<sup>92</sup> therefore, during a recent workshop run by Bob Doherty, participants called for more academic research in the Thai context to help build the capacity of the sector.<sup>93</sup>

However, though academic knowledge on social enterprise in Thailand is still limited, the sector is quite notable for its rapid growth (this will be shown in Chapter 7). The concept of social enterprise, particularly the mainstream one, has also become more or less widespread within the sector and in other interested quarters. This is probably the result of the support by strong social enterprise networks (as will also be shown in Chapter 7). Thai social entrepreneurs have perhaps been “learning by doing”, and members of the interested public have on their part been more regularly exposed to the idea of social enterprise via channels such as the media, seminars and workshops, and other more or less regular activities to promote this type of business.

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<sup>88</sup> The only article of this type that I have found is Dmitriy Berenzon and others, ‘Social Enterprise in Thailand: From Profit to Responsibility’ (2011) *Financiers Without Borders* 1.

<sup>89</sup> One such article is Park Kanjanapaibul, ‘Legal Entity for Social Enterprise’ (2011) 1 *Thammasat Business Law Journal* 131. This article is a summary and an adaptation of the author’s thesis of the same title.

<sup>90</sup> Natha Thammakittisiri, ‘The Promotion and Setting up of Social Enterprises for the Disable’ (MA thesis, National Institute of Development Administration 2012); Sarunyikha Thiemboonkit, ‘An Exploratory Study of the Development of Social Entrepreneurship: Key Concepts, Characteristics, Roles and Success Factors of Social Enterprise in Thailand’ (DPhil thesis, National Institute of Development Administration 2013); Sookyuen Tepthong, ‘Social Entrepreneurship and Organizational Performance: Combining Resource Dependence and Resource-Based Views’ (DPhil thesis, National Institute of Development of Administration 2014).

<sup>91</sup> Park Kanjanapaibul, ‘Legal Entity for Social Enterprise’ (LLM thesis, Thammasat University 2011).

<sup>92</sup> Research projects completed in recent years include ChangeFusion, *Final Report on the Social Enterprise Promotion Research Project with the Moral Promotion Centre’s Fiscal 2009 Funding Support* (2010) (the project was submitted to the Moral Promotion Centre); Sarinee Achavanuntakul (ed), *Thailand Social Enterprise 50* (Bangkok: Krungthepturakit 2010); Ekachai Nittayakasetrawat, ‘The Development of Social Enterprises in Thailand and Other Countries: Case Studies and Best Practice Applications’ (2011) 8 (*NIDA Business Journal*) 1; Office of the National Economic and Social Development Board, *Final Report on the Quarterly Survey of Social Opinions and Attitudes on the Participation of the Private Sector in Solving the Problem of Poverty and Reducing Social Inequalities: CSR and Social Enterprises* (2011).

<sup>93</sup> British Council, ‘Balancing Social and Commercial Objectives in Social Enterprise: Workshop with Professor Bob Doherty’ (Workshop summary, 3 August 2015).

It is quite interesting to note how understanding of social enterprise has permeated various quarters in Thai society. For instance, Sathit Limpongpan, Chairman of the Stock Exchange of Thailand (SET), in declaring SET's support for investment in social enterprise, referred to social enterprises as 'business models operating with missions to tackle and improve society and [the] environment through efficient business operation, while generating profits back into the business and the local community towards sustainable changes'.<sup>94</sup> To cite just one more example, an article on the Thailand Creative Design Centre website has characterised "the business of social entrepreneurs" in the following terms:

The business of social entrepreneurs is a profit-oriented one, but the so-called profit is measured by various indicators, such as profit measured from the earned cash, or profit in the form of better quality of life or better social structure. Moreover, the profit does not exclusively belong to shareholders or owners of the business but rather to all stakeholders – namely, consumers, the company, its employees, the community, and the environment. To put it more simply, the heart of the matter lies in the fact that once the business operation becomes profitable, both the company and the community are self-reliant. They no longer need to wait for assistance from the government or to depend wholly on donations. This will, in turn, result in upgrading or changing the living conditions of the disadvantaged in the community in the long run.<sup>95</sup>

The Thai concept of social enterprise may be said to be mainly attributed to Elkington's idea of the triple bottom line of profit, people, and planet.<sup>96</sup> This idea has become more generally known as the "triple bottom line" of financial, social and environmental goals. In Thailand it has become a mainstream, if still quite recent, idea of social enterprise. Nittayakasetrawat, for example, uses the triple bottom-line idea as a model<sup>97</sup> to identify the characteristics of Thai social enterprise.<sup>98</sup> From some of his "indicators", we can clearly see that the characteristics of Thai social enterprise are essentially those we have found in the

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<sup>94</sup> Stock Exchange of Thailand (SET), 'Thai Bourse Supports Investment in Social Enterprise' *News Release: SET News* (Bangkok, 4 March 2014)

<sup>95</sup> Chatcharaphon Penchom, "Business of the social entrepreneurs: A new economic model to create an ideal society" [in Thai], *TCDC: Thailand Creative Design Centre* <<http://www.tcdc.or.th/14862>> accessed 20 August 2015.

<sup>96</sup> This idea was originally developed in John Elkington, *Cannibals with Forks: The Triple Bottom Line of the 21<sup>st</sup> Century Business* (New Society Publishers, 1998).

<sup>97</sup> Nittayakasetrawat, 'The Development of Social Enterprises in Thailand and Other Countries' (n 92) 6.

<sup>98</sup> He has constructed 17 indicators of social enterprise for the purpose of comparing Thai social enterprises with those of other countries. The two sets of cases share most of the social enterprise characteristics he has identified in his work. *ibid* (n 92) 25.

general understanding of social enterprise,<sup>99</sup> especially as a business with social mission and features such as good corporate governance and potential for financial viability.

Another important research product represents a collective effort in listing 50 “good” social enterprises – *Thailand Social Enterprise 50*,<sup>100</sup> which currently serves as a very useful “handbook” and very important source of information on Thai social enterprises. It defines social enterprise as ‘an enterprise that clearly has the main goals of solving the problems of, and developing, the community, society, and the environment, and that has as its main source of revenue profits from the sale of goods and/or services in accordance with its goals’.<sup>101</sup> This definition clearly reflects the triple bottom line of community and society, the environment, and profit.

Still another important document I would like to refer to here is *Master Plan for the Promotion of Social Enterprise 2010-2014*.<sup>102</sup> Approved by the Cabinet in July 2010, *Master Plan* not only gives a definition of social enterprise but also sets forth the general orientation of this type of business activity in Thailand. The definition, which clearly embodies the triple bottom line concept, is given as follows:

Social enterprise is an enterprise that gains its revenue from the sale and production of goods and/or services, and that is set up with clear objectives at the very beginning of solving the problems of, and developing, the community, society, and/or the environment, and not maximising profits for its shareholders or owner. New objectives may be added to the original ones, or the latter may be modified [but only in keeping with this non-private profit principle].<sup>103</sup>

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<sup>99</sup> Some of these main characteristics are as follows: 1) social enterprise is a business engaging in providing goods or services, i.e. in a profit-making business activity; 2) social enterprise is a business set up in response to the existing gaps in the market; 3) social enterprise is a business that is financially viable on a long-term basis without financial support from other organisations; 4) social enterprise is an environmentally oriented business, or environmentally motivated in its inception; 5) social enterprise is a business that operates under good corporate governance; and 5) social enterprise is an enterprise that contributes to community development or improvement of people’s living conditions.

<sup>100</sup> Achavanuntakul (ed), *Thailand Social Enterprise 50* (n 92).

<sup>101</sup> *ibid* 23.

<sup>102</sup> Thailand Social Enterprise Office (TSEO), *Social Enterprise Promotion Master Plan 2010-2014* (September 2010).

<sup>103</sup> *ibid* 4.

*Master Plan* elaborates on this definition of social enterprise by delineating its “special” characteristics: having the production process and operation in providing goods and services that do not cause any permanent or long-term damage to society, popular well-being and the environment; having good corporate governance; having a potential for financial viability; re-investing most of the profits in expanding the business to achieve its objectives or returning those profits to society and users of its goods and services; being able to operate in various organisational structures; and adhering to the principles of sufficiency economy.<sup>104</sup>

Regulations of the Office of the Prime Minister on Social Enterprise Promotion (hereinafter called “Social Enterprise Promotion Regulations 2011”) were also issued the following year,<sup>105</sup> which restate in a more precise manner the definition of social enterprise and its characteristics as proposed in *Master Plan*:

“Social enterprise” refers to the activity of the private sector, either as an individual, a group of individuals, or the community, who engages in a venture or an operation with clear objectives at the very beginning of mainly solving the problems of, and developing, the community, society and the environment, generates revenue from the sale and production of goods, or provision of services, which is not meant at maximising profits for the shareholders or owners of the venture or the operation, and has the following characteristics:

- (1) relying on the production process and operation in providing goods and services that do not cause any permanent or long-term damage to popular well-being, society and the environment;
- (2) making use of the philosophy of sufficiency economy;
- (3) having a potential for financial viability;
- (4) re-investing most of the profits in expanding the business to achieve its objectives of solving the problems of, and developing, the community, society, or the environment, or returning those profits to society;
- (5) being able to operate in various organisational structures; and
- (6) having good corporate governance.<sup>106</sup>

The most recent and significant move is the introduction of the Social Enterprise Promotion Bill (to be further dealt with in Chapter 7), which has been placed as the *Special Agenda 1: Social Enterprise* by the National Reform Council.<sup>107</sup> This *Special Agenda* has crystallised the Thai social enterprise concept, which, following

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<sup>104</sup> *ibid.*

<sup>105</sup> ‘Regulations of the Office of the Prime Minister on Social Enterprise Promotion BE 2554 (2011)’, Royal Gazette No 128, Special Section 55 D.

<sup>106</sup> Social Enterprise Promotion Regulations 2011, reg 3.

<sup>107</sup> National Reform Council, *Special Agenda 1: Social Enterprise* (Secretariat of the House of Representatives 2015).

the enactment of the Bill in the near future, will be formalised, especially in an official definition of social enterprise. Now a “working definition” has been proposed which makes a distinction between two sides of social enterprise – the business side and social and public organisation side.

On the business side, social enterprise is defined in the following terms: ‘social enterprise is a type of business, which is set up mainly for social purpose and objectives, and which re-invests most of the profit it generates for the social purpose it sets for itself and not for the creation of private wealth and interests’.<sup>108</sup> On the social and public organisation side, social enterprise is defined with a more or less different focus:

...social enterprise represents a new organisational type formed to tackle social problems by adopting business models with efficient management and mainly depending on market mechanisms in its operation without abandoning its original purpose and objectives but with a belief that the reliance on the new organisational type will lead to financial self-reliance and reduction of the state’s financial support and donations, which are not consistent and certain, thereby making it impossible for the organisation to plan its operation for the achievement of its objectives.<sup>109</sup>

As part of the definition given above, *Special Agenda* identifies four characteristics of social enterprise, which, it states, are similar in all national contexts. These characteristics are as follows:

- (1) being an organisation set up with the main purpose of tackling social problems (not that of maximising profits and interests of shareholders);
- (2) relying on a business model in its operation, its main source of income thus being the sale of goods or services, not grants from the state or donations;
- (3) managing the profits by re-investing them back into the business or distributing them for public, not private, benefit; and
- (4) having good governance in management in relation to the people in the organisation, society and the environment.<sup>110</sup>

Finally, the Social Enterprise Promotion Bill supplies a formal definition of social enterprise. The Bill is now being subjected to public hearings by the Thai Social Enterprise Office (TSEO);<sup>111</sup> hence, certain modifications can be expected before

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<sup>108</sup> *ibid* 14.

<sup>109</sup> *ibid*.

<sup>110</sup> *ibid* 14-15.

<sup>111</sup> ‘Invitation to Public Hearings on the Social Enterprise Promotion Bill’, TSEO <<http://www.tseo.or.th/news/231673>> accessed 20 December 2015.

it eventually becomes law. However, by now the concept of social enterprise seems to have been firmly established, as embodied in the definition of social enterprise provided in section 4 of the Bill:

“Social enterprise” refers to a legal person, who produces goods, provides services, or engages in other activities in the private sector, with a clear objective at the very beginning of mainly solving the problems of, and developing, the community, society and the environment, and not that of principally maximising profits for the shareholders or owners, and with the following special characteristics:

- (1) setting social objectives as the main purpose of the venture;
- (2) having a potential to become financially sustainable;
- (3) relying on the production process and operation in providing goods and services that do not cause any continuing or long-term damage to society, popular well-being, and the environment; and
- (4) re-investing most of the profits in expanding the business to achieve its stated objectives, or returning those profits to society or its consumers.<sup>112</sup>

It is *Special Agenda* together with the Social Enterprise Promotion Bill attached to it that have most clearly and fully defined the concept of social enterprise, which is actually in line with the idea of social enterprise now generally adopted in many other countries. We may now conclude that the Thai concept of social enterprise has been conceptualised as a profit-oriented venture with social mission and environmental concerns and “special characteristics” such as those identified in the Social Enterprise Promotion Regulations 2011 and *Special Agenda*.

*Master Plan* explicitly acknowledges the practical relevance of the experiences of other countries in developing their social enterprises. In this respect, the UK experiences seem to have been particularly important. However, the development of social enterprise in each country has also been influenced by its specific problems and needs, and indigenous social or cultural innovations. In Thailand, a special mention should be made of the philosophy of “sufficiency economy”<sup>113</sup> developed by H.M. King Bhumibol Adulyadej. The idea has been adopted as a general

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<sup>112</sup> National Reform Council (n 107) 62-63.

<sup>113</sup> Incorporating three principles – moderation, rationality, and immunity to external vicissitudes – the philosophy actually aims to enable local communities to stand on their own feet and is thus compatible with the goal of social enterprise. For further detail, see Chaiyawat Wibulswasdi and others, *Sufficiency Economy Philosophy and Development* (Bangkok: Sufficiency Economy Research Project, Bureau of the Crown Property 2010).

guideline for the country's sustainable development,<sup>114</sup> and its principles have also been incorporated into the concept of Thai social enterprise.

Despite an existence going back several decades, Thai social enterprises '...just came into formal identification in 2010'.<sup>115</sup> That means that virtually no official documentation of this type of business existed prior to that year: to date, only *Master Plan* and the Social Enterprise Promotion Regulations 2011 can be found on the TSEO website, other official documents available there being orders appointing various committees. However, on the basis of other sources of evidence, we can say that the Thai social enterprise sector has experienced significant growth, which will be shown in Chapter 7. Now let me offer a very brief overview of the problems and needs of social enterprise as it is being developed in Thailand.

### **2.5.2 Problems and needs of social enterprise in Thailand**

I have already established an understanding of social enterprise as a *business* with social mission. As a business, it *mainly* relies on the revenue from its trading, and this orientation clearly distinguishes it from other public-oriented entities, such as some forms of charities, which also generate revenue in a similar way, but which still largely rely on donations and grants, especially from public sources. As will become clearer in subsequent chapters, Thai social enterprise has been conceived of and is being developed as such a business. However, a crucial problem for social enterprise in Thailand, as will be further elaborated in Chapters 6 and 8, is that it still lacks a legal form specifically designed to meet its needs. What then are these needs, and why such a legal form is required to satisfy them?

It is generally recognised that '[a] social enterprise is not defined by its legal status but by its nature: what it does that is social, the basis on which that social mission is embedded in a form of social ownership and governance and the way it uses its profits it generates through trading activities'.<sup>116</sup> Social enterprise in Thailand is

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<sup>114</sup> National Economic and Social Development Board, *The Eleventh National Economic and Social Development Plan 2012-2016* (2011)

<[http://www.nesdb.go.th/Portals/0/news/plan/p11/Plan11\\_eng.pdf](http://www.nesdb.go.th/Portals/0/news/plan/p11/Plan11_eng.pdf)> accessed 15 December 2015.

<sup>115</sup> Tepthong, 'Social Entrepreneurship and Organizational Performance' (n 90) 21.

<sup>116</sup> Bates, Wells and Briathwaite and Social Enterprise London (SEL), *Keeping It Legal: Legal forms for social enterprise* (SEL 2003) 1.

actually being developed without a specifically designed legal form: Thai social enterprises can operate within any of the existing legal structures or none at all. Though, as will be shown in Chapters 7-8, the Social Enterprise Promotion Bill particularly recognises the usefulness of social enterprises operating as limited companies under the Civil and Commercial Code, there are limits to this usefulness. In fact, as I shall demonstrate in Chapters 6-8, there are limits to the usefulness of reliance on any of the traditional legal forms.

As will also be shown in Chapter 8, though given the vast and varied nature of social enterprise in Thailand (and elsewhere in the world), the need for the diversity of legal vehicles is undeniable. Nonetheless, as will fully explored in Chapters 3-4, social enterprise is not just a type of business: it is essentially a *stakeholding entity*. As such, it needs not only legal rules to facilitate its operation as a business organisation but also those that assure accountability to its stakeholders. In this respect, I shall argue that, while the existing legal forms (most notably the limited company under the Civil and Commercial Code) provides most of the facilitative rules required by social enterprise, none of them fully meets its need for those that assure its accountability to stakeholders.

Both types of legal rules represent the fundamental needs of social enterprise as a stakeholding entity. That is why a legal form specifically designed to meet such needs is required. In the case of Thailand, as I shall point out, the unavailability of such a legal vehicle has further implications. It is my argument that a legal form properly designed for social enterprise not only satisfies its needs as a stakeholding entity but also contributes to the development of the social enterprise sector. How such a legal form, or more generally how a proper legal regime for this type of business, fosters its development is more fully explored in Chapter 8. Here, however, I deem it important to briefly discuss the importance of legal form in this respect with particular reference to the countries in Europe and the United States.

To begin with, we might simply say that the importance of a legal form specifically designed for social enterprise can clearly be seen in its creation, or currently being under preparation, in many European countries and the United States to promote this type of business. As Fici has observed,



...*ad hoc* legal forms for social enterprise began to be adopted by European legislatures in the 1990s. The social cooperative of Italian law No. 381/91 initiated this process. Today, at least 15 EU countries have laws specifically dedicated to the phenomenon of the social enterprise...while, in other EU countries, bills addressing this object are under either discussion or approval...Moreover, the matter of the social enterprise does not concern only the EU; it also extends to the US, among other countries...<sup>117</sup>

However, it is important to point out that still some other countries in Europe do not now see the need for such a legal form. As Lavišius has noted, '[s]o far it is up to the particular country to decide whether the social enterprise is supposed to obtain [a] special legal form or not'.<sup>118</sup> In other words, different approaches to social enterprise development may be adopted that suit the specific conditions in different countries, and not all these approaches require a specially designed legal form. So why do I see the unavailability of a legal structure specifically developed for social enterprise in Thailand as a problem?

In addressing this issue, what must first be emphasised is that the countries with more developed social enterprise sectors significantly rely on a proper *legal environment*. Lavišius has identified two broad approaches adopted by such countries in Europe. One involves adapting existing legal forms or creating new legal structures that satisfy the needs of social enterprise described above. The other resorts to providing social enterprise with a "legal status" or "legal qualification".<sup>119</sup>

The countries adopting the first approach have created new legal structures for social enterprise, especially by adapting or modifying existing legal entities. For example, France, Greece, Italy and Poland have created a legal vehicle for social enterprise by adapting the co-operative legal structure,<sup>120</sup> whereas other countries, including Portugal and Spain, recognise social co-operatives in their existing legal form which covers co-operatives in general. The UK has developed a separate legal form (the CIC) for use only by social enterprises. The countries using the second approach have introduced what is called "a social enterprise legal status":

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<sup>117</sup> Antonio Fici, 'Recognition and Legal Forms of Social Enterprises in Europe: A Critical Analysis from a Comparative Law Perspective' (2015) Euricse Working Papers 82, 8 <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2705354](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2705354)> accessed 18 August 2016

<sup>118</sup> Tomas Lavišius, 'Social Enterprises: Does the Legal Form Matter?' (2016) 4 Social Transformations in Contemporary Society 132.

<sup>119</sup> *ibid* 134.

<sup>120</sup> For details of each country's legal structures, see Cafaggi and Iamiceli (n 43) 7-15.

The idea of this concept is that the legal status of social enterprise can be adopted by different types of organizations, but these organizations have to meet the pre-defined criteria...The legal status can be obtained by...most of traditional organizations: cooperatives (traditional and social), investor-owned companies (share companies), associations, or foundations...<sup>121</sup>

The countries resorting to this approach include Belgium and Denmark. The latter has adopted a “certification scheme”: a law introduced in 2014 entitles enterprises that meet certain standards to the right to use the term “registered social enterprise”.<sup>122</sup> In Belgium the law giving the legal status to the “social purpose company” was adopted back in 1995: the law sets out conditions that an organisation must satisfy in order to be provided with this status.<sup>123</sup> As will be seen Chapters 7-8, Thailand has resorted to a similar scheme of creating a legal status of social enterprise, and now a certification scheme has been introduced principally as a basis for providing support for ventures satisfying certain conditions. However, as I shall argue in Chapter 8, this approach is still not adequate, especially for the need to *further develop* the Thai social enterprise sector.

It should also be pointed out here that, in the United States, many states have recently adopted new legal structures. These include the low-profit limited liability company (L3C), the benefit corporation and the flexible purpose corporation.<sup>124</sup> The L3C was first enacted by Vermont 2008, and many other states have adopted it. The flexible purpose corporation (FPC) was first introduced in California 2010 and became law the following year. However, in January 2015, it was given a new name: a social purpose corporation (SPC). Maryland was the first state to pass the

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<sup>121</sup> Fici (n 117) 134.

<sup>122</sup> For Denmark’s social enterprise law, see Lars Hulgård, ‘Danish Social Enterprises: A Public-Third Sector Partnership’, in Marthe Nyssens (ed), *Social Enterprise: At the Crossroads of Market, Public Policies and Civil Society* (Routledge 2006) 50-58.

<sup>123</sup> For Belgium’s social enterprise law, see Cafaggi and Iamiceli (n 43) 15-18; and Marthe Nyssens and Alexis Platteau, ‘Profiles of Workers and Net Effect of Belgian Work Integration Social Enterprises’, in Marthe Nyssens (ed), *Social Enterprise: At the Crossroads of Market, Public Policies and Civil Society* (Routledge 2006) 222-234.

<sup>124</sup> For an overview of the three legal forms, together with case studies, see Kate Cooney, ‘Mission Control: Examining the Institutionalization of New Legal Forms of Social Enterprise in Different Strategic Action Fields’ in Gidron and Hasenfeld (eds), *Social Enterprises: An Organizational Perspective* (Palgrave Macmillan 2012) 198; and Morrison Forster/Trust Law, *Which Legal Structure Is Right for My Social Enterprise? A Guide to Establishing a Social Enterprise in the United States* (2013) 59-83. <<http://www.trust.org/contentAsset/raw-data/1b34bbc3-de52-477a-adae-850a56c2aabe/file>> accessed 27 August 2016

law on the benefit corporation, which has now been recognised by many other states.

How can a legal form properly designed for social enterprise foster its development (apart from facilitating its operation)? In discussing this issue in Chapter 8, I focus on the problem of “branding”. So let me highlight this problem by again referring to the two authors I have drawn upon in this sub-section. According to Fici, ‘...the primary, essential and irreplaceable role of social enterprise law is (and should be) to establish a precise identity of social enterprises and to preserve their essential features. This justifies, *per se*, the existence of specific legislation on social enterprise and helps to identify its minimum and essential content’. In particular, it is imperative that social enterprise have ‘...a specific identity, operating with an identity *distinct from those of other organizations and appearing different under a legal designation that conveys objectives and modes of action...*’<sup>125</sup> Moreover, Lavišius has driven home the point I shall later make:

Probably the biggest challenge in the countries seeking *further development* of the social entrepreneurship is to develop company law rules that ensure that social enterprises actually pursue their social purposes, avoiding the misuse of the status of social enterprise on [the] one hand and ensure sufficient flexibility in their regulation on the other, eliminating obstacles in further development of social entrepreneurship sector in general.<sup>126</sup>

## 2.6 Conclusion

Social enterprise, together with terms related to it, such as the third sector and the social economy, still remains a contested concept. We thus still lack conceptual clarity in terms of how these terms are related to one another – and especially how the third sector and the social economy are related to social enterprise, in particular. Hence while I see the emergence of social enterprise as related to the development of “new entrepreneurship” within the third sector, academics like Ridley-Duff and Bull see it as more closely associated with the social economy. Anyway, for my practical purpose, I hope that I have achieved some conceptual clarity and understanding about both the concept and orientation of social enterprise.

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<sup>125</sup> Fici (n 117) 10.

<sup>126</sup> Lavišius (n 118) 137-138.

This understanding is crucial for my next task, which is to develop a blueprint for legal forms for social enterprises. That is, for this purpose, I need to understand what an ideal-type legal form for social enterprise would look like, i.e. one which is most compatible with the orientation and characteristics of social enterprise identified in this chapter. The following two chapters will be devoted to this task.

## **Chapter 3**

# **Designing a Legal Form for Social Enterprises: Legal Forms for Organisations and Entrepreneurs' Needs**

### **3.1 Introduction**

I have discussed the concepts and orientation of social enterprise in Chapter 2, and I hope that this discussion has clarified what social enterprise is and what roles in society and the market it is performing. We now turn to the question of “legal forms” (also called “legal vehicles”) for social enterprises. In this chapter and the next one, we shall develop a “blueprint” for such a form, seeking to identify the most important features that it should possess. Chapter 5 will then measure the Community Interest Company (CIC) – the legal vehicle the UK has most recently made available to social enterprises – against our blueprint, asking how far, in theory, this satisfies our recommendations as to the ideal content of a social enterprise legal form.

To develop this blueprint, we need further understanding of social enterprise specifically in terms of its organisational needs. Like starting any business, launching a social enterprise involves various concerns, most notably those relating to (1) rules *facilitating* its operations and (2) those *regulating* its governance. All organisations, large and small, engage in internal as well as external contractual relationships that need to be both *facilitated* (primarily to reduce the transaction costs these incur) and *regulated* (to provide appropriate protection for those involved with the organisations). Thus, my concern in this chapter and the next one is to explore how a legal form available to social enterprises can meet their specific needs in terms of both these *facilitative* and *regulatory* rules.

This chapter starts, in section 3.2, by exploring some of the conceptual issues that arise in respect of the design of a legal form for any organisational type. It considers, in sub-section 3.2.1, what is meant by a “legal form”, and, in sub-section 3.2.2, why the choice of form is important. As alluded to above, legal forms typically consist of a mix of both facilitative rules, which are typically in the form of “default rules”, and regulatory rules, in the form of “mandatory rules”. Sub-section 3.2.3 looks at

some explanations for why the law should bother itself with supplying default rules (rather than leaving the parties to draft their own) and what these explanations might tell us about the *proper content* of such default rules. Sub-section 3.2.4 considers some explanations and justifications for the inclusion of mandatory rules within a legal form. The conceptual discussion finishes in sub-section 3.2.5 with an analysis of the main types of legal form available, distinguishing between unincorporated and incorporated forms.

Sections 3.3 and the next chapter seek to apply this conceptual analysis to the specific nature of the social enterprise, *as Chapter 2 of this thesis has shown it to be*, particularly by showing just what mix of default and mandatory rules, with what particular content, a good legal form for social enterprises would exhibit, given its specific nature. Section 3.3 does this primarily in respect of the facilitative aspect of the legal form. It concentrates, in particular, on three requirements that social enterprises exhibit, and to which the legal form for this type of business must respond. First, it requires a corporate form. Second, to deal with risk, it requires a form that delivers limited liability. Third, it requires a form that facilitates the raising of capital, but which does so in a way that is consistent with the social mission of the social enterprise (and the limits on distributing profits that this social mission necessarily entails).

Given the connection between this chapter and the next one, it is appropriate to highlight here what Chapter 4 contains. It seeks to address the *regulatory* aspect of the rules constituting a good legal form for social enterprises, focusing on two governance issues that need to be addressed: first, the problem of agency costs within social enterprises, and, second, the issue of accountability to stakeholders within the social enterprise. Once again, the aim is to relate the discussion of the peculiar nature of social enterprises, settled in Chapter 2, to the regulatory content of a good legal form for social enterprises.

### **3.2 Legal forms for organisations: some conceptual issues**

Modern society is characterised by the proliferation of organisations. Of course, the underlying nature of these organisations varies massively, depending upon the

activities, the individuals involved, the wider society in which the organisation is located, organisational history, etc. For the production of economic goods or services, the underlying organisational type is “the firm”. According to Jensen and Meckling, a firm is a kind of organisation whose essential function is to serve as a nexus for specific set of contracting relationships among individuals.<sup>1</sup> Theorists believe firms exist not only as a way to lower transaction costs of going to the market, but also as a device for allocating resources.<sup>2</sup> The “firm” is an *economic* concept. It is not a *legal form* for an organisation to adopt. Firms might vary a good deal one from another, and different firms could choose different legal forms through which to structure, legally, their activities. A diversity of legal forms for firms has been created as a ‘rational institutional response to the function of the firm’.<sup>3</sup>

### 3.2.1 The meaning of “legal form”

What then do we mean by a “legal form”? In business, and indeed in most other sectors, organisations’ operational modes are recognised and/or regulated by the law. We call such formal organisational modes the legal forms for organisation. A legal form, then, describes a *package* of legal rules that will structure some aspects of the relationships between those involved in the organisation.

Bates, Wells and Braithwaite and Social Enterprise London define “legal form” as ‘the way in which a business is set up and the rules and regulations that govern it i.e. it provides the operating framework for an organisation’.<sup>4</sup> Similarly, Hansmann and Kraakman conceive of “legal forms” as a set of standard-form legal entities provided by the law: standard-form contracts among the parties who participate in an enterprise, including most notably the owners, the managers and the creditors of

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<sup>1</sup> Michael C Jensen and William H Meckling, ‘Theory of Firm: Managerial Behavior, Agency Costs and Ownership Structure’ (1976) 3 *Journal of Financial Economics* 305.

<sup>2</sup> Schumpeter, ‘Why do Firms Exist?’ in *The Economist*, *The Joy of Growing Old* (18 Dec 2010) <[www.economist.com/node/17730360](http://www.economist.com/node/17730360)> accessed 26 September 2013; See also Ronald H Coase, ‘The Nature of the Firm’ (1937) 4(16) *Economica* 386; Edith Penrose, *The Theory of the Growth of the Firm* (4<sup>th</sup> edn, OUP 1995).

<sup>3</sup> Mark Casson, *Information and Organisation: A New Perspective on the Theory of Firm* (OUP 2003) 79.

<sup>4</sup> Bates, Wells and Braithwaite and Social Enterprise London (SEL), *Keeping It Legal : Legal forms for social enterprises* (SEL 2003) 3.

the enterprise.<sup>5</sup> A legal form is a ‘standard set of default rules that govern when contracting parties have not specifically decided otherwise, and perhaps providing as well some mandatory rules that protect the interests of parties who would otherwise be disadvantaged in the contracting process’.<sup>6</sup> Hessen observes that legal forms function as ‘ready-to-wear clothes: if they fit well they can be worn without alteration, or they can be modified until they fit better. With the right legal craftsmanship or tailoring, any form can be modified to suit the needs of any group of clients, but the underlying core in *every* form is contract’.<sup>7</sup> Finally, Ogus observes that ‘each form carries with it a concomitant set of mutual rights and duties, the majority of which are nevertheless subject to being overridden by explicit provision in contracts or other legal instruments, such as the company articles or memorandum’.<sup>8</sup>

Each legal form will typically have some “trigger” that helps us identify whether those creating an organisation have chosen to employ that particular legal form. So, for example, under UK law, there are clear procedures for the creation of each type of registered company i.e. private companies and public companies limited by shares; private companies limited by guarantee; the unlimited companies; and the community interest company,<sup>9</sup> and it is evident whether an entrepreneur has followed those procedures, created a company, and thereby chosen that legal form for her business.

It is worth stressing that the rules that make up a legal form will not deal with all aspects of all relationships with the organisations. Some aspects of some relationships will be dealt with by separate bodies of rules that apply irrespective of the legal form that is chosen. So, for example, many of the rules that govern the relationship with consumers will typically apply irrespective of whether the consumer happens to be dealing with a company, a partnership, or whatever. Our law tends to adopt other labels – “employment law”, “consumer law”,

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<sup>5</sup> Henry Hansmann and Reinier Kraakman, ‘The Essential Role of Organisational Law’ (2000) 111(3) *Yale Law Journal* 387

<sup>6</sup> *ibid* 440.

<sup>7</sup> Robert Hessen, ‘The Modern Corporation and Private Property: A Reappraisal’ (1983) 26(2) *Journal of Law and Economics* 273, 283.

<sup>8</sup> Anthony Ogus, *Regulation: Legal Form and Economic Theory* (Hart Publishing 2004) 18.

<sup>9</sup> Companies Act 2006, pt 2.



“environmental law”, and so on – to describe these bodies of rules that apply irrespective of the chosen legal vehicle through which an organisation is being conducted.

In this thesis, as we develop our “blueprint” of a legal form for social enterprise, we are concerned *only with those rules that will be peculiar to that legal form*. We are not concerned with the employment law rules, consumer law rules, etc., that will admittedly apply to social enterprises (as well as non-social enterprises), but will exist outside of the legal form.

### **3.2.2 The importance of the choice of legal form**

Rules governing organisations will be determined by the choice of legal form, because for many (even if not all) one of the most important decisions anyone planning to set up an organisation has to make involves choosing a proper legal form. To be sure, the choice of form is not necessarily “set in stone” at the outset. Thus, firms may choose one legal form of organisation at start-up and may then change it later when they grow larger or their mission changes.<sup>10</sup> However, it is better to make the right decision in the first place to minimise the need for later changes, which can be difficult or expensive.

However, if it is important for those creating organisations to consider carefully their choice of legal form, it is surely as important that the law also offers a choice of legal forms that are “well-tailored” to the distinctive character of the different organisations to which they are being offered. We must therefore turn to consider the question: how shall we decide whether a legal form for social enterprises is indeed “well-tailored”? To answer this question, we first need to think more carefully about *why* the law creates distinctive legal forms in the first place. We have seen that they represent packages of rules, but why should the law present organisations with such packages?

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<sup>10</sup> For example, many firms start as private companies and some of those subsequently “outgrow” that form and reincorporate as public limited companies.

### 3.2.3 The facilitating role of legal form

Suppose a business were organised through the vehicle of the corporate form. That legal form, as provided by corporate law, might be defined by its core characteristics, namely, legal personality, limited liability, transferable shares, deregulated management under a board structure, and investor ownership.<sup>11</sup> With the exception of legal personality, as Armour *et al* have indicated, these defining characteristics of the corporate form could in theory be put in place simply by contract. That is, the relationships among the participants in a corporation are, to a significant degree, contractual in nature. Given that, they ask why it is that ‘...we today have, in every advanced economy, elaborate statutes providing numerous detailed *rules* for the internal governance of corporations?’<sup>12</sup> To move towards an explanation, they point out that a significant part of corporate law, more in some jurisdictions and less in others, consists of what they refer to as *default provisions* – those applying only if the parties do not explicitly provide for something different.

Thus, many of the rules that make up a legal form will – as the quotes from Hansmann and Kraakman, Hessen, and Ogus above emphasised – be provided as “mere defaults”. They provide rules that the parties could themselves have supplied by contract, and which the parties remain free to exclude or modify by contract if the default rules do not optimally fit the parties’ situation. But still, why should the law go into this trouble of providing such default rules? Several explanations can be given for the law’s role in supplying default rules in this way. We shall consider them in turn, and ask what, if any, these explanations then tell us about the *proper content* of these default rules.<sup>13</sup>

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<sup>11</sup> John Armour, Henry Hansmann and Reinier Kraakman, ‘What is Corporate Law?’, in Reiner Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2<sup>nd</sup> edn, OUP 2009) 1-2.

<sup>12</sup> *ibid* 20 (emphasis added).

<sup>13</sup> For an introduction to the issues raised by the content of default rules, see David Charny, ‘Hypothetical Bargains: The Normative Structure of Contract Interpretation’ (1991) 89(7) *Michigan Law Review* 1815.

### 3.2.3.1 Reducing transaction costs

The dominant explanation for the law's role in supplying default rules is that they can reduce transaction costs.<sup>14</sup> Transaction costs have been defined by Cooter and Ulen as 'the costs of exchange' and include 1) search costs, 2) bargaining costs, and 3) enforcement costs.<sup>15</sup> Thus, if the law supplies default rules, it can avoid at least some of these transaction costs. In particular, it can avoid the costs of the parties having to negotiate, or express, their own terms.

A good example of rules that seem to serve this transaction cost saving function is given by the "Model Articles of Association" that UK company law supplies.<sup>16</sup> These are "default rules" – prescribed by law, and applied unless a company chooses to exclude them.<sup>17</sup> They govern a number of matters relating to the internal organisation of registered companies, such as the division of managerial power between shareholders and directors, the calling of meetings, payment of dividends, and so on. These are all matters shareholders might reasonably easily foresee as being prudently covered in a constitution, but the parties are spared the costs of doing just that. The models are widely adopted.

If the aim in supplying default rules is indeed to save transaction costs, then does this tell us what rules – with what content – the law should offer? In simple terms, the usual prescription is that *the law should supply the rule that the majority of contractors, to whom the rule is being offered, would themselves choose*.<sup>18</sup> Or, for the purposes of this thesis, the law should offer social enterprises the default rules that a majority of such enterprises would themselves choose. By providing the "majoritarian defaults", the law saves the greatest number of organisations the costs of drafting their own rules.

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<sup>14</sup> Ian Ayres and Robert Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989-1990) 99 *Yale Law Journal* 87; Richard Craswell, 'Efficiency and Rational Bargaining in Contractual Settings' (1992) 15(3) *Harvard Journal of Law and Public Policy* 805; CA Riley, 'Designing Default Rules in Contract Law: Consent, Conventionalism and Efficiency' (2000) 20(3) *Oxford Journal of Legal Studies* 367.

<sup>15</sup> Robert Cooter and Thomas Ulen, *Introduction to Law and Economics* (6<sup>th</sup> edn, Pearson 2011).

<sup>16</sup> The Companies (Model Articles) Regulations 2008, SI 2008/3229.

<sup>17</sup> Companies Act 2006, s 18.

<sup>18</sup> Ian Ayres, 'Preliminary Thoughts on Optimal Tailoring of Contractual Rules' (1993) 3(1) *Southern California Interdisciplinary Law Journal* 1.

This prescription requires us to consider carefully the likely population of social enterprises to whom the legal form is to be made available, and attempt to anticipate what rules most social enterprises would choose. Of course, their choices are likely to be determined, to some extent, by the underlying purposes and values of social enterprises, the interests of those involved in social enterprises, and the relationships between those participants. The better we understand those things, the better we can anticipate the terms they would be likely to choose. And the analysis of social enterprises offered in Chapter 2 provides much material to deal with these issues.

However, we must now say a little more to question, and to refine, the prescription for default rules based on this rather simplistic “majoritarian default rules” approach. For, even if one were concerned only to reduce transaction costs as far as possible, it is not always the case that we can do that by supplying the rule *most parties* would choose.

Suppose, for example, we were deciding whether to include, in our legal form, a restriction on owners of the social enterprise transferring their shares in the social enterprise to an “outsider” (someone not currently a member of the organisation).<sup>19</sup> Suppose that drafting a rule to provide a restriction on transfers would be extremely expensive for the parties themselves. It might be so because, for example, it would need to be fairly long and complicated – containing detailed procedural machinery to give effect to the restriction on transfers to outsiders, detailed valuation machinery to determine the price at which insiders are to buy the shares, and so on. If the law’s default rule provides, then, that there is no restriction on such transfers, the costs for those parties who want a restriction, and have to draft their own rule, are very high. If, however, the law does provide a rule restricting transfers, the costs for those who do not want that term may be relatively low (they do not have to go to the trouble of drafting a detailed rule; instead they can simply “cross out” the law’s default). It may well be, then, that even if the majority would prefer there being no restriction, more transaction costs would be saved by including such a

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<sup>19</sup> This is usually achieved by giving a “right of pre-emption” to insiders.

rule; doing so is likely to generate a lot of contracting (as the majority have to exclude the rule) but it will be relatively cheap contracting.

The lesson here might be summarised as follows: it may be better for the law to err on the side of generosity, supplying more default rules, and rules that tend to be “over-specified” compared to what most parties might want, because the costs of striking them out in whole or part will usually be less than parties’ costs in drafting such rules from scratch if the law fails to help them.

A second reason why the “choose the majoritarian rule” might not always be appropriate follows on from the work of Barnett.<sup>20</sup> He has argued that sometimes the law should deliberately choose a rule it knows most parties would not in fact choose themselves. He accepts that this may well incur more transaction costs, as lots of parties choose expressly to exclude the law’s defaults. But he argues that this is beneficial if such contracting results in the better informed party having to release valuable information to the less well informed party.<sup>21</sup> The example often cited to illustrate this concerns second-hand car sellers and buyers. Typically, the vendor is likely to know more about the car’s quality than does the buyer – the vendor, in other words, is better informed than the buyer.<sup>22</sup> How can we get the vendor to release the information they have – about defects in a car – to the buyer? A default rule whereby the vendor warrants the car is free of defects might achieve this. Suppose that the law imposed a default rule whereby the vendor gives such a warranty. Suppose in practice such a default is more often than not excluded by car vendors. Nevertheless, in having to exclude expressly the law’s rule, the vendor puts the buyer on notice that the vendor may know that the car has defects that make the vendor want to exclude the warranty.

To recap, then, the transaction cost explanation for the law supplying default rules suggests that we should devise a legal form for social enterprises, the default rules

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<sup>20</sup> Randy E Barnett, ‘The Sound of Silence: Default Rules and Contractual Consent’ (1992) 78 *Virginia Law Review* 821.

<sup>21</sup> *ibid* 822. See also Armour, Hansmann and Kraakman (n 11) 20; Ayres and Gertner, ‘Filling Gaps in Incomplete Contracts’ (n 14) 94.

<sup>22</sup> This example of ‘informational asymmetry’ is the subject of Akerlof’s famous article. George A Akerlof, ‘The Market for “Lemons”: Quality Uncertainty and the Market Mechanism’ (1970) 84(3) *The Quarterly Journal of Economics* 488.

of which aim to replicate what most contractors would choose, subject to two caveats. First, sometimes it will be appropriate for the law to be rather more “generous” by drafting expansive clauses notwithstanding most parties might want to reject them. Second, sometimes rules might be designed “against” the better informed party, even where this produces more contracting, if such contracting releases valuable information to the lesser informed party.

### 3.2.3.2 Imperfect information and “bounded rationality”

The second explanation for the law to offer defaults is that this may be appropriate where parties would fail to appreciate a contingency that needs to be covered in their contract. Humans are recognised as having bounded rationality, which includes “limited cognitive capacities”.<sup>23</sup> These limitations include limited foresight: the failure to anticipate some contingencies – especially more remote future contingencies – which might arise and which it would be prudent to contract for. The law, however, has a sort of “collective wisdom” from its longer institutional experiences of dealing with such matters. It can see further than the parties themselves, providing rules for contingencies that parties themselves never anticipate.

Perhaps, for example, most owners forming a social enterprise would not even think to ask whether they want to prevent any one of them transferring their shares to outsiders in the future. But when the state devises a legal form for social enterprises, it is of course aware of this (and many similar “remote”) issues, and can ensure that a rule is provided to deal with it.

Does this explanation for the law supplying default rules tell us anything about their content? It does suggest again that the law might err on the side of generosity, in the sense of supplying a larger number of rules than most parties might choose. Suppose that most organisations would wish to restrict themselves from voting on transactions in which they are interested. Including a default rule that imposes such a restriction on directors might go against the preferences of most organisations,

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<sup>23</sup> Herbert A Simon, ‘Theories of Bounded Rationality’, in CB McGuire and Roy Radner (eds), *Decision and Organization* (North-Holland Publishing Company 1972) 161-176.

but might also prompt some organisations to consider the need for such a rule when, in the absence of a default to that effect, the matter would never have occurred to them.

### 3.2.3.3 The dynamic quality of the law

A third reason why the law might usefully offer default rules concerns their *dynamic* quality. This is a point that has been developed by Hansmann.<sup>24</sup> He notes that default rules are updated whenever the law itself is updated – with each decided case, or when the statute is amended. An organisation that has chosen to adopt any legal default rule is usually treated as being bound by the current version of that rule. An organisation, therefore, needs to do nothing itself to update the default rules it has adopted; the updating is done for it by the courts or by Parliament.<sup>25</sup>

By contrast, if an organisation drafts its own rules, it must itself update those rules over time. Given the likely long duration of organisations, some updating is likely to become necessary. But not only is such updating by the organisation itself an inconvenience; it also creates the possibility of “blackmail” by individual members. Where rules are settled by contract, typically the consent of all contractors will be required to change them. Even if the rules are put in a constitutional document, changing that may well require a substantial majority of members.<sup>26</sup> As Hansmann notes, individual members may be perfectly happy with some proposed change, but refuse their consent in order to secure private benefits. By accepting the law’s defaults, the parties effectively give to the party they trust – the state itself – the authority to update their contract for them, avoiding the possibility of individual blackmail.

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<sup>24</sup> Henry Hansmann, ‘Corporation and Contract’ (2006) 8(1) *American Law and Economics Review* 1.

<sup>25</sup> *ibid* 1-2. However, under UK company law, this argument does not work for one of the major sources of default rules – the “Model Articles of Association”. A company is “stuck” with the version of the model articles in force at the date the company adopted (usually by default) the model. To benefit from a new model, the company must expressly adopt it. See CA Riley, ‘The Not-so-Dynamic Quality of Corporate Law: A UK Perspective on Hansmann’s “Corporation and Contract”’ (2010) 21(3) *King’s Law Journal* 469.

<sup>26</sup> As it does in UK company law, Companies Act 2006, s 21 (75 per cent majority required). Moreover, there is always the possibility of the minority preventing the change by alleging that it is not made “bona fide for the benefit of the company as a whole”. See *Allen v Gold Reefs of West Africa* [1900] 1 Ch 656.

Once again, this tells us something interesting about why the state has a role to play in supplying default rules, and also why contractors may choose to accept those defaults rather than replace them with their own privately drafted rules.

### 3.2.4 Legal forms and mandatory rules

So far, we have explained why legal forms would include default rules, and said something about what the content of those default rules should be. We now turn to consider the position with regard to mandatory rules – rules that the parties are *not* free to exclude. To understand how mandatory rules are based on a different understanding of the proper role of law, it is worth considering Ogus' analysis.

Ogus refers to the tension between two systems of economic organisation – the market system and the collectivist system. In the market system, individuals and groups are generally left free, being subject only to certain basic restraints, to pursue their social or commercial goals. In this system 'the law has a primarily *facilitative* function: it offers a set of formalized arrangements with which individuals can "clothe" their welfare-seeking activities and relationships. The arrangements carry with them mutual rights and obligations which, if necessary, a court will enforce'.<sup>27</sup> In contrast to the market model, the collectivist system incorporates a *directive* function of law. Here the term "regulation" is used to denote this function of the law, and, '[in order to] achieve the desired ends, individuals are compelled by a superior authority—the state—to behave in particular ways with the threat of sanctions if they do not comply'.<sup>28</sup> Similarly, Freedman believes that a legal form comprises two main elements: one is an *external* element which has a regulatory function aimed at protecting the interests of outsiders; and the other is the *internal* element, which provides a facilitative function aimed at protecting owners of an organisation where ownership and management are separated.<sup>29</sup>

Nonetheless, Ogus has cautioned that if we accept such basic distinctions we might overlook the diverse and complex aspects of the law's function resulting from any

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<sup>27</sup> Ogus (n 8) 2.

<sup>28</sup> *ibid.*

<sup>29</sup> Judith Freedman, 'Small Businesses and the Corporate Form: Burden or Privilege?' (1994) 57 *The Modern Law Review* 555, 557.



system of economic organisation.<sup>30</sup> That is, whereas in the market system the state still needs to provide ‘a minimum degree of order and security’ through its imposition and enforcement of obligations and even decision to overrule ‘private agreements’, in the collectivist system ‘regulation is not always directive’. Indeed, in some areas, the regulation is initiated and enforced not by the state but rather by ‘self-regulatory agencies’.<sup>31</sup>

Freedman also accepts that legal forms (at least those that offer limited liability) must be a mixture of both default rules and mandatory rules. She notes that ‘[a]s soon as a firm ceases to be a one person concern, some minority protection may become necessary’;<sup>32</sup> in particular, ‘[u]ltimately, it must be accepted that regulatory provisions will be essential for any legal form offering the benefits of limited liability’.<sup>33</sup>

But why exactly do we need the law to play this “protective” or “regulatory” function? Why, in other words, should there be any mandatory legal rules? The need for mandatory legal rules and the merits of “freedom of contract” have of course long been debated.<sup>34</sup> This debate has been seen especially in relation to corporate law, where “contractarians” and “anti-contractarians” have argued at length<sup>35</sup> over whether corporate law should include mandatory legal rules.<sup>36</sup>

#### 3.2.4.1 Arguments against mandatory rules

We do not have space here to consider this debate in detail, or provide a comprehensive defence of mandatory rules. Typically, two arguments are put forward *in favour* of freedom of contract.

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<sup>30</sup> Ogus (n 8) 3.

<sup>31</sup> *ibid* 3.

<sup>32</sup> Freedman (n 29) 559.

<sup>33</sup> *ibid* 558.

<sup>34</sup> For a basic idea of “freedom of contract”, see Hugh Collins, *The Law of Contract* (4<sup>th</sup> edn, LexisNexis 2003) 25.

<sup>35</sup> For this issue, see Lucian A Bebchuk, ‘The Debate on Contractual Freedom in Corporate Law’ (1989) 89(7) *Columbia Law Review* 1395.

<sup>36</sup> In addition, they have also argued over the extent to which, as a positive matter, company law already does contain mandatory rules, and the extent to which it is already merely “enabling” or “facilitative”. See Frank H Easterbrook and Daniel R Fischel, ‘The Corporate Contract’ (1989) 89(7) *Columbia Law Review* 1416.

The first is that such freedom helps to promote the parties' own autonomy. "Personal autonomy" is something that most political, and legal, systems place a high value upon.<sup>37</sup> Parties should be free to work out for themselves what ends they wish to pursue, and should be free to enter into private bargains with others in order to pursue those ends. In the context of social enterprises, a social entrepreneur should be free to determine what social ends he or she wishes to promote, and what relationships the enterprise will engage in with others to do so. If, to anticipate an example we shall return to later in the next chapter, he or she wants to give the organisation's stakeholders a say in the running of the organisation, then he or she should be free to do so; conversely, if he or she wants to exclude stakeholders from such a say, then he or she should be free to do that too. To impose mandatory norms requiring the organisation to treat stakeholders in a particular way would restrict the entrepreneur's personal autonomy.

The second argument advanced in favour of freedom of contract is a more economic argument.<sup>38</sup> It is that people are usually the best judges of their own welfare, and of the bargains they should make to promote their own welfare. Interfering in private exchange by imposing mandatory rules on the parties is therefore likely to reduce their welfare. Suppose that a worker, W, decides that, given her own options, she is better off working for £5 per hour, whilst some employer, E, is prepared to employ her for that rate, but no more. To insist, as a mandatory rule, that all employees must be paid a minimum hourly rate in excess of £5, thereby preventing W from entering into this bargain, not only interferes with the autonomy of W and E, but it also undermines the welfare of W and E. Each is left materially worse off by their inability to reach an exchange that would have been mutually beneficial.

#### 3.2.4.2 Arguments in favour of mandatory rules

The arguments in favour of mandatory rules, in turn, typically invoke a range of values. Armour *et al*, for example, note that corporate law is itself comprised of

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<sup>37</sup> Marina Oshana, 'Personal Autonomy and Society' (1998) 29(1) *Journal of Social Philosophy* 81.

<sup>38</sup> Easterbrook and Fischel (n 36) 1418. This article emphasises the "enabling" function of corporate law – that is enabling 'the participants to select the optimal arrangement for the many different sets of risks and opportunities that are available in a large economy. No one set of terms will be best for all; hence the "enabling" structure of corporate law'. They thus set out a typical case against mandatory rules on economic and welfare grounds.

important rules that are mandatory – those leaving the concerned parties with no option but to conform to them. Taking an approach based on economic analysis, they regard the existence of mandatory rules as being based on some form of “contracting failure”, which is inherent in certain situations. One such situation involves some parties being taken advantage of because they are not well informed. Another possible situation is the case of third parties’ interests being affected. Still another situation is when ‘collective action problems’ such as ‘the prisoners’ dilemma’ might give rise to contractual terms which are ‘inefficient and unfair’.<sup>39</sup> Moreover, according to the same legal theorists, mandatory rules may also have a ‘useful standardizing function’, as when accounting rules, for example, give rise to ‘the benefits of compliance increase if everyone adheres to the same provisions’.<sup>40</sup>

Picking up on some of these points, contracting parties may, because of their ignorance, or cognitive problems,<sup>41</sup> misunderstand what terms will benefit their own welfare. They might then agree to contractual terms that leave them worse off, rather than better off. The mandatory rules might therefore be appropriate to protect people from their own ignorance. To give one example of how this might apply to social enterprises, suppose that the label of “social enterprise” induces in those dealing with such enterprises a set of beliefs about the activities and values of such enterprises, including the extent to which profits are maximised or extracted. If erroneous, acting on these mistaken beliefs (by dealing with a social enterprise) might undermine the welfare of those who do so. Mandatory rules might therefore be necessary to ensure that any organisation that uses this “trigger” term of being social enterprise must behave in ways that roughly reflect these social expectations.

A second reason in favour of mandatory rules is to control “externalities” – where an action imposes uncompensated costs on a third party (i.e. costs which the third party is not paid to bear).<sup>42</sup> The *easy* example often given for an externality is pollution. A factory that operates so as to emit pollution on its neighbours thereby

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<sup>39</sup> Armour, Hansmann and Kraakman (n 11) 22.

<sup>40</sup> *ibid.* For a detailed explanation of the role of mandatory rules, see Jeffrey N Gordon, ‘The Mandatory Structure of Corporate Law’ (1989) 89(7) *Columbia Law Review* 1549, 1555-74.

<sup>41</sup> That is, an inability to process rationally information a party does have.

<sup>42</sup> Gordon (n 40) 1567-69. See also Ian Ayres, ‘Regulating Opt-Out: An Economic Theory of Altering Rules’ (2012) 121 *Yale Law Journal* 2032.

causes an externality if the pollution causes a loss to the neighbours which the factory owner does not pay the neighbours to accept.

In the context of our social enterprise, an example of an externality might again relate to the usage of the very term social enterprise. Suppose that that term is indeed a valuable “brand”. Suppose that (regardless of what the law said) most social enterprises did restrict their pursuit and distribution of profits, and therefore enhanced this brand value. Suppose also that the public responded to this positively, and “rewarded” enterprises operating under the badge of social enterprise. That badge would, however, become tarnished if some enterprises operated under its label but acted contrary to its profit-sacrificing values. An enterprise doing so would impose a cost (or, externality) on other social enterprises that made use of, and upheld the values of, the social enterprise label.

Much economic analysis accepts the two foregoing arguments in favour of mandatory rules, because those arguments both focus on “inefficiencies” in private contracting (based on informational problems, or externalities).<sup>43</sup> Mandatory rules might therefore make contractual arrangements more efficient. Economists tend to be less ready to accept a third argument that can be put in favour of mandatory rules, namely to “redistribute” benefits from stronger (including richer) to weaker (including poorer) parties. Return to our worker and employer example. The worker does not appear to be misinformed when she concludes that she is better off working for £5 per hour. Yet we may still feel that the only reason the employee reaches this conclusion is because of her weak bargaining position compared to the employer; too many workers are chasing too few jobs. Mandatory legal rules – minimum wage rates, rent controls, ceilings on energy prices, and so on – may be explained as attempts not to constrain ignorance, but rather to constrain more powerful contractors for the benefit of weaker ones, and thereby achieve a redistributory outcome compared to what the “market” – free contracting – would deliver.

*Opponents* of mandatory rules on redistributory grounds typically either do not support redistribution per se (which we shall not consider here), or else argue that,

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<sup>43</sup> Philippe Aghion and Benjamin Hermalin, ‘Legal Restrictions on Private Contracts Can Enhance Efficiency’ (1990) 6(2) *Journal of Law, Economics, and Organization* 381.

even if one favours redistribution, nevertheless *interfering in private contractual arrangements* is a poor means to achieve that (compared, for example, to using the tax and welfare system). We can briefly note here two points often made in support of this second, “poor means”, argument. The first point is that a stronger party that is unable to change one term in a contract (say an employer mandatorily required to provide health insurance) will simply respond by adjusting other terms of the contract to compensate (say, reducing other non-mandatory benefits for the worker). The end result will be the same overall distribution of benefits and burdens between the two parties, yet in a less efficient way (both parties might prefer the worker foregoing health insurance and receiving the other benefits instead). The second point is that the stronger contracting party may simply choose not to contract on the mandatory terms at all.

We do not have space here to consider these counter-arguments in full, but they clearly do have some force. In the specific context of legal forms, our concern in this chapter, we might note that they do have some relevance. Suppose that we regard the social entrepreneur as generally the stronger party, and some of those “stakeholders” dealing with social enterprises as weaker ones. Suppose we were, for redistributory reasons, to include within the legal form for social enterprise mandatory rules designed to enhance the position of stakeholders, as against the social entrepreneur. The burden of these mandatory elements may make the social entrepreneur choose to conduct his or her business under some other legal form whose constitutive rules do not include those mandatory rules. The end result is that the intended redistributory effect is not achieved anyway (it is avoided by the choice of the other legal form) but efficiency is sacrificed as the social entrepreneur is forced to operate under a less suitable legal vehicle.

Finally, we might just observe that some writers have questioned whether the distinction between facilitative (default) rules and regulative (mandatory) rules is always as clear as might be assumed.<sup>44</sup> So, for example, Armour *et al* note that mandatory rules, when used in conjunction with a choice of corporate forms, can

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<sup>44</sup> Duncan Kennedy, ‘Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power’ (1982) 41(4) *Maryland Law Review* 563.

assume an enabling function similar to that provided by default provisions. In this respect, mandatory rules can facilitate freedom of contract by enabling corporate actors to signal the terms they offer and to formally commit themselves to adhering to those terms.<sup>45</sup> The law accomplishes this by, first, offering a menu of different standard-form legal entities from which parties may choose in forming their business enterprise, and, second, with respect to a particular type of legal entity, such as the publicly traded business corporations, allowing the organisers of a firm to choose among different jurisdictions' law – a situation leading to what they call “regulatory competition in corporation law”.<sup>46</sup>

### **3.2.5 A synoptic view of existing legal forms**

I have explained the meaning of the legal form as an operating framework for an organisation. In real life, we indeed need a diversity of such formal frameworks to accommodate a myriad of business objectives and activities. In any modern economy there are many different types of organisation. The range of differences makes it very difficult even to categorise them – for-profit, non-profit, and not-for-profit organisations; pure business and social enterprises; big and small business organisations, some more risky and others less risky; joint owner and single business organisations, and so forth. Freedman provides another perspective on this diversity:

In practice, there is a continuum from the one person firm, through the husband and wife company, the family company, the private company which brings in outside finance, the unlisted public company and the quoted company to the multinational group. Even this list understates the variety of the firms for which the law of business organisations must cater and fails to recognise their changing character: some firms will transmute through a number of these categories over their life cycles.<sup>47</sup>

Since my purpose in this chapter is to establish what a well-designed legal form for social enterprises would look like, it is not necessary to describe all existing legal forms available for this type of business. However, since, in Chapter 5, I shall attempt to determine whether the UK does provide a legal form which fits the needs

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<sup>45</sup> Armour, Hansmann and Kraakman (n 11) 22.

<sup>46</sup> *ibid* 22-23.

<sup>47</sup> Freedman (n 29) 559.

of a social enterprise, it will be useful to establish here a brief overview of the main types of legal form. The basic division between types of legal form is between those forms that create a separate body with its own legal personality, and those which do not do so.

### 3.2.5.1 Unincorporated legal forms

Examples of UK unincorporated legal forms include the sole trader, the general partnership, and the unincorporated association. Where a business or organisation is pursued through one of these forms, the form does not confer any separate legal personality upon the business or organisation itself. Activities undertaken by those involved with the business or organisation are carried on by the human beings who act for it. Thus, a sole trader his/herself enters into contracts with others, a partner does so on behalf of his or her fellow partners, and so on.

Equally, property used by the organisation must be owned by individuals on its behalf, since the organisation has no legal personality of its own. This, as we shall see later, can be administratively inconvenient where those holding the property sever their relationship with it, probably resulting in the transfer of the property to those whose relationship with the organisation is continuing.

Because contracts are entered into personally by individuals connected with the organisation, those individuals will typically have personal liability in respect of those contracts. Equally, they will be personally liable for civil wrongs committed in their management of the organisation. This means that all their personal assets are at risk of being taken to satisfy such liability. In this sense, their liability is “unlimited”.

The rules governing unincorporated forms are typically default rules that govern the “internal relationship” between, say, multiple owners of the organisation, and address the authority of individuals acting for the organisation.<sup>48</sup> On the other hand, the rules governing unincorporated forms typically tend to impose fewer restrictions on the management of the organisation than do incorporated legal

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<sup>48</sup> See, for example, Partnership Act 1890, s 5.

forms. This is explicable, and justifiable, by the absence of limited liability. Much of the regulation that constitutes a part of incorporated legal forms, which do confer limited liability, is designed to protect the interests of creditors. Accordingly, unincorporated legal forms tend to be cheaper (and quicker) to form, and easier and cheaper to run.

### 3.2.5.2 Incorporated legal forms (corporation)

Examples of incorporated legal forms in the UK include a number of different types of registered company,<sup>49</sup> the limited liability partnership (LLP)<sup>50</sup> and the charitable incorporated organisation (CIO).<sup>51</sup> The essence of these legal forms is that the law permits those setting up the organisation to create a separate body corporate, which the law recognises as having a legal personality of its own.

Where a legal form entails the creation of a separate body, with its own legal personality, a number of legal consequences follow, which in turn produce a number of commercial advantages. First, the separate legal entity will be able to own property, avoiding the inconveniences mentioned above. Second, the corporate entity continues in existence until, in accordance with the rules governing the legal form, it is brought to an end. This “perpetual succession” means that it survives changes in the identity of those who, say, own it from time to time. Third, the corporate body is able to contract with others. Human beings may still conduct activities for the organisation, but legally speaking they do so as the agents of the separate corporate entity. It is that entity which will be liable for contracts made on *its* behalf by *its agents*.

This ability of the corporation to become the contracting party, in place of the agents who act on its behalf, provides the basis for the limited liability of those agents (whether they be owners or managers of the corporate body). It does not entirely

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<sup>49</sup> There are, under Companies Act 2006, pt 1, a number of different corporate forms: private companies and public companies limited by shares; private companies limited by guarantee; unlimited companies; and the community interest company.

<sup>50</sup> Limited Liability Partnerships Act 2000.

<sup>51</sup> The framework for the CIO is set out in Charities Act 2011, pt 11, The Charitable Incorporated Organisation (General) Regulations 2012, SI 2012/3012, and a variety of secondary legislation.



tell us, however, what liability those owners or managers may continue to face, notwithstanding the primary liability of the corporate body itself. For example, whilst they will not be liable for contractual obligations entered into as agents of the corporate body, they may be liable for torts which they commit in pursuing corporate activities.<sup>52</sup>

The usual downside of the corporate form is a larger body of mandatory rules which deal with the process of creating the form, or designed to protect creditors. However, quantitatively speaking, the predominance of corporate forms suggests that, for most organisations, the benefits of incorporation (legal personality, perpetual succession and limited liability) outweigh its disadvantages (greater regulation).<sup>53</sup>

### 3.2.5.3 The architecture of the legislation creating corporate legal forms

Given that the law must offer a range of corporate legal forms, how should the legislation allowing for these forms be structured? One way would be for each corporate form to stand alone, governed by a comprehensive, and self-contained, separate piece of legislation. There would thus be a separate legislative instrument creating, and entirely dealing with, the private company limited by shares, one dealing with the private company limited by guarantee, one the public limited company, one the unlimited company, one the LLP, one the CIO, and so on. If a new corporate form were to be introduced, such as the CIC, this too would be a separate, stand-alone, corporate entity, governed by its own statute.

However, it may be that whilst some of the rules that make up each of these forms need to differ in some respects (the rules governing accounts for the private

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<sup>52</sup> In fact, in UK law the liability of corporate employees, including directors, in tort for wrongs committed by them in their conduct of the corporation's affairs is complex. Whilst as a general rule individuals will be liable if, say, they negligently injure a third party (a director, say, runs over a pedestrian whilst driving to a business meeting) they are unlikely to be held liable for torts which require an "assumption of personal responsibility" on the part of the director, such as a negligent misstatement committed by the director (see *Williams v Natural Life Health Foods Ltd* [1998] UKHL 17, [1998] 1 WLR 830, [1998] 2 All ER 577, [1998] 1 BCLC 689) or where the director's actions constitute merely the "governance" of the organisation. See Alan Dignam and John Lowry, *Company Law* (8<sup>th</sup> edn, OUP 2014) paras 3.43-3.48.

<sup>53</sup> Michael C Jensen, *A Theory of the Firm: Governance, Residual Claims, and Organizational Forms* (Harvard University Press 2003) 2-3.

company, for example, may need to differ from those for the public company) some issues may require the same rule for different legal forms.

Given this possibility of overlap, it looks better instead, to some extent, to create a separate core corporate entity and then allow variations to those core rules for the different corporate variants. This is essentially what UK legislation achieves. It creates the core form of a “registered company” under the Companies Act 2006. However, the Act then permits different types of registered company to exist, each of which is subject to some rules that are distinctive to it. The advantages of this structure are at least fourfold.

First, the law itself should become clearer and more certain. Since the core rules, which apply to all registered companies, are the same, they are likely to be litigated more frequently. This generates a body of precedents applicable to the whole population of registered companies. If different rules were drafted for each different form, differences in language between those rules would undermine this process.

Second, and relatedly, it likely creates greater familiarity, especially for professional advisers (including lawyers). The core rules that govern any registered form are likely to become more familiar, since they are encountered in respect of all registered companies (of whatever sub-species). As Cross noted at the time of the initiation of the CIC, comparing its structure with that of the LLP,<sup>54</sup> the CIC’s company form would subject it to the existing provisions of company law. In contrast with the LLP, the CIC’s structure would benefit from ‘a level of certainty for potential users, advisers, and judiciary who, when dealing with CIC’s, will simply to the existing principles of company law on most routine matters’.<sup>55</sup>

Third, the legal form is likely also to be more familiar to the public at large. The public will encounter the core type more often, albeit in its various embodiments (as a private company, or a public company, or a guarantee company, and so on). And they may therefore be readier to trust that form. A legal form that exists as

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<sup>54</sup> ‘The LLP is an entirely new species of legal form which has a strongly corporate character with features of a partnership but which is entirely distinct from both the company and the partnership’. Stuart R Cross, ‘The Community Interest Company: More Confusion in the Quest for Limited Liability’ (2004) 55 Northern Ireland Legal Quarterly 302, 306.

<sup>55</sup> *ibid.*

something separate (as, for example, the CIO does) is likely to appear as novel, and perhaps less trustworthy.

Finally, the updating<sup>56</sup> of the rules governing the form may be more efficient and therefore undertaken more frequently. One exercise – for example, in the UK, updating the Companies Act 2006 – ensures that the rules for all the different types of registered company are modernised. With multiple stand-alone forms, a number of separate updating exercises must be conducted, and there is a risk that some forms will be addressed less frequently, and their rules may become outdated in consequence.<sup>57</sup>

To conclude this discussion of “architecture” of the legislation, it is worth contrasting the manner of introducing two new corporate forms into the UK. Although introduced by a separate statute, the CIC, which we shall address further in Chapter 5, was created as a sub-species of registered company. It therefore shares many of the familiar rules which other registered companies are subject to under the Companies Act 2006. And it should therefore enjoy the four benefits of this sort of legislative structure outlined above. The CIO, by contrast, was introduced as a separate, stand-alone legal form. Although some of its rules are borrowed from the law of registered companies, it remains a separate form that stands apart from the family of registered companies.<sup>58</sup>

### **3.3 What do social entrepreneurs need from their legal form?**

#### **3.3.1 Social Enterprises: similarities to, and differences from, for-profits**

In Chapter 2 we started with the consideration of the nature of social enterprise. Recall that I characterise the social enterprise as a not-for-profit venture lying

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<sup>56</sup> But for some doubts about how readily legislators can engage in such updating, see David Kershaw, *Company Law in Context: Text and Materials* (2<sup>nd</sup> edn, OUP 2012) 313-14.

<sup>57</sup> One might argue that this has occurred in the UK in respect of the stand-alone Industrial and Provident Society governed by Industrial and Provident Societies Act 1965.

<sup>58</sup> The legislation creating the CIO as ‘a new legal form designed specifically for charities’ was introduced at roughly the same time as that creating the CIC. Moreover, the policy objectives for the creation of the two legal forms were also similar – i.e. the benefits of incorporation and the inappropriateness of the current corporate forms. For the history, policy objectives, and characteristics of the CIO, see Stuart R Cross, ‘New legal forms for charities in the United Kingdom’ (2008) 7 *Journal of Business Law* 662.

somewhere between for-profit firms and non-profit organisations. It has many things in common with other for-profit businesses. Like them, it is privately owned, and pursues revenue-generating activities. To some degree, it seeks to make a profit. In this respect, the needs of social enterprise generally resemble those of other for-profit business enterprises. Accordingly, much of what we already know about the needs of for-profit businesses – and thus what such businesses might need from a legal form – can be applied to the social enterprise.

However, social enterprises are also distinguishable from for-profit businesses in ways we have already noted in Chapter 2. Being not-for-profit ventures, social enterprises are notable for their triple bottom-line mission: they simultaneously pursue financial, social, and environmental goals. For such a mission social enterprises require what I shall call a *corporate-plus* legal vehicle, in two important respects.

First, social enterprises require a corporate-type legal form to satisfy their revenue-generating needs; and, at the same time, such a legal vehicle must incorporate mechanisms to limit profit extraction.

Second, we have seen that the tradition of democratic accountability, which remains powerful in the third sector, is particularly relevant to social enterprise. Thus, social enterprise requires a legal form that also meets this democratic need, which in practice requires it to be accountable to stakeholders other than those normally associated with a traditional company. A legal form for social enterprise should thus be embedded with rules that facilitate participation by such constituents.

To take points further, we can begin by considering three needs held by social enterprises in common with for-profits, namely: *legal personality*, *protection against risk* and the *organisation's need to raise finance*.

### **3.3.2 An organisation with its own legal personality**

For several reasons, social enterprises may benefit from a legal vehicle that provides them with “legal personality”. First, as Armour *et al* note, legal personality

facilitates a firm's functioning as a "nexus for contracts".<sup>59</sup> It is, in this respect, enabled by corporate law to serve as a single contracting party distinct from the various individuals who own or manage the firm, and, as such, it enhances the ability of these individuals to jointly run the business.<sup>60</sup>

Second, it simplifies the ownership of assets. Just as all contracts can be concluded by the single corporate entity, so too all assets can be held by that same entity, rather than in the hands of some, possibly fluctuating group of individuals on behalf of the enterprise. This can be particularly significant if that group of individuals does, indeed, fluctuate frequently.

Third, it enables the entity to sue, and be sued, in the name of the company, rather than in the name of individual owners. The ability to be sued more easily may seem a rather questionable "advantage". However, one prominent reason for the introduction of the registered company into British law in 1844, was precisely to overcome the problems being encountered in suing "joint stock companies" which lacked legal personality.<sup>61</sup>

Fourth, the separate personality of the company may also give a sense of stability and prestige to the enterprise. This was one of the conclusions reached by Freedman in her study of small businesses.<sup>62</sup> Freedman found that many small companies did not, in fact, confer limited liability upon their owners, because of the proliferation of personal guarantees that lenders often demanded<sup>63</sup> (we consider financing questions in the next section below). Nevertheless, entrepreneurs still opted for the

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<sup>59</sup> Armour, Hansmann and Kraakman (n 11) 6.

<sup>60</sup> *ibid.*

<sup>61</sup> Ross Grantham and Charles Rickett, 'The Bootmaker's Legacy to Company Law Doctrine', in Ross Grantham and Charles Rickett (eds), *Corporate Personality in the 20<sup>th</sup> Century* (Hart Publishing 1998) 1-10. The authors emphasise that overcoming practical problems such as suing or being sued were greater motivations for the introduction of the registered company than was the creation of limited liability, which appears to have been something of an "afterthought" to Parliament. Note that the law has also now introduced separate measures to simplify suits by or against partnerships.

<sup>62</sup> Freedman (n 29) 563-64.

<sup>63</sup> According to the survey which formed the basis for this study, while predominantly concerned to retain personal control over their business, most unincorporated firms must have been aware that even incorporated companies were often required to provide personal guarantees and mortgages for bank borrowing. So the company owners were in fact providing financial backing, though indirectly. *ibid* 561-63.

corporate form, and often did so because it was felt that the public accorded a higher status to incorporated businesses.

Fifth, the company does not come to an end simply because those connected with it – its founding shareholders, or its directors – come and go. By contrast, a partnership, for example, is deemed to dissolve on the death or the retirement of one of the partners (assuming it is a partnership at will), or on the expiry of any fixed term.<sup>64</sup> The importance of longevity is clearly reflected in Freedman's survey.<sup>65</sup> The survey found that 28 per cent of the unincorporated firms believed that being unable to survive the owners was the second most significant disadvantage after the lack of limited liability.<sup>66</sup> Even though the survey did not cover social enterprises, we can presume for the reason given above that this is one of the specific needs which are particularly pertinent to this type of business.

Indeed, taking the last two advantages (status and longevity) together, we might note a feature of the corporate form which, I would argue, is *especially* important for social enterprises, but which the existing literature has failed to emphasise sufficiently. Both these advantages stress the “separateness” and the autonomy of the corporate entity. It has a life of its own, and the public arguably recognise that it has a stature separate from, and more than, its individual creators. Social enterprises, like other businesses, may at some point face the problem of how to survive their founders. But, in the absence of a separate corporate personality, a social enterprise might be even more closely associated with the personality of its founding social entrepreneur(s) than is a for-profit business. It is often through the *personal* “passion” and devotion of these people that many social enterprises come into being. The founders will be responsible not only for the “enterprise” of the venture but also its specifically *social aspect*. As we have seen, it is important that the public trust this social commitment and ability to survive any change in the

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<sup>64</sup> It is possible for well drafted partnership deeds to avoid these consequences, and the inconveniences to which they give rise, but drafting such a deed is itself high in transaction costs. This demonstrates the cost-saving advantage of the corporate form, which automatically avoids such problems “by default”.

<sup>65</sup> Owing to lack of empirical research on the matter, even though the survey was conducted quite a while ago, the findings still seem to be relevant even at the present time. The findings of the CIC surveys also support Freedman's survey well. The results of her survey can be found in Freedman (n 29) 560-66.

<sup>66</sup> *ibid* 561.

ownership of the organisation. Giving the organisation its own autonomous existence can, I would argue, provide some reassurance that the organisation is separate from, and in some sense bigger than, its current owners.

### **3.3.3 Protection against risk**

Any venture typically involves risk. The question arises who is to bear the risk of losses that may arise. In the absence of any special provision, the usual rule would be that the owners of the enterprise would face liability for contracts entered into by them (or by their agents) in pursuit of the venture. Likewise, they would be vicariously liable for torts incurred by their employees. If the sum total of these contractual and tortious liabilities exceeded the value of the firm's assets, they would remain personally liable for the difference. This is the legal position that faces, say, the sole trader, or the partner of a general partnership. In such a legal structure there is no difference between the owner-operator of the business and the business itself. This is a situation of unlimited liability.

Of course, the owners might divert some of the risk to a third party by insuring. However, it is unfeasible for a business to insure, at a realistic premium, against its costs simply exceeding its revenues. Alternatively, owners could avoid risky ventures in the first place. However, this is somewhat undesirable for any economy, since it would deter entrepreneurial activities, precisely what our choice of a well-designed legal form is trying to encourage.

A further possible strategy, in the face of unlimited liability, would be for those who would otherwise be liable to monitor intensively the way the business is being run, to ensure that the risks of failure are substantially reduced. However, this "monitoring strategy" would throw up a lot of further problems in turn. It would again lead to overly cautious management, and also impose substantial costs on the owners-investors, forced to monitor how riskily the business is being operated. This is only feasible if the owners own a substantial part of the enterprise and thereby stop the latter from being "widely owned" by a large number of small investors. This possibility is clearly indicated by Easterbrook and Fischel as follows:

If investors could be required to supply unlimited amounts of additional capital, wealthy people would be reluctant to make small investments. Every share of stock would place all of their personal assets at risk. To guard against this risk, the investor would reduce the number of different forms he holds and monitors each more closely.<sup>67</sup>

A fourth strategy for owners, facing unlimited liability, would be to try to include, in every contract the enterprise enters into, a term limiting the owners' liability (for example, limiting it to the assets of the enterprise). Yet this would raise transaction costs. A legal form such as the registered company, which operates to give limited liability to the owners of the company, might be said to be operating as a "default rule" that in every contract entered into by the company, the other party's claims shall be limited to the company's assets. As Easterbrook and Fischel observe, 'If limited liability were not provided by law, firms would attempt to create it by contract. The legal rule enables firms to obtain the benefits of limited liability at lower cost'.<sup>68</sup> Similarly, Armour *et al* note, 'The corporate form effectively imposes a default term in contracts between a firm and its creditors whereby the creditors are limited to making claims against assets that are held in the name of ('owned by') firm itself, and have no claim against assets that the firm's shareholders hold in their own names'.<sup>69</sup>

Thus, "limited liability" can be said to be the second feature of a legal form that is attractive for traditional businesses and social enterprises alike. Such a rule would still be a "default rule", in that it would remain open to those dealing with a social enterprise, in any particular case, to insist on the owners being liable, up to the full extent of their assets, for the debts of the enterprise. But in the absence of such a "personal guarantee", the default rule of limited liability would protect investors from the types of liability to which they would otherwise be exposed. They could then feel secure that their personal assets would not be at risk and would be encouraged to invest their money in an enterprise. Even the less wealthy would be encouraged by limited liability to start a business or to make investments.<sup>70</sup>

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<sup>67</sup> Frank H Easterbrook and Daniel R Fischel, 'Limited Liability and the Corporation' (1985) 59 Chicago Law Review 89, 90.

<sup>68</sup> *ibid* 93.

<sup>69</sup> Armour, Hansmann and Kraakman (n 11) 9.

<sup>70</sup> Kershaw (n 56) 20-28.



It is worth expanding on the benefits of limited liability a little. The limited company has been described as ‘the greatest single discovery of modern times...Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it’.<sup>71</sup> It especially facilitates “sleeping investors”, who do not need to expend time and money monitoring those who run the organisation. It encourages diversification of investment (there is no greater risk of personal liability owning shares in 10 companies than owing shares in one company). And with diversification comes the growth of liquid share markets and the benefits they bring.<sup>72</sup>

Moreover, as Armour *et al* make clear, the mechanism by which limited liability is created, namely through endowing the company with its own separate personality (and limited liability) also works to the *benefit of the creditors* in some cases. In providing for a separate legal personality, the law actually creates what they refer to as a “separate patrimony”, whose function is also to provide “entity shielding” – that is, shielding the assets of the entity – the corporation – from the creditors of the entity’s owners.<sup>73</sup>

Moreover, again according to Armour *et al*, ‘...by shifting downside business risk from shareholders to creditors, limited liability enlists creditors as monitors of the firm’s managers, a task which they may be in a better position to perform than are the shareholders in a firm in which share ownership is widely dispersed’.<sup>74</sup> Other writers make similar points. Cheffins, for example, argues that ‘In important ways limited liability helps to distribute risk away from poor risk bearers in favour of those better positioned to deal with the consequences...creditors can take precautionary measures when negotiating debt contracts to deal with the burden of limited liability’.<sup>75</sup> Likewise, Posner also maintains that creditors might be

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<sup>71</sup> Attributed to Nicholas Murray Butler, past President of Columbia University, in Brian Broughman, ‘Entrepreneur Wealth and the Value of Limited Liability’ (2011) 2 <<http://moritzlaw.osu.edu/events/mslsc/broughman.pdf>> accessed 4 August 2013

<sup>72</sup> Easterbrook and Fischel, ‘Limited Liability and the Corporation’ (n 67) 92.

<sup>73</sup> Armour, Hansmaan and Kraakman (n 11) 6.

<sup>74</sup> *ibid* 11.

<sup>75</sup> Kershaw (n 56) 22, citing Brian R Cheffins, *Company Law: Theory, Structure and Operation* (OUP 1997) 502.

“superior” risk bearers because they may be in a better informed position and less risk averse than shareholders.<sup>76</sup>

So far we have explained the problems of unlimited liability, and the benefits of limited liability. Two final points should be considered to complete our analysis.

First, none of the above should be taken as meaning that a legal form that gives limited liability should not also impose conditions for, and exceptions to, that principle. Some of these may come through the law relating to that particular legal form. So, for example, UK company law provides for duties on directors to protect the interests of creditors in certain situations.<sup>77</sup> It imposes a range of “capital maintenance” rules designed to ensure that share capital which the company claims to have raised has indeed been acquired, and is not improperly returned to shareholders.<sup>78</sup> Other protections may come through insolvency law, with rules designed to swell the assets available for distribution to creditors.<sup>79</sup> Moreover, there will have to be substantial disclosure requirements on any legal form which provides for limited liability. Such requirements enable those dealing with that entity to discover that limited liability will apply,<sup>80</sup> and to find out enough about the company’s financial circumstances to assess the riskiness of dealing with this entity.<sup>81</sup> We shall not consider these rules in detail in this thesis, other than to suggest that there seems no obvious reason why such protective rules as already exist in this case of the registered for profit company would not be equally appropriate in a legal form that gave limited liability for a social enterprise.

The second, and arguably more fundamental, point is to ask whether it is indeed the case that social enterprises do require a legal form that delivers limited liability.

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<sup>76</sup> Richard A Posner, ‘The Rights of Creditors of Affiliated Corporations’ (1975-1976) 43 *University of Chicago Law Review* 499, 501-502. However, Easterbrook and Fischel find Posner’s argument implausible and argue that creditors are in fact more risk averse than shareholders. Easterbrook and Fischel, ‘Limited Liability and the Corporation’ (n 67) 91.

<sup>77</sup> See for example, Companies Act 2006, s 172 (3).

<sup>78</sup> See for example, Companies Act 2006, pts 17, 18 and 23.

<sup>79</sup> See for example, Insolvency Act 1986, ss 213-214.

<sup>80</sup> Hence the requirement, under UK company law, to include “Ltd” or “Plc” as part of a limited company’s name.

<sup>81</sup> See the accounting requirements applicable to companies in Companies Act 2006, pt 15. Admittedly, there is some scepticism as to the effectiveness, in terms of creditor protection, of such disclosure requirements.

Whilst we have noted the general benefits of limited liability in managing the risks faced by an enterprise's owners, we have also noted that any legal form that provides for limited liability is likely to include some potentially costly conditions. Can we be sure that, specifically for social enterprises, the benefits of limited liability to owners will outweigh these costs?

Two observations might be made. First, the desirability of limited liability does not appear to be undermined by the social objectives of a social enterprise. Indeed, if anything, the argument seems to go the other way. The desirability of limited liability is arguably even *greater* in the case of a social enterprise compared to a for-profit. That is because the not-for-profit orientation of social enterprises subjects them to limits on the distribution of profits. In the case of a for-profit, the entrepreneur stands to capture all the surplus and can weigh that prospective gain against the risks of potential liability. For a social enterprise, limits on the extraction of profits will severely constrain the benefits earned. With the prospect of gains so reduced, the protection against risk seems to be particularly essential. Otherwise, *how could social investors and financial backers be expected to invest in a venture that offers neither attractive profits nor protection for their personal assets?* Therefore, even though many existing legal vehicles are useful for social enterprises, a corporate form with limited liability appears to be especially attractive.

However, secondly, the desirability of limited liability depends on the perceived risk of losses occurring. There may be some social enterprises that will have operations that generate relatively low risks of insolvency. If the enterprise has relatively low running costs, mainly relying on the labour of its founding social entrepreneur, the "outputs" may be modest. If the enterprise primarily sells services which are only produced when a particular client demands them, there may well be less risk than where an untested product is being produced, in advance, at great cost, without any guarantee that the product will be bought by anyone. In some cases, the only real risk may be where services are provided negligently, but against such a risk something approaching full indemnity insurance may be available. Where risks are very low, the benefits of limited liability may be marginal, and may not outweigh the substantial regulatory costs that must accompany a limited liability

form. Thus, for example, for a professional firm the personal liability protection provided by a corporate legal form might be outweighed by other considerations, such as the need to protect confidential information.

However, the reality is that ‘today limited liability has become a nearly universal feature of the corporate form,’<sup>82</sup> and the corporate form is very widely chosen. Freedman’s survey also found that whilst limited liability is not absolute, and does not always suit every type of organisational form and every need, ‘lack of limited liability is the main perceived disadvantage of non-incorporation’.<sup>83</sup> Moreover, recall that limited liability, if part of the legal form for social enterprise, will operate as a default rule (sub-section 3.2.3). The general principle when deciding which defaults to include within a form is guided by transaction cost saving considerations. And these considerations generally imply that a rule should be chosen which most (but not necessarily all) enterprises would want. Provided that a majority of social enterprises would desire limited liability, it makes sense to provide for that. That a minority of social enterprises, especially those providing services to others, with modest outputs and good insurance cover, may see limited liability as an unnecessary luxury, does not challenge this conclusion.

### **3.3.4 The social enterprise’s need for, and sources of, finance**

Starting a business enterprise, especially a small one like most social enterprises, requires an initial funding from those who are creating it. Ordinarily, the start-up capital consists of cash, property, or services – or the personal guarantee to provide any or all of these in the future.<sup>84</sup> The initial start-up capital often needs to be supplemented by “insider loans” (e.g. from family members). Nonetheless, there are limits to such initial and “internal” sources of funding. Very often, personal capital and insider loans are not enough, and also inside lenders are usually reluctant to lend large amounts of money without some personal guarantees.<sup>85</sup> Hence, the

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<sup>82</sup> Armour, Hansmann and Kraakman (n 11) 9.

<sup>83</sup> Freedman (n 29) 563. From the survey, 46 per cent of the unincorporated firms agreed that lack of limited liability was a disadvantage while 66 per cent of the LLC respondents agreed that they incorporated in order to obtain limited liability.

<sup>84</sup> Fred S Steingold, *Legal Guide for Starting & Running a Small Business*, (7<sup>th</sup> edn, Nolo 2003).

<sup>85</sup> Jim Brown, ‘Equity Finance for Social Enterprises’ (2006) 2(1) Social Enterprise Journal 73.

entrepreneur needs to seek outside funding. This is also likely in a social enterprise, as it develops in size. As a not-for-profit venture (as distinct from a charity depending mainly on grants and donations), a social enterprise cannot avoid the need to raise finance.<sup>86</sup>

There is no question that social enterprises actually rely on several funding sources. The point here is that social entrepreneurs should be encouraged to rely more on “market resources” rather than grants and donations in order to be financially viable for long-term growth. In the UK social enterprises are regarded “first and foremost as businesses”;<sup>87</sup> thus, in its effort to encourage the growth of the social enterprise sector, the British government has been trying to stop grant dependency of the sector and overcome what it describes as the sector’s ‘cultural aversion to borrowing’.<sup>88</sup>

Generally, two sources of external financing are available, namely, equity capital provided by new additional owners of the enterprise, and loan capital (or debt finance). The legal form’s rules about whether the organisation can borrow, create security, pay interests, sell shares to members, and, if so, pay dividends back to members are crucial here, for they determine how easily it can raise equity and debt finance. I shall consider what rules would facilitate a social enterprise to raise each type of finance in turn.

#### 3.3.4.1 Equity (share) capital

The corporate form, especially if the corporation has limited liability, provides a number of key advantages to raising “equity” capital from investors who become part owners of the enterprise. The first arises from the owner’s *promise of limited liability, which tempts outside investors*. We have already seen how limited liability works to give protection against risk to personal assets and how this has the

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<sup>86</sup> As explained in Chapter 2, section 2.2.2, social enterprise, as a “new entrepreneurship”, is expected to depend significantly on earned income and to mobilise different kinds of market as well as non-market resources to financially sustain itself. On this latter point, see Jacques Defourny and Marthe Nyssens, ‘Social Enterprise in Europe: At the Crossroads of Market, Public Policies and Third Sector’ (2010) 29(3) *Policy and Society* 231.

<sup>87</sup> *ibid* 238.

<sup>88</sup> Brown (n 85) 73.

important effect of encouraging outside investors to invest in a business enterprise which offers such protection

The second advantage follows from the first one: *with no threat to their other property, outside investors have much less need to monitor the way the business is being run*. The third advantage is related to *how easy it is to recover one's investment*. One important characteristic of the corporate form is its transferable shares.<sup>89</sup> Transferability amounts to the investors' shares being tradable. This means that one's investment is always recoverable (though probably not at the same prices for which the shares have been paid) – this is still not to mention the recoverability in the form of the return on investment.

Thus, it would seem that most social enterprises, like for-profit enterprises, would generally welcome a legal form that provides limited liability and transferable shares in order to facilitate capital raising. However, for social enterprises this is only one half of the story. The other half concerns the *need to impose limits on social enterprise's ability to reward investors* (whether the original social entrepreneur, or outsider investors) by distributing profits to them. Even in a for-profit, there are some limits on the company's ability to make payments to investors. This restriction is to protect creditors, and typically requires that payments to shareholders be made out of "distributable profits". For social enterprises, more extensive limits are appropriate. Why is this so? This issue will be more fully dealt with in Chapter 4 (sub-section 4.3.2.1) and Chapter 5, where we consider how this mechanism functions as a feature of the CIC (sub-section 5.5.2.1).

To summarise, then, the need to raise finance suggests that social enterprises will want a corporate legal form, with limited liability, but one which imposes a limit upon the amount of profit that can be returned to investors.

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<sup>89</sup> Armour, Hansmann and Kraakman (n 11) 11.

### 3.3.4.2 Loan capital

The corporate legal form also has a number of advantages in terms of raising loan capital. At first sight, this might seem implausible. After all, a creditor (say a bank) contemplating lending to a company (rather than, say, a sole trader) should appreciate that the loan will be recoverable only from the company itself. The creditor will be unable to seize the personal assets of the company's owners. A sole trader will be liable to the full extent of his or her assets.

However, we have already noted the credibility that normally comes with a body corporate, with Freedman's survey noting that 'The most often mentioned reason for incorporation after obtaining limited liability was prestige and credibility (50 per cent)...'<sup>90</sup> We might doubt whether sophisticated financial institutions are really quite so impressed by a company's supposed status when deciding whether to lend to it, but there is a second factor that certainly does establish why companies can find it easier to borrow. They can provide more security to the lender, because they can create floating charges over those assets which are not amenable to being made subject to a fixed charge.<sup>91</sup>

## 3.4 Conclusion

This chapter has begun the task of devising a blueprint of a legal form for social enterprises. It began by explaining the importance of legal forms, and offered some examples of existing forms in the UK. It then noted some of criteria that govern the design of a good form, which should contain a *mix* of default rules and mandatory rules. Its defaults should usually, but not always, offer what best meets the needs of *most* organisations. The rules should also well fit in with the architecture of legislation governing other similar legal forms. In addressing what will best serve most social enterprises, we suggested three needs that the legal form should try to meet. First, it should confer legal personality. Second, it should provide limited liability. Third, it should facilitate the raising of capital.

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<sup>90</sup> Freedman (n 29) 561.

<sup>91</sup> Unincorporated bodies cannot create floating charges, because of their inability to register the charge.

All the elements echo features of for-profits. However, I also argued that a legal form for social enterprises should have a *corporate plus* structure. Thus, it requires rules to limit the return of profit to ensure that it adheres to its social purpose. Additionally, it requires rules that will ensure their democratic and social accountability. In part, this latter requirement encompasses mechanisms to ensure the control of agency costs, an area of governance that again overlaps with for-profits. But it entails much more than that. To these issues, the next chapter now turns.



## **Chapter 4**

# **Designing a Legal Form for Social Enterprise: Regulatory/Governance Rules in a Legal Form for Social Enterprises**

### **4.1 Introduction**

We now turn to what we earlier called the “regulatory” (as opposed to “facilitative”) rules constituting a good legal form for social enterprises. The main focus is on two regulatory issues that need to be addressed. The first concerns the problem of *agency costs*. The second concerns the issue of *accountability to stakeholders*. Once again, the aim is to relate the discussion of the peculiar nature of social enterprises, settled in Chapter 2, to the regulatory content of a good legal form for social enterprises.

The thrust of the argument in this chapter will run as follows. Although the two regulatory issues mentioned above are both important in designing a good governance regime for social enterprises, only the second of these – accountability to stakeholders – deserves prolonged analysis in this thesis.

Why? The agency cost problem, identified in section 4.2, focuses primarily upon the difficulties in ensuring that those managing the social enterprise – its “agents” – serve the interests of all its owners, rather than pursuing their own self-interest, or only the interests of the majority (but not the minority) owners. The extent of this problem varies according to the number of owners the organisation has, whether there are owners who do not participate in running the organisation (“sleeping investors”) and whether there is a split between minority and majority owners. Typically, social enterprises tend to be relatively small organisations with few sleeping investors; hence, as a practical matter, agency problems associated with protecting owners are likely to be less intense in most social enterprises than in other larger companies where there is a sharper separation of ownership and control.

However, agency costs still exist and cannot be completely ignored in the social enterprise. And a good legal form for social enterprise must ensure that appropriate provisions are in place to control such costs. But these provisions will largely replicate those that are seen in a for-profit. I shall say more, briefly, below about the sort of regulatory strategies that may be appropriate to control such costs, but no prolonged discussion of them is required, because such strategies are well-covered in existing accounts of company law and corporate governance regimes, and there is little that is peculiar about the control of agency costs in the context of the social enterprise to warrant any expanded discussion of them here.

## **4.2 Controlling agency costs**

It has come to be widely accepted that one of the central tasks of the governance regime for any organisation – and thus something that any legal form for an organisation must also address – is the reduction of “agency costs”. Agency costs are seen as inherent in any “agency relationships”; they are not something that only arises within organisations. This section presents a brief review of this concept and tries to relate it to social enterprise.

### **4.2.1 Agency costs and social enterprise**

An agency relationship is defined by Jensen and Meckling as ‘a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent’.<sup>1</sup> Similarly, according to Armour *et al*, ‘...an “agency problem”—in the most general sense of the term—arises whenever the welfare of one party, termed the “principal”, depends upon actions taken by another party, termed the “agent”. The problem lies in motivating the agent to act in the principal’s interest rather than simply in the agent’s own interest’.<sup>2</sup> It is such a

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<sup>1</sup> Michael C Jensen and William H Meckling, ‘Theory of Firm: Managerial Behavior, Agency Costs and Ownership Structure’ (1976) 3 *Journal of Financial Economics* 305, 308.

<sup>2</sup> John Armour, Henry Hansmann, and Reinier Kraakman, ‘Agency Problems and Legal Strategies’, in Reinier Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2<sup>nd</sup> edn, OUP 2009) 35.

problem, which is inherent in all contractual relationships, that gives rise to “agency costs”:

The core of the difficulty is that, because the agent commonly has better information than does the principal about the relevant facts, the principal cannot easily assure himself that the agent’s performance is precisely what was promised. As a consequence, the agent has an incentive to act opportunistically, skimping on the quality of his performance, or even diverting to himself some of what was promised to the principal.<sup>3</sup>

Armour *et al* have identified three relationships, within the company, where agency problems may arise. The first arises between *all* the company’s owners and its hired managers. The second is between, on the one hand, the owners who possess the majority or controlling interest in the company and, on the other hand, the minority or the non-controlling owners. The third is the conflict between the firm itself – especially in so far as this involves its owners – and the other parties with whom the firm contracts, including creditors, employees, and customers.<sup>4</sup> Armour *et al* include this within their agency-cost analysis framework, but I shall delay discussion of this issue until the section on “stakeholding”, in section 4.3. Relevant to social enterprises is the difficulty to assure that the firm, as the agent, does not behave opportunistically towards various other principals (or “stakeholders”) – for example, by expropriating creditors, exploiting employees, misleading customers, or exploiting or neglecting the welfare of the community.

Before we come to a definition of agency costs themselves, let us see how the principal could limit the divergences from his or her interest. According to Jensen and Meckling,

The *principal* can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring monitoring costs designed to limit the aberrant activities of the agent. In addition in some situations it will pay the *agent* to expend resources (bonding costs) to guarantee that he will not take certain actions which would harm the principal or to ensure that the principal will be compensated if he does take such actions.<sup>5</sup>

In view of the measures and efforts taken by the principal to limit the problem arising from the agency relationship, we can define the agency costs as ‘the sum of:

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<sup>3</sup> *ibid.*

<sup>4</sup> *ibid* 36-37.

<sup>5</sup> Jensen and Meckling (n 1) 308.

(1) the monitoring expenditures by the principal, (2) the bonding expenditures by the agent, [and] (3) the residual loss'.<sup>6</sup> Monitoring and bonding costs are those necessary to enforce the contract defining the agency relationship: expending resources on enforcement pays only to the point where the reduction in the losses resulting from aberrant activities equals the increase in the enforcement costs. It is nevertheless the residual loss,<sup>7</sup> in Williamson's view, that is '...the key feature, since the other two are incurred only in the degree to which they yield cost-effective reductions in the residual loss.'<sup>8</sup> It is thus the key cost that the principal would seek to reduce by incurring monitoring costs and making the agent incur the bonding cost.

I shall say a little more, shortly, about the sorts of strategies that can be employed to control agency costs. Before doing so, however, it is worth saying something about the issue of the "separation of ownership and control".<sup>9</sup> As we have defined agency costs, they arise because the company is being run by agents who are different from the principal. It is the separation of ownership from management of the company that gives rise to an agency relationship, not the separation of ownership and control. However, the severity (but not existence) of the agency cost problem will depend upon whether there is a separation between ownership and control.

The separation of ownership and control typically arises where there are many individual shareholders, each of whom holds a relatively small proportion of the company's shares. This "dispersion" of the company's ownership usually means that each individual shareholder feels relatively powerless in intervening to ensure

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<sup>6</sup> *ibid.*

<sup>7</sup> The residual loss actually affects the interest of shareholders as the "residual claimants" of the company. According to Armour *et al.*, 'Shareholders are a corporation's "residual claimants" in the sense that they are entitled to appropriate all (and only) the net assets and earnings of the corporation after all contractual claimants—such as employees, suppliers, and customers—have been paid in full'. John Armour, Henry Hansmann and Reinier Kraakman, 'What is Corporate Law?', in Reinier Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2<sup>nd</sup> edn, OUP 2009) 28.

<sup>8</sup> Oliver E Williamson, 'Corporate Finance and Corporate Governance' (1988) 43(3) *The Journal of Finance* 567, 572.

<sup>9</sup> See generally Adolf A Berle and Gardiner C Means, *The Modern Corporation and Private Property* (Transaction Publishers 1932); Eugene F Fama and Michael C Jensen, 'Separation of Ownership and Control' (1983) 26(2) *The Journal of Law & Economics* 301.

that those managing the company – its agents – behave well and serve shareholder interests. Each shareholder normally doubts that they can make much difference to ensuring that the company is well run. That is, they do not think they would be able to intervene and make a difference. Moreover, they would bear all the costs of their own intervention to secure only a small proportion of the benefits. All other owners would also share in the fruits of any one owner's action to improve the company's management, even though they had not taken any part in the intervention. This is, in other words, a classic situation of "collective action",<sup>10</sup> in which it becomes rational for each shareholder to sit back, do nothing and hope they can free ride on the efforts of others. But the end result is that all shareholders reason in this way, ensuring little effective shareholder oversight. As a result, shareholders not only do not manage their company, but nor do they *control* those who do manage it on their behalf.

Clearly, the extent of this separation of ownership and control depends upon the pattern of share ownership in the company. Dispersed ownership, amongst many small shareholders, gives rise to the greatest separation of ownership and control.

How does all this relate to social enterprises? Typically, social enterprises will be relatively small companies, owned by a single person, or a small number of shareholders. With relatively concentrated share ownership, it is less likely that shareholders will lose control of the company. It may well be that all the owners of the enterprise will also be involved in managing it, reducing agency costs substantially, and giving those owners effective control over the organisation. However, while problems of separation of ownership and control, and hence also of agency costs, are likely reduced in many social enterprises, they will not be wholly avoided. The potential for agency cost problems is greater in the case of a social enterprise having multiple owners. This is particularly the case if some of those owners are not involved in the management of the enterprise.

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<sup>10</sup> For the issue of collective action problem, see Marco Becht, Patrick Bolton and Alisa Röell, 'Corporate Governance and Control' (2005) ECGI Working Paper 02/2002 <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=343461](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=343461)> accessed 5 July 2014

#### 4.2.2 Strategies for reducing agency costs

As noted already, there is no need in this thesis to discuss in detail the best strategies to control agency costs, so as to protect owners against managers, or minority owners against majority ones. The problem of protecting owners against agency costs in the social enterprise are not significantly different from the problems of protecting owners, including minority owners, in the for-profit enterprise. The problems, and the best strategies to address the problems, are well covered in existing literature, and there are no special considerations applicable to social enterprises that require detailed analysis here. It will suffice, then, simply to give a very brief sense of the main strategies that are available to reduce such costs, and to assume that a good legal form for social enterprise would pay due regard to these strategies.<sup>11</sup>

One strategy involves ensuring effective disclosure of information to owners, so that they are able to ascertain how well the social enterprise is being managed, and use whatever power of intervention they enjoy to act where problems are disclosed.<sup>12</sup>

A second strategy is to impose standards of conduct, i.e. legal duties, on the most senior tier of the organisation's management, namely its directors. Such standards will provide an indication of the sort of conduct that is, or is not, permitted by directors, with the threat of legal action if those standards are breached. Clearly, if this strategy is to work well, then certain conditions must be satisfied. First, the standards of conduct must be well defined and clear in their content, so that all parties can see clearly what is required. Second, the standards must be sufficiently demanding so that they properly capture all the harmful behaviour in which directors might engage, but they must not be excessively strict so that they preclude

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<sup>11</sup> For a detailed analysis on agency cost reduction strategies, see Armour, Hansmann and Kraakman, 'Agency Problems and Legal Strategies' (n 2) 35-53.

<sup>12</sup> There is an extensive literature on accounting and disclosure standards for companies. See for example SP Kothari and JE Short, 'The Importance of Corporate Disclosure: How Market Transparency Affects the Firm's Financial Health' (2003) Center for eBusiness @ MIT Research Brief Vol II No 2, 1-4 <[http://ebusiness.mit.edu/research/Short\\_PwC.pdf](http://ebusiness.mit.edu/research/Short_PwC.pdf)> accessed 24 March 2013; Gregory F Maassen, Frans AJ van den Bosch and Henk Volberda, 'The Importance of Disclosure in Corporate Governance Self-Regulation across Europe: A Review of the Winter Report and the EU Action Plan' (2004) 1(2) *International Journal of Disclosure and Governance* 146.

desirable managerial conduct by directors, or make the risk of being a director so great that few would take on the position. Third, there must be effective means of enforcing the standards against directors.<sup>13</sup>

A third strategy moves beyond the protection of shareholders against managers, and towards the protection of minority against majority shareholders. A well-designed vehicle for a social enterprise, like a well-designed vehicle for a for-profit, must ensure some effective protection for minority owners against oppressive majority shareholders. Again, because this is a feature that is not unique to the social enterprise, I shall not examine it in any detail here. However, we might just note that there are several ways in which minorities can be protected. For one, they can be given the right to bring proceedings on behalf of the company for a breach of directors' duties, where the majority are otherwise blocking action by the company (typically, because the majority are also the directors against whom the action would be brought). For another, the minority might be given "personal rights" to insist on certain procedures being followed in the company, and the rights to take proceedings personally to enforce those rights. Finally, minorities might be given the right to escape from the company, at a fair price, where they have legitimate complaints about the way the company is being run, or the way they are being treated within the company. In many smaller companies, where there are few shareholders, the third of these protections can be especially valuable. In such companies minorities who have fallen out with the majority will find it practically unappealing simply to remain a shareholder and take steps to protect the company's rights, or take steps to protect their own rights. In such cases, *exit* from the company – what is sometimes called a "corporate divorce" – will be the only realistic way of

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<sup>13</sup> Black argued that only the two basic fiduciary duties of directors, namely the duty of loyalty and the duty of care, are not enough. He thus proposed two additional duties, the duty of disclosure and the duty of extra care when selling the company. He also suggested the tests for whether these duties are met as well as the remedies, which include injunction for damages. Bernard S Black, 'The Principal Fiduciary Duties of Boards of Directors' (Third Asian Roundtable on Corporate Governance, Singapore, April 2001)

<[www.oecd.org/daf/ca/corporategovernanceprinciples/1872746.pdf](http://www.oecd.org/daf/ca/corporategovernanceprinciples/1872746.pdf)> accessed 31 January 2015; see also Carsten Gerner-Beuerle, Philipp Paech and Edmund P Schuster, *Study on Directors' Duties and Liability*, prepared for the European Commission DG Markt (LSE Enterprise, April 2013)

resolving disputes where the relationship between majority and minority has broken down.<sup>14</sup>

We shall now turn to focus on the area of governance where the social enterprise *is* clearly different from the for-profit, and, accordingly, where a good legal form for social enterprise would include provisions different from those found in the for-profit legal vehicle. This concerns the position of stakeholders within the social enterprise.

### **4.3 Assuring accountability to stakeholders within social enterprises**

Governance promotes accountability, legitimacy and effectiveness within social enterprise. According to Connolly and Kelly, three questions should be raised to ‘contextualise’ the consideration of accountability: namely, who the organisation is accountable to; what they are accountable for; and how that accountability is to be discharged. However, the “who”, “what” and “how” of the accountability relationship are not so obvious.’<sup>15</sup>

This section starts, in sub-section 4.3.1, with a brief discussion of two leading theories of governance, one focusing on the shareholder value and the other stressing the stakeholder interest. In my view, both theoretical models are relevant to the governance rules social entrepreneurs are looking for in a legal form for social enterprises. Together they address the concern to reduce agency costs, which have already been dealt with in section 4.2, as well as answering the question to who the social enterprise is accountable. Sub-section 4.3.2 then seeks to identify what sort of package of governance rules a legal form for social enterprises should have, which could assure accountability to stakeholders as well as democratic decision-making. The difficulties in applying these two governance models to social

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<sup>14</sup> For minority shareholder protection under English law, i.e. ways in which English Company Law responds to the possible abuse of power and influence by controlling shareholders, see David Kershaw, *Company Law in Context: Text and Materials* (2<sup>nd</sup> edn, OUP 2012) 664-705; FH O’Neal, ‘Oppression of Minority Shareholders: Protecting Minority Rights (1987) 35(1) *Cleveland State Law Review* 121.

<sup>15</sup> Ciaran Connolly and Martin Kelly, ‘Understanding Accountability in Social Enterprise Organisations: A Framework’ (2011) 7(3) *Social Enterprise Journal* 224, 227.



enterprises, with their “multiple goals”, will also be discussed.

### 4.3.1 Shareholding versus Stakeholding

It is useful to start by clarifying the difference between a shareholder value approach (also called “shareholder primacy”) and a stakeholder approach.<sup>16</sup>

#### 4.3.1.1 Conventional concepts of shareholding and stakeholding

Shareholder primacy argues that managerial decisions should be informed by the interests of shareholders. The decision maker sees the objective of each individual decision to be the satisfaction of shareholder interests. If shareholders are assumed to want to maximise their financial return from the company, then this likely means that each decision should have, as its objective, the maximisation of shareholder wealth or, perhaps, something more easily calculable, such as the maximisation of the company’s own profits (assuming the maximisation of profits will lead to a maximisation of the shareholder’s wealth).

The main argument in favour of shareholder primacy is that shareholders have the greatest stake in the company and bear residual risk, they are thus residual claimants. And in order to run the company efficiently, there should be one single objective for directors to focus on, which is the maximisation of shareholder value. If directors have to take into account other social purposes, it could give them opportunities to abuse their power. Shareholder primacy is thus believed to best address the agency problems which exist in all organisations having principal-agent relationships and at every level of management.<sup>17</sup>

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<sup>16</sup> For an overview of the shareholding versus stakeholding issue, see Steve Letza, Xiuping Sun and James Kirkbride, ‘Shareholding Versus Stakeholding: A Critical Review of Corporate Governance’ (2004) 12 (3) *Corporate Governance* 242. There are in fact other corporate governance models i.e. the stewardship and the political approaches. However, according to Letza *et al*, ‘[w]ith the conventional mode of thought, all the theoretical models neatly fall within two opposing perspectives: the shareholder perspective and the stakeholder perspective’.

<sup>17</sup> For shareholder primacy approach, see Jill E Fisch, ‘Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy’ (2006) 31 *Journal of Corporation Law* 637; Andrew Keay, ‘Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?’ (2010) 7(3) *European Company and Financial Law Review* 369; David Collison and others, *Shareholder Primacy in UK Corporate Law: An Exploration of the Rationale and Evidence* (Certified Accountants Educational Trust 2011); Governance Institute of Australia, *Shareholder Primacy: Is there a Need for Change? A Discussion Paper* (Governance Institute of Australia 2014).

In response to concerns over the effectiveness of shareholder primacy, stakeholder theory was introduced and categorised into normative, instrumental and descriptive approaches.<sup>18</sup> Stakeholder approach sees the interests of stakeholders as deserving independent weight in their own right. The argument is that '[s]takeholders have a right to be regarded as an end, and not a means to an end (i.e. they are not used to benefit the corporation in the long run, but their benefits are an end for the corporation).'<sup>19</sup> A decision on the pay rate for a group of employees, for example, would attempt to determine what wage rate would be in the interests of those employees. Having done so, that interest would then need to be *balanced against* the interests of other stakeholders, rather than merely being a factor in calculating the overall profit maximising, wage rate.

Thus, the crucial difference between the two approaches is about how individual decisions are taken. Shareholder primacy requires each decision to be taken with the goal of maximising profits, and views the impact (including, if the decision maker is sophisticated, the very long-term impact) of each potential decision as merely a factor to be taken into account in calculating what will maximise profits. Stakeholder approach abandons profit maximisation as the goal to guide at least some individual decisions. At least some individual decisions instead are to be the product of a balancing of competing interests, which enjoy weight in their own right.

In respect of for-profits, there are a variety of arguments that have been put in favour of stakeholder approach. It is useful, however, to distinguish between two different

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<sup>18</sup> Thomas Donaldson and Lee E Preston, 'The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implication' (1995) 20(1) *Academy of Management Review* 65. There is an expansive literature on stakeholder approach, see for example, R Edward Freeman, *Strategic Management: A Stakeholder Approach* (Pitman/Ballinger 1984); Roberta S Karmel, 'Implications of the Stakeholder Model' (1993) 61(4) *George Washington Law Review* 1156; Thomas M Jones, 'Instrumental Stakeholder Theory: A Synthesis of Ethics and Economics' (1995) 20(2) *Academy of Management Review* 404; Kevin Gibson, 'The Moral Basis of Stakeholder Theory' (2000) 26 *Journal of Business Ethics* 245; Andrew L Friedman and Samantha Miles, 'Developing Stakeholder Theory' (2002) 39(1) *Journal of Management Studies* 1; Andrew Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' (2010) 9(3) *Richmond Journal of Global Law and Business* 249. For opponents of the stakeholder theory, see Elaine Sternberg, 'The Defects of Stakeholder Theory' (1997) 5(1) *Corporate Governance* 3; Elena P Antonacopoulou and Jérôme Méric, 'A Critique of Stake-Holder Theory: Management Science or a Sophisticated Ideology of Control' (2005) 5(2) *Corporate Governance* 22.

<sup>19</sup> Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' (n 18) 257.

types of argument. The first type – which I shall call the “anti-shareholder” argument – does not seek to justify the approach by reference to the interest of shareholders themselves. Rather, it accepts that shareholders may be *less well off* as a result of companies adopting a stakeholder approach, but nevertheless asserts that there is some overriding reason why this might be justified. So, for example, it might be asserted that stakeholders simply have *a right* to have (at least some of) their interests given genuine weight, and whilst this may cause a loss to shareholders, shareholders are morally obliged to accept this (moral basis). Or, focusing on economic considerations (instrumental ground), it might be argued that corporate governance rules should be designed to maximise social wealth, and that a stakeholder approach will produce greater social wealth, in aggregate, although it will leave shareholders worse off.

A second type of argument for stakeholder approach – which I shall call the “shareholder-friendly” argument – seeks to justify it as improving the position of both stakeholders and, crucially, shareholders themselves too. ‘Stakeholding is the instrument through which efficiency, profitability, competition, and economic success can be promoted on the basis that if one removed cohesion among stakeholders it would not be possible for corporations to be competitive.’<sup>20</sup> Thus, shareholders themselves should favour stakeholding, because they, as well as stakeholders, will be better off under such a regime.

It is easy – but wrong – to think that the shareholder-friendly argument for stakeholding simply collapses back into shareholder primacy. After all, as we noted above, shareholder primacy does require decision makers to take account of the impact of decisions on stakeholders. If stakeholding will leave shareholders better off, then why will decision makers not take as much account of stakeholder interests under a shareholder primacy regime as they would under a stakeholder regime? But this is to ignore the crucial difference between the two regimes. Under a true stakeholder regime, decision makers no longer calculate, at the level of each individual decision, about what shareholders’ interests require. They pursue a different target. Even if the shareholder-friendly argument for stakeholding is

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<sup>20</sup> *ibid* 265.

correct, it still suggests that rational shareholders want those running the organisation to abandon shareholder value as their guide when they take individual decisions.

Why, however, might shareholders want this? Again I think that, two different types of reason can be offered. The first – and that most commonly made by stakeholder proponents – accepts that shareholders are interested in maximising their financial returns, but then seeks to argue that a company run under stakeholder principles is likely to be financially more profitable, and thus produce higher returns even for investors. One influential version of this reason is found in the literature on “team production”, which views the firm as a team to which different persons contribute, and from which they can expect returns.<sup>21</sup>

The second reason why it might be asserted that shareholders would be better off under stakeholder approach is related to the idea that shareholders themselves did not in fact want to maximise their financial returns, but wanted instead some of the interests of stakeholders to be given some genuine weight, regardless of whether that would generate greater financial returns for investors. Some investors, in other words, may be more altruistic than is usually assumed.<sup>22</sup> Now, this argument does not seem wholly implausible, even with regard to for-profit companies. After all, there has been a growth of “socially responsible” investment vehicles, which promise to select companies in which investments will be made according to ethical criteria other than return on capital. Their proliferation may provide some evidence that some investors do not themselves seek profit maximisation. But such ethical investments are only a small fraction of total investments in companies,<sup>23</sup> and so

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<sup>21</sup> Margaret Blair and Lynn Stout, ‘A Team Production Theory of Corporate Law’ (1999) 85(2) *Virginia Law Review* 247; Margaret Blair and Lynn Stout, ‘Team Production in Business Organizations: An Introduction’ (1999) 24(4) *Journal of Corporation Law* 743; Lawrence E Mitchell, ‘Trust and Team Production in Post-Capitalist Society’ (1999) 24 *Journal of Corporation Law* 869; D Gordon Smith, ‘Team Production in Venture Capital Investing’ (1999) 24 *Journal of Corporation Law* 949.

<sup>22</sup> Dennis Krebs, ‘Altruism—A Rational Approach’, in Nancy Eisenberg (ed), *The Development of Prosocial Behavior* (Academic Press 1982); Rabindra N Kanungo and Jay A Conger, ‘Promoting Altruism as a Corporate Goal’ (1993) 7(3) *Academy of Management Executive* 37; M Todd Henderson, ‘Corporate Philanthropy and the Market for Altruism’ (2009) 109 *Columbia Law Review* 571.

<sup>23</sup> Hal Brill, Jack A Brill, and Cliff Feigenbaum, *Investing with Your Values: Making Money and Making a Difference* (Bloomberg Press, 1999); Bhagwan Chowdhry and Shaun Davies, ‘So You Want to Invest to Make Impact?’ (November 2014) *Stanford Social Innovation Review*.

provide less than compelling evidence of widespread investor altruism.

#### 4.3.1.2 Shareholder vs stakeholder debate: who won? Or a move towards a new approach?

An answer to this is not as simple as whether to choose *either* shareholder primacy *or* stakeholder approach since they both have merits and weaknesses, i.e. depending on a particular point in time or different organisational objectives. However, there have been calls for and attempts to create a new approach, such as a compromise between the two, combining the strong points of each. According to Keay, ‘The problem is not so much in finding weaknesses in shareholder primacy, it is replacing the theory with something else. Stakeholder theory is the obvious answer, but it too has significant shortcomings. There is a desperate need for a new approach’.<sup>24</sup> Similarly, Letza *et al* argue that these two traditional approaches are ‘over-abstracted and over-static in modelling and theorising corporate governance...far removed from the current modern business environment where, for example, the boundary of the firm has become blurred...’<sup>25</sup>

One of the moves towards a new model is the introduction of the “enlightened shareholder value” approach,<sup>26</sup> which has been put statutorily in the UK. The main concept is that even though profit maximisation is the objective of the organisation, stakeholder interests are not ignored. As managers take each decision, seeking to maximise profits, they will inevitably have to consider how their decisions impact upon the interests of their non-shareholder stakeholders. They will have to do that because such an impact will affect how those stakeholders will respond to the organisation, and their responses will in turn affect the company’s profitability. When working out, for example, the profit maximising decision regarding how much to pay a group of employees, such calculation must take into account how different pay rates will impact on those employees, in terms of their work-output, their loyalty, and so on, because their work-output and their loyalty will in turn affect future profitability. Thus, the enlightened shareholder value is ‘believed to be

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<sup>24</sup> Keay, ‘Shareholder Primacy in Corporate Law’ (n 17) 413.

<sup>25</sup> Letza, Sun and Kirkbride, ‘Shareholding Versus Stakeholding’ (n 16) 243.

<sup>26</sup> For a detailed analysis of the enlightened shareholder value, see Virginia Harper Ho, ‘“Enlightened Shareholder Value”: Corporate Governance Beyond the Shareholder-Stakeholder Divide’ (2010) 36(1) Journal of Corporation Law 59.

an emerging third position, a compromise between shareholder value and the stakeholder model'.<sup>27</sup>

But the interests of stakeholders feature only instrumentally: they are relevant only as a means to calculate better the profit maximising decision. Decisions are not guided by the aim of satisfying the interests of stakeholders as an independent objective in its own right.<sup>28</sup> Gamble and Kelly view the enlightened shareholder value as rather a modified version of the traditional shareholder primacy than a new model as '[m]any of the interests and the ideas which have sustained shareholder value as the dominant conception of the company are still in place'.<sup>29</sup> Also, Letza *et al* see it just as part of the paradigmatic shift from the shareholder model to the stakeholder model, which 'does not necessarily represent a true dominance of stakeholder forces...'.<sup>30</sup>

Then, what should a new model look like? Letza *et al*, being quite hostile towards the traditional models, call for a new governance approach which could work in practice. Such a model should 'better explain the idiosyncratic workings of local governance, rather than try to force-fit reality into the established abstracted templates'.<sup>31</sup> Instead of establishing a new approach, they provide some characteristics of a rather ideal than practical governance model as follows. It should be "processual" reflecting the changing nature of the business environment; "balanced" reflecting the diversity of firms; "relational" recognising the corporate reality as interconnected and independent; "pluralist" recognising various players i.e. economics, politics, social norms and so on; "dynamic and flexible" not attaching itself to a *once-and-for-ever* view; and "enlightening" being ready to

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<sup>27</sup> Sarah Kiarie, 'At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road Should the United Kingdom Take?' (2006) *International Company and Commercial Law Review* 329, 339. William and Conley view the approach as "third way" which represents a shift in focus to stakeholder constituencies such as employees, suppliers, communities and the environment. Cynthia Williams and John Conley, 'An Emerging Third Way – The Erosion of the Anglo-American Shareholder Value Construct' (2005) 38(2) *Cornell International Law Journal* 493, 496.

<sup>28</sup> Collins C Ajibo, 'A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory' (2014) 2(1) *Birkbeck Law Review* 37.

<sup>29</sup> Andrew Gamble and Gavin Kelly, 'Shareholder Value and the Stakeholder Debate in the UK' (2001) 9(2) *Corporate Governance* 110, 116.

<sup>30</sup> Letza, Sun and Kirkbride, 'Shareholding Versus Stakeholding' (n 16) 253.

<sup>31</sup> *ibid* 256.

change ways of thinking about governance.<sup>32</sup> Even though this model is aimed to be workable and explicable in practice, rather it does not really distance itself from the abstract themes of the traditional models.

There is actually an attempt to create a new governance model, seeking its own justification different from those of the traditional concepts. It is called the “Entity Maximisation and Sustainability” model (EMS), which was introduced by legal theorist Andrew Keay.<sup>33</sup> The model has two main elements: first, a commitment to maximising the entity; and second, a sustainability of the entity to ensure its survival. Its core justification is

...[the] focus on the company as an entity or enterprise, that is the company is an institution in its own right. The fact of the matter is that the entity exists separately from those who invest in it, and continues to exist notwithstanding changes in the identity of the investors.<sup>34</sup>

The EMS is different from shareholder primacy in that it maximises the company’s interests, rather than shareholders’. Such maximisation does not solely focus on financial return, but also ‘research and development, the training of employees, and to make investments in the local and broader community because it intends to be located there for a long haul’.<sup>35</sup> Even though the EMS values stakeholders just like the stakeholder approach does, balancing differing interests to keep everyone happy is not its main goal (though preferable if possible). For the EMS, directors can make decisions that might make investors (including shareholders and stakeholders) less well off if that enhances the company’s interest.<sup>36</sup> Whether this new approach will be widely accepted still depends on its effective enforcement.<sup>37</sup> For now it confirms the need for an alternative to the traditional governance approaches.

#### 4.3.1.3 Social enterprise and its governance approach

Turning now to the social enterprise, we have already seen in Chapter 2 that this is

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<sup>32</sup> *ibid* 257-58.

<sup>33</sup> Andrew Keay, ‘Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model’ (2008) 71(5) *Modern Law Review* 663.

<sup>34</sup> *ibid* 679.

<sup>35</sup> *ibid* 686.

<sup>36</sup> *ibid* 685-98.

<sup>37</sup> Andrew Keay, *The Corporate Objective: Corporations, Globalisation and the Law* (Edward Elgar 2011) Chapter 5: The Enforcement of the Entity Maximisation and Sustainability Model 231-75.

an organisation which is defined precisely in terms of its owners' desire to forego profit maximisation and to elevate the interests of other stakeholders affected by the organisation. It is rather obvious that the traditional shareholder primacy is not compatible with the nature of social enterprise in that it mainly focuses on maximising shareholders' wealth. Even the enlightened shareholder value, which seems to take consideration of stakeholders, cannot completely fulfil its needs.<sup>38</sup> The stakeholder approach, which seems to be the most compatible model, has one primary weakness, that is, it does not provide a guideline on how to balance various interests of stakeholders. The process of balancing could cause opportunism since directors end up accountable to no one in particular (or too many stakeholder groups), distracting them from the true (social) objective which could lead to mission drift. The strongest argument for a social enterprise governance is likely to be what we labelled the shareholder-friendly argument for stakeholding. It will indeed be beneficial not only to stakeholders, but even to owners themselves, and this will be so because it better reflects those owners' own preferences, in terms of compromising profits in order to fulfil the social goal of the organisation.

It may also be the case that some owners of the social enterprises believe that the social objectives of the organisation will eventually make the organisation outperform, financially, a for-profit company. Such owners, then, subscribe to the reason in favour of shareholder-friendly stakeholding – the belief that stakeholder approach will make the organisation financially more successful than if it adopted a profit maximising approach. However, this is probably a secondary consideration for most social entrepreneurs, if it features in their calculations at all.<sup>39</sup>

To sum up, the social enterprise, it must be emphasised, is by its very nature, a stakeholder entity. To be sure, it needs to be, and actually strives to become,

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<sup>38</sup> This will be clearer when we analyse the implementation of this approach in the CIC in Chapter 5.

<sup>39</sup> For an overview of social enterprise governance, see Chris Low, 'A Framework for the Governance of Social Enterprise' (2006) 33(5/6) *International Journal of Social Economics* 376; Chris Mason, James Kirkbride and David Bryde, 'From Stakeholders to Institutions: The Changing Face of Social Enterprise Governance Theory' (2007) 45(2) *Management Decision* 284; Roger Spear, Chris Cornforth and Mike Aiken, *For Love and Money: Governance and Social Enterprise Executive Summary Report* (NCVO 2007); Mirjam Schöning and others, *The Governance of Social Enterprises: Managing your Organization for Success* (Schwab Foundation for Social Entrepreneurship 2012).



financially viable, but it must in any case adopt a stakeholder approach – that is, no matter whether this approach results in greater or lesser “financial” success.

#### 4.3.1.4 Should the stakeholder elements of social enterprise be mandatory or default?

Thus, the legal form for social enterprises should reflect this, and should include provisions – “governance rules” – that reflect and implement this philosophy in order to serve the interests of stakeholders. However, should these rules be mandatory or merely default rules? The argument advanced so far might seem only to justify the stakeholder governance requirements being “default rules”. We are trying here to “help” or “facilitate” the social entrepreneurs; we are presuming that they want their social enterprise to pursue a stakeholder approach, and so we include stakeholder governance provisions as default rules to help them to achieve that. However, perhaps some social enterprises would not wish to adopt this approach, and so, in order to remain facilitative, the rules for social enterprises should permit such exceptional cases to exclude the law’s stakeholder provisions if they do not reflect the exceptional, non-stakeholder, philosophy of their particular social enterprise.

However, I shall now argue that making the stakeholder governance provisions mere defaults would be dangerous, and that accordingly the stakeholder governance regime should be made mandatory for social enterprises. There are, I shall suggest, three arguments in favour of this argument.

First, a social entrepreneur only gets the full benefit of the stakeholder provisions if the public can reliably assume that the social enterprise they are dealing with is bound to be a true social enterprise – to be a true stakeholder entity. It is only if they know that the social enterprise is “handcuffed” in this way that they will truly trust it, and favour it with their business, custom, loyalty and so on. So the social entrepreneurs benefit by handcuffing themselves in this way – they benefit by being able to secure the public’s trust more fully. But for this the rules must be mandatory – the public must believe the rules requiring stakeholder elements will undoubtedly apply and will not have been modified or excluded by the social entrepreneur. Only mandatory rules provide that guarantee or reassurance to the public.

Second, switching from benefits for the social entrepreneur to the public, we need a stakeholder regime to fulfil the expectations of those dealing with social enterprises. As noted above, the “social enterprise” label is a brand inducing expectations in those dealing with it that it is not an organisation that maximises profits and treats all others as a mere means to profit maximisation. It represents itself as an organisation that compromises profits to elevate the interests of stakeholders. Those expectations that others have about the mission of the social enterprise must be respected; otherwise the public is being conned or cheated.

But this argument surely requires mandatory rules; the public expects social enterprises to be stakeholder organisations, and the public is not going to peer into the private contractual or constitutional affairs of the social enterprise to discover if its owners have in fact chosen to exclude any legal stakeholder governance rules that were merely “defaults”. So, *whether or not mandatory rules would indeed benefit social entrepreneurs*, the public expects stakeholder norms, and to fulfil this expectation, the norms have to be followed by the social enterprise – i.e. they must be mandatory.

Third, and finally, to protect the brand – for the benefit of the genuine social entrepreneur, if the public sometimes “rewards” the social enterprise – dealing with a social enterprise in preference to dealing with a for-profit, then there is clearly a danger that some unscrupulous individuals would pretend to be a social enterprise in order to win the public’s trust and patronage, but in fact acting as a normal for-profit. This would cheat other true social enterprises and risk bringing the whole of the social enterprise sector into disrepute when it is discovered that some social enterprises are really just for-profits in disguise. This again requires a mandatory stakeholder governance framework.

#### **4.3.2 Devising efficient governance rules in a legal form for social enterprises**

We have established that social enterprise is by definition a stakeholder organisation and learned that the stakeholder approach will be beneficial to social enterprises in the long term. In achieving such benefits, I argue that mandatory rules are needed to secure stakeholder elements. The problem now is how a social enterprise could

develop an effective relationship with its stakeholders and find an efficient method of involving the latter in its operation. Moreover, since social enterprises are normally related to more than one stakeholder group – if not the whole community – they often face the task of managing multi-stakeholder involvement. My focus is thus on the systems and rules needed to achieve the stakeholder governance approach.

#### 4.3.2.1 Asset lock and non-distribution constraint

There is a lot of discussion of “asset lock”, which is one of the *social* dimensions of social enterprise,<sup>40</sup> and which Hansmann calls non-distribution constraints for not-for-profits.<sup>41</sup> The social objectives of social enterprise are clearly linked to stakeholder interests as opposed to those of the shareholders or owners. Therefore, this must be the first governance regulation that should be embedded in a legal form for social enterprise for the purpose of protecting social or public interests and reducing opportunism. Hansmann sets out a typical non-distribution constraint as covering the following principles:<sup>42</sup>

- (1) The owners could promise that no more than, for example, five percent of the income they receive from all sources will be distributed to the owners as compensation and profits.
- (2) The owners could promise that the total amounts distributed to themselves as compensation and profits will not exceed a given dollar limit.
- (3) The owners could promise that the amounts distributed to themselves will not exceed "reasonable" compensation for the services and capital they contribute to the organization.

In practice, however, a legal form with a complete lock on assets would be undesirable. As defined in Chapter 2, social enterprise has both social and commercial dimensions. We want to limit profit taking, not to wholly exclude it. A

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<sup>40</sup> This is related to the need to limit the rights of shareholders in so far as the appropriation of profits is concerned. As Defourny and Nyssens point out, social enterprise legal frameworks in various European countries try to reduce the power of shareholders by prohibiting or limiting the distribution of profits. Jacques Defourny and Marthe Nyssens, ‘The EMES Approach of Social Enterprise in a Comparative Perspective’, in Jacques Defourny, Lars Hulgård and Victor Pestoff (eds), *Social Enterprise and the Third Sector: Changing European Landscapes in a Comparative Perspective* (Routledge 2014) 48, 54-55.

<sup>41</sup> Henry Hansmann, ‘The Role of Nonprofit Enterprise’ (1980) 89(5) *The Yale Law Journal* 835, 835-45.

<sup>42</sup> *ibid* 852.

complete lock would be unattractive to investors, particularly private investors who would expect some financial return. Unlike non-profits like charities, the social enterprises are allowed to seek private investment and even encouraged to rely more on equity finance. The problem for social enterprises as not-for-profits is how to set the limits. That is, how much profit taking is appropriate, or to what extent is this considered “reasonable”? This is clearly a matter of how to strike a balance.

Actually, a non-distribution constraint, which is normally in the form of an “asset lock”, may be voluntary or mandatory. Social enterprises opting for the legal structures that are not statutorily required to have an asset lock may impose this on themselves through appropriate provisions in their constitutions. Dunn and Riley have nonetheless indicated that there are difficulties for companies in incorporating such a provision into their constitutions.<sup>43</sup> The provisions are not protected from change or removal by the members of the organisation subject to the law under which it operates. Also, a non-distribution constraint that is merely self-imposed is likely to poorly “signal” to the public and is thereby unlikely to gain the latter’s trust.<sup>44</sup> According to Dunn and Riley,

...it is crucial to not-for-profits that they are indeed able to signal clearly to the public their assets are indeed locked in, for by doing so they should be able to engender greater trust from those whose support they hope to win. Donors will likely be happier to contribute their time, labour or money to organisations that are constrained in this way. And others will probably be happier to purchase the goods or services supplied by not-for-profits, knowing that they have, compared to for-profits, less incentive to act opportunistically.<sup>45</sup>

In my view, a statutory asset lock is required in social enterprises. In practice, this will result from such an organisation opting to operate within a legal vehicle that statutorily requires an inclusion of this mechanism in its governing document.

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<sup>43</sup> A Dunn and CA Riley, ‘Supporting the Not-for-Profit Sector: The Government’s Review of Charitable and Social Enterprise’ (2004) 67 (4) *The Modern Law Review* 632, 647.

<sup>44</sup> Seanor and Meaton’s extensive literature review on trust in social enterprise shows that trust relationships between social enterprises and their community users (stakeholders) are a key factor in helping the social enterprise find its firm ground together with the two dominating public and private sectors. Pam Seanor and Julia Meaton, ‘Learning from Failure, Ambiguity and Trust in Social Enterprise’ (2008) 4(1) *Social Enterprise Journal* 24, 29-30. For an empirical evidence on the issue, see Timothy Curtis, Jan Herbst and Marta Gumkowska, ‘The Social Economy of Trust: Social Entrepreneurship Experiences in Poland’ (2010) 6(3) *Social Enterprise Journal* 194, which suggested that ‘trust precedes performance, in that the public sector partner extended a trust relationship before the organisation was able to demonstrate their track record’.

<sup>45</sup> Dunn and Riley (n 43) 647-48.

#### 4.3.2.2 Social benefit requirement

One way in which stakeholder interests might be protected is through restrictions on the activities which any social enterprise can pursue. Whereas a for-profit entity can pursue any business objectives it wishes (provided they are not illegal,<sup>46</sup> and subject to any self-imposed restrictions in the company's own constitution),<sup>47</sup> it would be possible to provide that the legal vehicle made available to social enterprises can be used only by organisations pursuing some, pre-determined, business activities, but not others. This restriction would address, then, not how the social enterprise must approach whatever line of business it chooses to pursue but, more fundamentally, what lines of business are available to the social enterprise to begin with.

Thus, the law would identify which area of business would be considered, by whatever criteria, as sufficiently "social", and would restrict the availability of the legal form to organisations pursuing those lines of business. I opt for the view that there should be such restrictions, and shall argue that the law should include such restrictions. Three compelling arguments can be made for this view.

First and foremost, as a guide on social enterprise legal forms has made clear, 'A social enterprise is not defined by its legal status but by its nature...'<sup>48</sup> In particular, it is what it does that essentially designates it as "social". Hence, restricting the activities the social enterprises can engage in would have the important effect of not only making them more or less readily identifiable but, more significantly, protecting the public from being misled or deceived by a commercial venture disguised as a social enterprise. Protecting the public in this way is very important, because the public is normally not sufficiently informed about particular social enterprises and their activities. Restrictions can at least guarantee that the activities

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<sup>46</sup> See, for example, Companies Act 2006, s 7(2), which provides that a company may not be formed for an unlawful purpose.

<sup>47</sup> See, for example, Companies Act 2006, s 31, which provides that a company is deemed to have unrestricted capacity, subject to any express limitations in its constitution.

<sup>48</sup> Bates, Wells and Braithwaite and Social Enterprise London, *Keeping It Legal: Legal forms for social enterprises* (SEL 2003) 1.

a social enterprise is pursuing are for the public benefit, even though we need an effective regulator to monitor them.

Secondly, restricting the activities of social enterprises would actually amount to protecting their “core mission”, i.e. the social benefit requirement, by elevating it to the status of law. That is, the restrictions would ensure that by opting to operate within the legal vehicle for social enterprise, they would not be able to deviate from such a mission. No “mission drift” would occur in the event of the social enterprises having a new management or new investors, who would be obligated to follow the enterprises’ pre-defined line of business.<sup>49</sup>

Thirdly, the restrictions would also benefit social entrepreneurs. As has been indicated above, with such restrictions, the social enterprises would be more or less readily recognisable. Moreover, sometimes it is difficult to make clear to the public how certain lines of business could have social benefit. The restrictions could serve to communicate with the public how they do. The social entrepreneurs can therefore focus on achieving their social aims rather than wasting their time and effort in explaining they are social enterprises. There are at least three counter-arguments to my view. None, however, are persuasive.

First, there is the idea that it is difficult to justify what types of activities should not be made available to social enterprises, since it seems that most, if not all, business activities have potential social benefit of one kind or another. However, it hardly needs emphasising that the social benefit requirement is plainly not a requirement for a business enterprise to have a *potential* social benefit. It is a requirement that the social enterprises create social benefits. A potential for this might not always be *actualised*. To be a social enterprise, a business must create social benefit, and there must be a guarantee that a drift from this “core mission” would not occur.

Secondly, it might be argued that restrictions on the activities of the social enterprises would result in the obstruction of the growth of social entrepreneurship. My view is nevertheless that this is not true. Social entrepreneurship is itself full of

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<sup>49</sup> Christopher Cornforth, ‘Understanding and Combating Mission Drift in Social Enterprises’ (2014) 10(1) Social Enterprise Journal 3.

creative potential. Extensive opportunities exist for entrepreneurial initiatives to “fill the gaps” left by the state and the market. In other words, there are extensive *unmet needs* in the community that remain to be satisfied by entrepreneurial initiatives.<sup>50</sup>

Thirdly, it might be argued that restrictions on social enterprise activities would limit the financial potential of social enterprises. This objection could be rebutted by the argument raised above. Though social enterprises must strive for financial viability, as stakeholder organisations, they are not concerned about whether they could achieve greater or lesser financial success. Moreover, empirically, we cannot definitely say that following a certain, pre-defined line of business activities would limit the financial potential of social enterprises.

Dunn and Riley raised some objections to the idea of restricting not-for-profits to public benefits, especially because they did not see “clear advantages” in doing so.<sup>51</sup> However, I believe that not only are their objections rebutted by my argument in favour of the social benefit requirement, but the practical experience of the CIC, which we will see in the next chapter, particularly its growing popularity, also seems to contradict the concerns they expressed in those objections, which I shall not elaborate here.

#### 4.3.2.3 Stakeholder participation

Two questions are posed to constitute the central theme of this sub-section. First, why should there be stakeholder participation in social enterprises? And, second, how can stakeholder participation, through different techniques, contribute to the achievement of protection of stakeholder interests? The first question is apparently the more fundamental of the two; we thus turn to it first.

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<sup>50</sup> Paul Hunter (ed), *Social Enterprise for Public Service: How Does the Third Sector Deliver?* (The Smith Institute 2009).

<sup>51</sup> Referring to the “community interest test” for the CIC as a not-for-profit entity, they see that this goes beyond holding it to its own chosen objects by limiting what purposes the social entrepreneurs adopting the CIC form themselves can opt to pursue. In their view, this is acceptable for charities, given the public subsidies they enjoy. ‘But for not-for-profits, which do not benefit from such subsidies, this insistence on public benefit seems quite undesirable...’. Dunn and Riley (n 43) 652.

There are both pragmatic and moral or normative reasons for stakeholder participation in social enterprises. From the pragmatic point of view, the involvement of stakeholders in their governance is a way to help them secure their access to critical resources such as information, expertise, and funds.<sup>52</sup> For social enterprises as stakeholder entities, however, the normative reason seems particularly compelling. Social enterprises require what Argyrou *et al* refer to as the “internalisation of stakeholders in the decision-making process”.<sup>53</sup> This requirement stems from their need to be ‘...accountable to a large variety of stakeholders with diverse interests’ that need to be prioritised, and this accountability can be achieved only through the “active participation” of their stakeholders, ‘...which ultimately leads to more open and democratic decision-making processes...’<sup>54</sup> Indeed, in Young’s words, it is such ‘...governing arrangements that help insure an enterprise pursues the right combination of social and private goals’.<sup>55</sup>

The need for such a right combination is related to social enterprise being, as discussed in Chapter 2, a business with a social mission. As such it is encouraged to generate their income through trading, depending on a more entrepreneurial, market-based mechanism in much the same way as traditional businesses do.<sup>56</sup> But this entrepreneurial, commercial activity risks a “mission drift”; participatory governance thus helps ensure against such a risk. Moreover, in so far as stakeholder interests are concerned, it would be strange if the responsibility for making decisions in a social enterprise is left entirely to people with no direct involvement

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<sup>52</sup> For a view on the resource dependency of organisations, see Benjamin Huybrechts, Sybille Mertens and Julie Rijpens, ‘Explaining Stakeholder Involvement in Social Enterprise Governance through Resources and Legitimacy’, in Defourny, Hulgard and Pestoff (eds.), *Social Enterprise and the Third Sector* (Routledge 2014) 159-60.

<sup>53</sup> Aikaterini Argyrou and others, ‘An Empirical Investigation of Supportive Legal Frameworks for Social Enterprises in Belgium: A Cross-Sectoral Comparison of Case Studies Concerning Social Enterprises in the Social Housing, Finance and Energy Sector’, in Volker Mauerhofer (ed), *Legal Aspects of Sustainable Development: Horizontal and Sectorial Policy Issues* (Springer 2015) 155.

<sup>54</sup> *ibid* 155-56.

<sup>55</sup> Victor Pestoff, ‘The Role of Participatory Governance in the EMES Approach to Social Enterprise’ (2013) 2(2) *Journal of Entrepreneurial and Organizational Diversity* 48, 52, citing Dennis Young, ‘Alternative Perspectives on Social Enterprise’, in JJ Cordes and CE Steuerle (eds), *Nonprofit and Business* (The Urban Institute 2008) 21, 33.

<sup>56</sup> This is also the pragmatic reason for social enterprises to have good relationships with their stakeholders, allowing key-resources providers to participate, preferably directly, in the organisation.



whatsoever with the interests of stakeholders. The latter presumably know their needs best; they should thus be directly involved, or effectively represented, in the governance of social enterprise. Involving particular stakeholders will therefore enhance organisational legitimacy. Referring to the CIC, Cooperatives UK reaffirms the significance of stakeholder involvement in the following terms:

There would be no exceptions, with even the smallest CICs required to show some effort to involve stakeholders. We recognise, however, that the Government may wish to make the CIC form available to entrepreneurs who have little interest in stakeholder involvement. What is important, therefore, is transparency.<sup>57</sup>

We can clearly see why participatory governance is so important.<sup>58</sup> Alternatively, we may say that stakeholder involvement is important to not-for-profits mainly because by their very nature they are *participatory* communities. Many stakeholders see the value of such organisations as providing them with the opportunities to participate in their activities as well as their governance and, in doing this, to express their own values and commitment.<sup>59</sup> In short, serving such a participatory purpose provides these organisations with both legitimacy and trustworthiness in the eyes of participants.

...stakeholders may participate in not-for-profits not to achieve control, but because they find it rewarding to have an area of life in which they have the chance to speak, and in which they can share and defend ideas for change.<sup>60</sup>

Various techniques are available for achieving stakeholder participation. ‘A continuum of involvement can be highlighted, from rather passive strategies (stakeholder information) to the more active ones (stakeholder representation).’<sup>61</sup> Or, as Argyrou *et al* have pointed out, ‘[s]takeholders can either participate in the organisational decision-making processes as formal members and co-owners of the social enterprises, or they can influence informal processes of decision-making...’<sup>62</sup>

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<sup>57</sup> Rory Ridley-Duff and Mike Bull, *Understanding Social Enterprise: Theory & Practice* (Sage Publications 2011) 122, citing Co-operatives UK in DTI, *Enterprise for Communities: Proposals for a Community Interest Company – Report on the Public Consultation and the Government’s Intentions* (October 2003).

<sup>58</sup> Pestoff (n 55) 57.

<sup>59</sup> CA Riley, ‘Theorising the Governance of Not-for-Profits’ (2007) 16 *Nottingham Law Journal* 44, 55-57.

<sup>60</sup> *ibid* 59-60.

<sup>61</sup> Huybrechts, Mertens and Rijpens (n 52) 157.

<sup>62</sup> Argyrou and others (n 53) 155.

Taking cue from these views, we may separate the stakeholder involvement techniques into two main types: the *direct* and *indirect* participation of stakeholders.<sup>63</sup> Indirect participation can take various forms, especially consultation and coordination with corporate and institutional stakeholders. The latter technique may take the form of joint ventures or partnerships.<sup>64</sup> Direct participation, on the other hand, may preferably take the form of a “stakeholder board”.

The issue of stakeholder board will be discussed below, but it may be pointed out here that providing for direct stakeholder participation is not easy in practice. Defining acceptable, multiple missions suitable to all stakeholder groups can be tricky. As Mason has pointed out, ‘SEs cannot be all things to all people, and key stakeholder groups will possess different views on a range of issues such as greater entrepreneurship, as well as conformity with expected standards of ethical conduct’.<sup>65</sup> However, though we can expect to face difficulty in managing multi-stakeholder participation, I agree with Pearce that ‘structures exist which allow efficient management to coexist with active participatory and democratic structures’,<sup>66</sup> perhaps in the form of a mechanism for what Vidal calls “multi-stakeholder dialogue” for multi-stakeholder governance.<sup>67</sup>

#### 4.3.2.4 Stakeholder board

In my view, the arguments in favour of direct participation of stakeholders in the form of “stakeholder board” are compelling. Therefore, let me just briefly discuss

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<sup>63</sup> For an empirical research on stakeholder involvement mechanisms in the social enterprise governance, see Justin Lerner and Chris Mason, ‘Beyond Box-Ticking: A Study of Stakeholder Involvement in Social Enterprise Governance’ (2014) 14(2) *Corporate Governance: The International Journal of Business in Society* 181.

<sup>64</sup> In my view, the development strategy of the Italian social co-operatives might be relevant here. As Borzaga and Galera have pointed out, ‘...one of the main strategies adopted by social cooperatives has been, not to increase the size of the individual cooperative to match the growing demand for services, but to spin-off new initiatives and create local consortia...[This is]...the main form of collaboration among cooperatives which join together in pursuit of business and productive ends’. Carlo Borzaga and Guilia Galera, ‘The Concept and Practice of Social Enterprise. Lessons from the Italian Experience’ (2012) 2(2) *International Review of Social Research* 85, 99.

<sup>65</sup> Chris Mason, ‘Choosing Sides: Contrasting Attitudes to Governance Issues in Social Firms in the UK’ (2010) 6(1) *Social Enterprise Journal* 6, 11.

<sup>66</sup> Lerner and Mason (n 63) 182, citing John Pearce, *Social Enterprise in Anytown* (Calouste Gulbenkian Foundation 2003) 67-68.

<sup>67</sup> Isabel Vidal, ‘Multi-Stakeholder Governance in Social Enterprise’, in Defourny, Hulgaard and Pestoff (eds), *Social Enterprise and the Third Sector: Changing European Landscapes in a Comparative Perspective* (2014) 180-82.

how to organise a stakeholder board.<sup>68</sup> Two issues will be considered: (1) who should be on the stakeholder boards, and (2) how should we select board members to represent either directly or indirectly the different stakeholder groups? Let us first consider the first question.

Social enterprises are normally multi-stakeholder organisations; multi-stakeholder boards could thus be an effective form of multi-stakeholder governance.<sup>69</sup> In view of this need for multi-stakeholder participation, and for my practical purpose, stakeholders are categorised for this purpose into two groups.

The first group can be further divided into two sub-groups. One is composed of the internal stakeholders such as owners, shareholders and investors. They are stakeholders because they directly risk their capital which they have invested in the organisation. The other comprises the employees, including the hired professional managers, whose stakes are nonetheless not derived from investing capital but are rather in the form of their skills, experience and labour. They are, in other words, part of the human capital investments.

The second group comprises external stakeholders such as customers, suppliers, users, social investors including philanthropists and even members of the general public. These stakeholders do not have direct ties with the social enterprises, because they do not bear any risks or liability if these organisations go bankrupt. Also, in the case of social investors, even though they make financial contributions to the social enterprises, they normally do not expect financial, but rather social, returns.

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<sup>68</sup> I shall not touch upon the issue relating to its structure – whether it should be a unitary (one-tier) board, which normally refers to the board of directors, or a dual or two-tier board of directors comprising a management board and a supervisory board. In this latter case, there is normally a separation of functions between the two. See Christine A Mallin, *Corporate Governance* (4<sup>th</sup> edn, OUP 2013) 166. For the development of the social enterprise boards, see Chris Mason and Maurine Royce, ‘Fit for Purpose – Board Development for Social Enterprise’ (2007) 6(3) *Journal of Finance and Management in Public Service* 57.

<sup>69</sup> Spear *et al* point out that multi-stakeholder boards involve transaction costs and a potential for goal conflicts, but may have greater social capital in the form of the strength of community linkages providing the social enterprises with legitimacy, incorporation of external stakeholders and user involving structures. They may have economic advantages in terms of better links to multiple sources. Spear, Cornforth and Aiken, *For Love and Money* (n 39). See also Roger Spear, Chris Cornforth and Mike Aiken, ‘The Governance Challenges of Social Enterprises: Evidence from a UK Empirical Study’ (2009) 80(2) *Annals of Public and Cooperative Economics* 247.

However, there are arguments pointing to the disadvantages of having a stakeholder board.<sup>70</sup> In particular, if one particular group of stakeholders dominates the board, this is clearly in conflict with the nature of social enterprise, whose mission is to protect the interests of *all* stakeholders. In addition, it is not an easy task for a social enterprise to identify different stakeholders and balance their conflicting interests. However, this task is part of its operation as this type of business. Social entrepreneurs who decide to set up a social enterprise thus need to accept this from the beginning.

There are indeed arguments in favour of stakeholder boards being composed of multiple or diverse board members.<sup>71</sup> Stakeholder boards of the social enterprises should be formed of people of diverse stakeholder groups, internal and external, as well as independent directors who do not have any ties with the organisations or stakeholders. Such a board composition will truly represent stakeholder organisations like social enterprises.

Having the board members with both business and not-for-profit backgrounds is beneficial to the social enterprises financially and morally. Internal stakeholders such as shareholders and managers with business background could support the trading side of the social enterprises, whereas external stakeholders could help ensure the achievement of the social objectives, since they tend to be more sensitive to public benefits. This could bring a great advantage to the social enterprises if they could complement each other's qualities.

There are other advantages of creating a multi-stakeholder board, but I shall not discuss them here.<sup>72</sup> We turn now to the second question raised in this sub-section: how should we select board members to represent, either directly or indirectly, the

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<sup>70</sup> For criticisms of the stakeholder theory of governance, see Mason, Kirkbride and Bryde, 'From Stakeholders to Institutions' (n 39) 289-90.

<sup>71</sup> Vidal (n 67).

<sup>72</sup> For example, a more diverse and plural board could serve as a better mechanism for monitoring managers (agency problems), because board diversity increases board independence. It will be difficult for one stakeholder group to dominate the board, because the members are not chosen only on the basis of how much they invest. Moreover, as Spear *et al* have pointed out above (n 39), boards of directors comprising multiple stakeholders can provide better and wider resources because of their business relationships and non-business/social connections.

different stakeholder groups? Two types of stakeholder boards will be considered here.<sup>73</sup>

The first type may be identified as a self-selecting board. A big advantage of self-selecting board is that the members can be recruited from a wide range of networks. It helps strengthen and fill the gaps in the board. For example, it is generally not easy for the social enterprises to compete with mainstream businesses. If they would like to widen their business opportunities and networks, the social enterprises might consider hiring a business consultant or appointing a representative from majority shareholders as their board member. The appointment process is neither complicated nor costly and can be expected to most directly fulfill the needs of the social enterprises.

However, one great danger of the self-selecting boards involves the issue of accountability to stakeholders representing the wider public or community interests. Such a board does not generally have direct accountability to stakeholders, and this is in conflict with the nature of stakeholder organisations. It therefore requires a much stronger regulatory system to ensure transparency and compliance of actions of the social enterprises with their public benefit purpose.

The second type of stakeholder boards includes those which have a democratic, member-based structure (membership boards). The democratic structure with “one person one vote” method is the fairest way to elect board members. It has direct accountability to stakeholders, which helps ensure the delivery of private and social benefits. However, the practicality of such a board structure as used in the social enterprises is still in doubt. Most social enterprises are small with no or very few membership. To arrange the board election might be difficult in practice or might not ensure or guarantee true democracy. For example, if the election is made among internal stakeholders, the board might end up mainly with those who hold the majority shares. Or if the election is made among external stakeholders, the process will be complicated, costly and time-consuming.

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<sup>73</sup> On the issue of recruiting board members, see Spear, Cornforth and Aiken, ‘The Governance Challenges of Social Enterprises’ (n 69) 255-56.

#### 4.3.2.5 Directors' duties

The main issue of this sub-section is how to normatively frame the directors' duties such that they reflect the nature of social enterprise. Two questions are raised in connection with this issue: first, whose interests must directors serve, and second, what standard of competence would we expect of the directors, especially if they are drawn from various stakeholder groups unlikely to be able to satisfy a level of competence usually expected of those sitting on the board of a business firm?

##### 4.3.2.5.1 Whose interests?

Clearly, the law must require the directors to represent "stakeholder interests", because social enterprises are stakeholder organisations by nature. The directors' duties, in other words, cannot be solely to maximise profits for the owners (shareholders/investors), as directors in for-profit organisations do, even though the social enterprises, unlike charities, are expected to generate revenue. This is still not to mention the directors' general duties under the Companies Act 2006, which will not be discussed here.<sup>74</sup>

One complaint against framing the duty of directors in terms of "balancing interests" is that directors cannot easily balance differing and sometimes conflicting interests. In the context of social enterprises, this objection is easily addressed. Stakeholder directors must follow the social enterprise's *objectives*, which normally show how the social enterprise can benefit its stakeholders and relevant members of the general public. Together with the social benefit requirement, the *objectives* of the social enterprise prescribe the line of business, as well as how to pursue such a business line and who would benefit from it. In doing all this, the directors must not set profit-making as a priority, but only as a way to obtain sufficient funds for the pursuit of the social mission of the social enterprise.<sup>75</sup>

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<sup>74</sup> For an analysis of the directors' duties under the Companies Act 2006, see Parker Hood, 'Directors' Duties under the Companies Act 2006: Clarity or Confusion?' (2013) 13(1) *Journal of Corporate Law Studies* 1.

<sup>75</sup> Leonard Sealy, 'Directors' "Wider" Responsibilities – Problems, Conceptual, Practical and Procedural' (1987) 13(3) *Monash University Law Review* 164.

However, this gives rise to another question: what if there is a conflict between the interests of the group which has nominated the director, and the pursuit of the social enterprise's social objective? Can the director prioritise the former at the expense of the latter? Can, in other words, a director put the interests of the group he or she represents above the interests of the whole organisation?

Four arguments may be put forward in favour of saying that each stakeholder director should be able to prefer or prioritise the interests of the group he or she represents. First, to be able to do so is precisely the reason why he or she has been chosen by that group to start with. The group actually wants a director "championing its interests" on the social enterprise board. Second, if a stakeholder director cannot prefer the interests of the group he or she represents, what then is the point in having a stakeholder director in the first place? He or she serves no purpose if he/she is not a champion for his/her nominating group. Third, it does not make sense to think of the "interests of the organisation" as a whole – the organisation does not have any "overarching" interests of its own that transcend the interest of individual groups within it; all we have are the conflicting interests of different groups.

Finally, rather than expecting each individual director to understand, and then decide how to "merge", the different interests of different groups affected by the organisation, it is better to see the board as a "pluralist" arena, in which each individual director should be allowed to be "partial" and to champion the group he or she represents: board decisions will then be the outcome of the negotiations, compromises, trade-offs, and/or straightforward votes within this group of individually "partial" directors (in the same way, we might say, Members of Parliament should not try to advocate what is in the "national interest" – instead, different MPs representing different interest groups should do their best for the group they represent, and Parliament's decisions will be the outcome of the political trade-offs, compromises, votes, horse trading, etc., that occur between these individual representatives of different groups of electors).

On the other hand, three counter-arguments can be advanced. First, stakeholder directors can still do much to benefit the group she represents, though she cannot

prefer the interests of that group against the organisation's interests: they make sure that others *understand* the position and needs of the stakeholder group; they can better appreciate how organisational decisions will impact on the group, and how that might in turn affect the organisation; they can make sure that the group is better informed about organisational decisions, and so on.

Second, against argument 3 above, it does make sense to think of “what is in the interest of the organisation as a whole”, because the organisation – and especially the social enterprise – has its own purpose – and achieving that overall purpose most effectively is what is in its interests. That gives us a standard which each director should aim for, and is higher than the “sectional” interests of individual groups within the organisation.

Finally, seeing the board as an arena in which different directors representing the interests of different groups fight it out is a recipe for conflict within the organisation. It also means that decisions will depend on which groups have most representation on the board, or which groups have the most articulate, powerful or aggressive representatives on the board. It is better to require all directors to be pulling in the same direction – i.e. in the interests of the organisation. Representing different groups, and influenced by different considerations in different ways different, directors may think differently about what the good of the organisation requires. But at least they will be trying to answer the same question – what best serves the purpose of the organisation.

Having presented both sides of the question, I do not see that they are in total conflict, such that we can only opt for one and reject the other. My position is that stakeholder directors can advocate the interests of the groups they represent *without* losing sight of the overall purpose of the organisation. Moreover, in much the same vein as how politics is played out at the national level, in the organisational setting not only “interest aggregation” is possible but, in case the interests of different stakeholder groups are in actual conflict, we can always resort to acceptable, i.e. “democratic”, principles and mechanisms to resolve such conflict.



In practice, a social enterprise cannot always make arrangements for equal representation of all stakeholder groups. A very important normative expectation of the stakeholder directors is thus required; that is, we expect that their duty is to make sure that the interests of all groups are fairly and suitably catered for. This normative expectation leads us to the second question raised in this sub-section – that of the “competence” of stakeholder directors.

#### 4.3.2.5.2 *Competence*

This question covers issues which we have to separate out – one involves the activities that we expect our directors to carry out (“care”) and the other is that of how well we expect them to perform those activities (“skill”). Let me begin with the first issue: what activities do we expect of our directors? This is really about the level of “care” we want from directors – in the sense of the sorts of activities we expect them to perform.

Are there certain “core” activities which are absolutely central to being a director, and which *every* director must perform? The usual candidate for such a core activity is to ensure the company is “well governed” – which means exercising some degree of oversight over the management of the company, ensuring it has a reasonably well functioning board, and so on. Attendance at board meetings is necessary to perform this core activity.

The alternative possibility is to assert that although ensuring that the company is well governed is a core activity of the board, this does not need to be a core activity of *each and every director*. Some directors – especially those appointed as representatives of stakeholders – may be excused this governance function. In other words, we could have a “division of responsibility” on boards.

There are some arguments for requiring all directors to perform a governance role. So, perhaps the more directors who deal with governance, the better it will be handled. And more directors responsible for it should produce a wider range of characters and skills in those who are responsible for it. However, the argument against seems compelling. If every director thinks that all directors are responsible for governance, each one may tend to do much less, believing their fellow directors

will attend to it. Moreover, it is surely more efficient to have a smaller number of directors focused on this task, than expecting all the members of the board to duplicate each other's efforts.

Most importantly, it is not appropriate with a stakeholder board where different directors have very different roles. Some, to be sure, are there to ensure that the company is well governed. But others are there for other reasons – in particular, to represent stakeholders and to cement relationships with other people or organisations that are important to the company – (“resource dependency”). The law should recognise that different directors are appointed to play different roles, and should not burden those who are appointed for “non-governance” purposes with performing a governance role.<sup>76</sup>

Let me now deal with the second issue: should all directors be subject to *at least* an objective standard of competence i.e. should all directors have to perform as well as a reasonably competent director?

Again, the crucial issue seems to me to be that, for the social enterprise, where we want a “stakeholder board”, there might be people who would make excellent stakeholder directors, but would not have the skills necessary to perform to the minimum objective standard expected of every director. This would be particularly likely for organisations whose activities mean their key stakeholders are quite likely to lack these skills. A social enterprise involved with, say, drug addicts, the homeless, those with mental health problems, and so on, might (at the risk of some stereotyping) have stakeholders who are less likely to possess the skills of a “reasonable director”.

I think that this argument is very strong, and may well justify having a subjective standard. However, its strength does depend somewhat upon how one resolves the issue of “care” addressed above. If we accept that different directors can have different roles, then there is less of a risk in imposing an objective standard. Even if every director must exhibit the skills, at least, of a reasonable director, we would

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<sup>76</sup> On this issue, see CA Riley, ‘The Case for Non-Governing Directors in Not-for-Profit Companies’ (2010) 10 *Journal of Corporate Law Studies* 119.

then say “of a reasonable director carrying out the role actually being carried out by the defendant director in this company”.

Hence, someone appointed to be a governing director would have to demonstrate the skills of a reasonably competent governing director – at least, a reasonable ability to read and understand accounts, to spot fraud, etc. But a director who has been appointed, for instance, to represent a particular stakeholder group, and who has no responsibility for or role in governance, would not be expected to carry out governance, and so would not need to demonstrate any of those skills. Instead, they would only need to demonstrate the skills of a reasonably competent stakeholder-representing director. An objective standard would mean those accepting appointment to the board would need to ask if they have the skills necessary to carry out, reasonably, the role to which they are being appointed.

#### 4.3.2.6 External regulator and public disclosure

Unlike the for-profit company, in which much of the policing of its management is carried out “internally”, the social enterprise is endowed with the internal mechanisms that may work poorly, particularly in ensuring that the stakeholder-oriented features of the governance work well. Shareholders are unlikely to be especially diligent in enforcing those mandatory rules, which primarily benefit stakeholders (and themselves only in a very indirect way). Shareholders do not exist in some social enterprises, and even where they do, they can hardly be expected to enforce the asset lock, to take action against stakeholder board members who fail to give stakeholder interests precedence over shareholder interests, and so on.

Social enterprises thus seem to have a much greater need for an effective external regulator to ensure that the stakeholder governance mechanisms outlined above are effectively enforced. What might an effective external regulator look like? First and foremost, the external regulator must be independent, structurally and financially.

This is not just a matter of being independent of government interference. Equally important, there is the problem identified by Nobel Laureate economist George

Stigler as “regulatory capture”. The problem involves regulatory agencies coming eventually to be dominated by the very industries they were created to regulate.<sup>77</sup>

In a structural sense, the social enterprise regulator should be a body or agency separate from the government or other governmental organisations. Being independent also involves independence of participants in the sector, particularly by dealing with them fairly and straightforwardly, keeping any personal relationship at an arm-length, and not bowing to any external influence. Failing to maintain such an independent stance would obviously compromise the regulator’s work, i.e. failing to protect stakeholder interests or to resolve disputes in such a way as to protect these interests, especially against those with negotiating power. Providing the social enterprise regulator with structural independence will thus help him or her to work in a fair and timely manner and help reduce the possibility of political or industrial influence.

Structural independence alone might not be sufficient to ensure successful development of the social enterprise sector. The regulator should also have financial independence, being free from political and private funding. The sources of the regulator’s funds and the process by which these funds become part of the actual budget of the regulator can directly impact on the degree of his or her autonomy and competence when carrying out his or her responsibilities. The funds should mainly come from taking good care of the sector and receive payments, in the form such as administrative and service fees, in return.

However, independence certainly does not amount to the regulator being able to do whatever he or she wants. Independence must also come with transparency and accountability in order to ensure effectiveness. The external regulator of the social enterprises therefore should be monitored so that he or she is accountable for his or her actions.

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<sup>77</sup> For a review of this issue, see Ernesto Dal Bo, ‘Regulatory Capture: A Review’ (2006) 22(2) *Oxford Review of Economic Policy* 203; Daniel Carpenter and David A Moss (eds), *Preventing Regulatory Capture: Special Interest Influence and How to Limit It* (Cambridge University Press, 2013).

Then, who should monitor the social enterprise regulator? Ideally, as an independent body or agency, the regulator should be held accountable to all stakeholders in the sector as well as the general public. As it is not easy in practice for the stakeholders and members of the general public to directly monitor the work of the regulator, accountability may be achieved through a reporting mechanism such as a publication of an annual report that describes the regulator's activities or decisions and claims which are made for public access. Some might argue that the social enterprise regulator should also be accountable to the government since it would significantly contribute to building investor security and confidence, particularly for the newly-established sector like the social enterprises.

In considering the social enterprise external regulator's accountability, we need to understand clearly what his or her duties and responsibilities are. This understanding will enable us to see how this regulatory mechanism works. First and foremost, the regulator must ensure that the social enterprises comply with all the rules and regulations. There are several requirements to which the regulator must pay a close attention (effective enforcement is required). Failure to do so could result in the mission drift or emergence of social enterprises in disguise, which could affect the interests of stakeholders.

There is ongoing debate over the degree of control to be exercised by the regulator. On the one hand, it is argued that the social enterprise regulator should apply a light-touch approach to regulating social enterprises, because the sector is still new and small. Too much control would make the sector unattractive and thereby scare people from joining, and this, in turn, could affect the growth of the sector in the future. The regulator should only intervene when necessary. On the other hand, it is argued that a stricter approach is needed, since the sector involves the interests of communities and society at large. If the sector is abused, it would affect a lot of people. It is the regulator's responsibility to make sure that social entrepreneurs understand why such regulatory requirements are necessary. An approach that is "too light" in its application of rules could affect the confidence and trust of supporters and investors.

Apart from being a law enforcer and protector of the sector, it is also the duty of the social enterprise regulator to act as a promoter of the sector. The social enterprise sector still lacks funding and other resources, and even understanding among members of the general public. The regulator has a duty to provide information and give advice to the current participants in the sector as well as prospective ones.

There are other aspects of the functions and responsibility of the external regulator. However, for lack of space, let me proceed to very briefly discuss the issue of disclosure. For social enterprises with various stakeholders, disclosure needs to be designed not only to protect shareholders and creditors, just as for a normal for-profit venture, but also to cater for the interests of others in society. In this respect, disclosure is particularly relevant to our concern to assure accountability of the social enterprises to their stakeholders.

Disclosure is a fundamental aspect of accountability.<sup>78</sup> That is, together with compliance with mandatory obligations to fulfil the organisation's mission, disclosure, minimally in the form of financial report, represents a most fundamental accountability requirement for a business organisation. Disclosure may be voluntary; however, as Connolly and Kelly point out (in connection with the idea of having voluntary bases of accountability driving the mission of social enterprises), '...it is unlikely that appropriate voluntary mechanisms will be in place without first complying with legal obligations'.<sup>79</sup>

Now, with regard to the social enterprises, I would like to begin with a basic question: why should we need to incorporate a mandatory public disclosure rule into the legal vehicle for social enterprises? The stakeholding orientation of social enterprise governance is directly associated with its social performance, and this requires public disclosure. In other words, stakeholders as well as the general public expect to know how stakeholder organisations like social enterprises pursue their

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<sup>78</sup> For a theoretical discussion of accountability, see Connolly and Kelly (n 15) 224-37.

<sup>79</sup> *ibid* 231. There is in fact a voluntary disclosure theory, according to which '...businesses with worse performance would have less interest to report their results in the social and environmental field and *vice versa*'. Matteo Pozzoli and Alberto Romolini, 'The Impact of Social Reporting on the Performance of Italian Social Enterprises' (2013) 10(3) *Corporate Ownership & Control* 294, 296.

social objectives. Public disclosure would therefore greatly benefit a broader community of stakeholders.

In for-profit companies, disclosures generally come in the form of financial reporting, since shareholders naturally expect financial return on their investment. Such a financial disclosure provides many benefits to shareholders, particularly the reduction of transaction costs and information asymmetry. In a similar vein, a public disclosure could benefit stakeholders by reducing transaction costs for those who wish to see social achievements from the social enterprises they support, and helping them to decide whether to provide long-term support.

According to Richardson and Welker, public disclosure can reduce the cost of equity capital directly through investor preference effects. 'Investor preference effects arise if investors are willing to accept a lower rate of return on investments by an organization that supports a social cause for which some investors have an affinity.'<sup>80</sup>

Public disclosure is also used as a strategy for providing an enterprise with legitimacy. To put it simply, it is a way to communicate to stakeholders and the general public that one engages in social activities, and, through public disclosures, one can reassure the stakeholders that the organisations through which one pursues such activities are social enterprises.

However, while public disclosure certainly provides legitimacy for the social enterprises, this mechanism should rather be used to ensure accountability in social enterprise governance; that is, as a means of evaluating social performance and monitoring the management of social enterprises. If the social enterprises perform well in the pursuit of their social mission, the disclosure will signal their hard work and commitment, and this can help them to gain more support. On the other hand, if the social enterprises have poor performance, the disclosure would serve to signal warning. Stakeholders might decide to stop their support or take actions such as informing the external regulator.

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<sup>80</sup> Alan J Richardson and Michael Welker, 'Social disclosure, Financial Disclosure and the Cost of Equity Capital' (2001) 26(7) *Accounting, Organizations and Society* 597, 599.

There might be those who argue against public disclosure, whose views should also be taken into account. One such view is that public disclosures might be used for self-promotion. Poor performers might attempt to gain acceptance and legitimacy by reporting the positive social contributions that they make and under-reporting negative social effects. It is also possible that if the social enterprises are required to disclose information which may be used in litigation against them, they might choose to minimise the disclosure of such important information and to increase unnecessary disclosures instead, which could directly affect the quality of the information disclosed.

Preparing public disclosures such as public benefit reports is much more complicated than managing financial disclosures. Public disclosure is characterised by greater uncertainty and fuzziness both in terms of which issues are to be considered important and which measure better depicts the performance of firms. This means that although stakeholders' pressure might be high, the reliability of the disclosures made by firms is also harder to discuss and evaluate.

To assure accountability to stakeholders, *enhanced disclosure* (in the sense of full mandatory disclosure of all relevant information and not simply voluntary disclosure) is thus required. To ensure such a disclosure, we need an effective regulator. Moreover, it needs to be clearly provided what type of information should be disclosed, and what stakeholders would want to know. An effective public disclosure must also be transparent, factually reliable and publicly accessible. To put it simply, enhanced social disclosure must provide sufficient information about social activities undertaken by the social enterprises, which could help the stakeholders to forecast their social as well as financial returns.<sup>81</sup>

## 4.5 Conclusion

As a follow-up to the previous chapter with its focus on legal forms for organisations and social entrepreneurs' needs, this chapter has pursued a discussion

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<sup>81</sup> More on this see Christine Mallin, Giovanna Michelon and Davide Raggi, 'Monitoring Intensity and Stakeholders' Orientation: How Does Governance Affect Social and Environmental Disclosure?' (2013) 114(1) *Journal of Business Ethics* 29.



on the need for a legal form particularly designed to suit the multiple-stakeholder character and the multiple-goal nature of social enterprises. These two chapters represent the central theme of my thesis – i.e. the *legal aspects* of social enterprise. I have addressed the issues relating to the meaning of legal form for organisations, what social entrepreneurs expect from the legal form they adopt, and, most significantly, I have tried to deal with issue of whose interests social enterprises serve – who the “principals” and “agents” are in terms of agency relationship – and how a legal blueprint for social enterprises should cater for stakeholder involvement in their governance and activities.

Essentially, in presenting a legal blueprint or model for social enterprises, these two chapters serve as a “framework” for the discussion of relevant issues in, as well as organisation of, the subsequent chapters, especially those dealing with the CIC and its regulatory regime, the main legal forms for social enterprises in Thailand, and my proposed development of a legal vehicle for Thai social enterprises. I now propose to measure the CIC against the legal model we have developed.

## **Chapter 5**

# **The Community Interest Company (CIC): An Evaluation of a Legal Form for Social Enterprise**

### **5.1 Introduction**

I have mapped out a model legal form for social enterprise in Chapters 3 and 4. Now, in this chapter, I propose to take the UK community interest company (CIC) as a case study of an actual legal form for social enterprise. The purpose is to see how closely the main features of the CIC, which has been specially designed for social enterprises, match the requirements in my blueprint. The CIC has already been in use for a full decade; its popularity<sup>1</sup> and growth in registration<sup>2</sup> testify, at least indirectly, to its usefulness. Therefore, if we can show that the CIC closely matches the blueprint, this testifies to the practical value of the latter as well.

Section 5.2 explains the initiation of the CIC, focusing upon the rationale for its introduction, the architecture of the legislation, and the general character of the law governing this legal form. The following two sections deal with the CIC's main features, i.e. those (in section 5.3) catering for the needs of social entrepreneurs, and those (in section 5.4) representing its governance (mandatory) rules and meant to ensure accountability to its stakeholders.

### **5.2 Initiation and legislation of the CIC**

I have pointed out in Chapter 2 that the emergence of social enterprise in the UK in the late 1990s, especially in terms of its institutionalisation, was closely associated with the New Labour Government's policy to create entrepreneurial culture and

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<sup>1</sup> Sam Burne James, 'Analysis: The Rise and Rise of Community Interest Companies' (*Third Sector*, 1 June 2015) <[www.thirdsector.co.uk/analysis-rise-rise-community-interest-companies/governance/article/1348096](http://www.thirdsector.co.uk/analysis-rise-rise-community-interest-companies/governance/article/1348096)> accessed 3 January 2016

<sup>2</sup> According to the CIC Regulator, '2015 sees the 10 year anniversary of the opening of the CIC Office. When the office opened in July 2005, it was predicted that we would be registering about 200 applications a year. We are currently registering this number each month and passed the 10,000 mark in November 2014. CICs are an amazing success story...' Office of the Regulator of Community Interest Companies, *Annual Report 2014/2015* (10<sup>th</sup> Anniversary edn, CICs 2015) 16.

build a more enterprising society. It was against this backdrop of the emergence and development of social enterprise in the UK that the CIC was initiated.<sup>3</sup>

The CIC concept was proposed in the Cabinet Office Strategy Unit Report, *Private Action, Public Benefit*, in 2002.<sup>4</sup> The report raised concerns about *outdated law and regulations* that might obstruct the efficiency and rapid growth of the sector. Legal and regulatory reform therefore was called for,<sup>5</sup> which led to the creation of the CIC.

The rationale for the proposal for the CIC involved the difficulties faced by social enterprises to explain their business model to stakeholders, especially funders, who might be concerned that the money could end up in private pockets. The CIC was expected to bring about big improvements in access to finance, asset-lock approach and branding. The report received a positive support as evident in the response to *Private Action, Public Benefit*.<sup>6</sup> It was recommended that the proposed CIC be established with certain characteristics, including lock-in assets for a community interest purpose, the use of surpluses to further social aims, the improvement of access to finance by permitting the issue of shares, and the introduction of a strong brand.<sup>7</sup>

The CIC was introduced as a new type of registered company. This basically meant that the users of this new legal vehicle could enjoy the flexibility and certainty of the company form under company law.<sup>8</sup> However, since the CIC belonged to a special type of company whose profits and assets would be used for the public good, there need to be some special features such as those indicated above. It was also viewed as a “new brand” for social enterprise and as an addition to the existing legal forms such as charities and industrial and provident societies. A change in the law

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<sup>3</sup> Department of Trade and Industry (DTI), *Enterprise for Communities: Proposals for a Community Interest Company* (2003).

<sup>4</sup> Cabinet Office, *Private Action, Public Benefits: A Review of Charities and the Wider Not-for-Profit Sector Strategy Unit Report* (2002).

<sup>5</sup> *ibid* 6.

<sup>6</sup> Home Office, *Charities and Not-for-profits: A Modern Legal Framework – The Government's Response to “Private Action, Public Benefit”* (2003).

<sup>7</sup> *ibid* 2.

<sup>8</sup> ‘The CIC will be a transparent model; clearly defined, easily recognisable and understandable by users, staff and the wider community they serve. It will be a flexible structure, allowing organisations that use the CIC model to thrive and grow, while being accountable to local communities.’ *ibid* 3.

would certainly not in itself create all the conditions to enable social enterprises to grow and to become significant players in the economy, but *it was an important step in removing barriers to their growth, and in the process of cultural change.*

A proposal paper launched in March 2003 received extensive support.<sup>9</sup> Most of the proposals were supported by over 80 per cent of the respondents.<sup>10</sup> However, the proposal on whether a statutory requirement for CICs to seek views of their stakeholders, with an exemption for small CICs, would be appropriate gained only 43 per cent of the respondents supporting it.<sup>11</sup>

Many of those who favoured a statutory requirement for stakeholder consultation thought that it would ensure stakeholder involvement in CICs while those who argued against a statutory requirement viewed that such a measure was unnecessary, burdensome or difficult to enforce. Though the government reaffirmed the *need for stakeholder involvement*, since it was one of the characteristics of social enterprise, it believed that a statutory requirement for stakeholder consultation could raise genuine technical and practical difficulties. And in view of the clear practical difficulties and the lack of a consensus on the need for a statutory requirement, the government did not propose to introduce one.

The Government believed that the requirement that CICs should report annually on the extent of their engagement with stakeholders, together with the provision for the Regulator to issue guidance on stakeholder engagement, should achieve, at a significantly lower cost in terms of practical difficulty and regulatory burdens, most of the benefits that could be obtained by a statutory requirement.

The paper discussed other important issues in the consultation responses,<sup>12</sup> but here I shall touch upon only one of them – internal governance. It was suggested that CICs adopt democratic governance structures, or the “one member, one vote” principle: without this, the operation of CICs could be counter-productive. Moreover, directors should have a duty to observe the community interest purpose

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<sup>9</sup> DTI, *Enterprise for Communities: Proposals for a Community Interest Company – Report on the Public Consultation and the Government's Intentions* (2003).

<sup>10</sup> *ibid* 5.

<sup>11</sup> *ibid* 25-27.

<sup>12</sup> *ibid* 36-50.

of CICs in their decision-making. The structure of the board of directors could be used to incorporate key stakeholders. However, believing that the company law on corporate governance was sufficient to regulate CICs, the Government did not wish to impose additional rules on governance for CICs. If a CIC or its directors were found not to be pursuing the community interest, the Regulator should be able to take practical steps to compel them to do so.

With this brief account on the introduction of the CIC, let me now proceed to consider how a legislative measure was taken to create it. It is important to note what has been referred to as the architecture of the legislation creating a corporate legal form in Chapter 3 (sub-section 3.2.5.3). We shall see that the Government opted to create the CIC as a variant of the core form of a “registered company” rather than as a stand-alone one. The advantages of this strategy were fully presented in that sub-section.

The proposal for the creation of the CIC was incorporated as part of the Companies (Audit, Investigations and Community Enterprise) Bill, which was introduced into the House of Lords in December 2003, and received Royal Assent on 28 October 2004.<sup>13</sup> Measures on the CIC were set out in part 2 of the Companies (Audit, Investigations and Community Enterprise) Act 2004 (hereafter “CAICE Act 2004”) which had two objectives: (1) improving confidence in companies and financial markets; and (2) promoting social enterprise. With regard to the CIC, the main provisions include:

- a statutory “lock” on assets and profits of CICs;
- a “community interest test”, which companies must pass in order to be registered as CICs;
- an annual community interest report, which CICs must provide to show how their activities have benefited the community; and
- a CIC Regulator, who is responsible for ensuring that CICs comply with their legal requirements.

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<sup>13</sup> DTI, *Companies (Audit, Investigations and Community Enterprise) Bill* [HL] (2004).

In creating this new type of company, the Act also provided the Secretary of State with power to make regulations on CICs and the Regulator of Community Interest Companies.<sup>14</sup> The Community Interest Company Regulations 2005 (hereafter “CIC Regulations 2005”)<sup>15</sup> were laid in Parliament in February 2005 and from the following July the take-up and registration of CICs started.

CICs are limited companies formed under the Companies Act 2006; they are thus subject to that Act and company law generally.<sup>16</sup> However, in order to ensure that CICs operate their businesses for the benefit of the community and the wider public, they have to abide by some additional statutory requirements, particularly the community interest test and the asset lock. In the following two sections, we shall consider the main features of the CIC in more or less the same format as set forth in the previous two chapters.

### **5.3 The CIC start-up process**

Creating a CIC is actually easy, quick and cheap, though there is still room for improvement. The CIC Regulator provides the forms and step-by-step guidelines, including those on the conversion procedure: how to convert from other legal forms to the CIC and *vice versa*.<sup>17</sup> However, I shall focus only on how to set up a new CIC. Here, as we shall see, even though the process is very simple, certain procedural issues should be addressed.

Since the CIC adopts a corporate-type form, applicants must first register a company (private or public). It is easy, cheap and convenient for first-time applicants to register a company by themselves. The IN01 form must be completed: necessary information about the company is required by the form, i.e. company

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<sup>14</sup> For this latter purpose, the Government launched the *Consultation on Draft Regulations for Community Interest Companies* on 11 October 2004.

<sup>15</sup> The Community Interest Company Regulations 2005, SI 2005/1788; The Community Interest Company (Amendment) Regulations 2009, SI 2009/1942; and The Community Interest Company (Amendment) Regulations 2014, Draft SI 2014/2483

<sup>16</sup> The legislation on the creation of CICs is mainly in the CAICE Act 2004. More detailed requirements containing the rules under which CICs operate are contained in *ibid*.

<sup>17</sup> Office of the Regulator of Community Interest Companies, ‘Guidance: CIC Business Activities: Forms and Step-by-Step Guidelines’ (*GOV.UK*, updated 5 February 2016) <[www.gov.uk/government/publications/community-interest-companies-business-activities/cic-business-activities-forms-and-step-by-step-guidelines](http://www.gov.uk/government/publications/community-interest-companies-business-activities/cic-business-activities-forms-and-step-by-step-guidelines)> accessed 10 March 2016

name, address, the names of directors, capital, and shares or guarantee. Company registration costs only £15, the registration can be easily undertaken online, and the process takes 24 hours. However, to register a CIC, the applicants must also submit Form CIC36: “Declarations on Formation of a Community Interest Company”, which cannot be completed online. Only postal application is available to CIC applicants, which costs £35 (£20 for the Companies House fee and £15 for the Regulator fee). The fee can be paid only by cheque payable to Companies House. It is important that the company name has the tag “community interest company” or “CIC”; otherwise the application will be rejected. Both forms can be downloaded free of charge from the government website.<sup>18</sup> Together with the company form IN01, the CIC form CIC36 will be placed on the public record.

Moreover, for CICs, the forms and other required documents need to be approved by two independent bodies, i.e. both Companies House and the CIC Regulator. The Registrar of Companies cannot incorporate a company as a CIC until the CIC Regulator has decided that it is eligible to be a CIC and notified the Registrar of this decision. It is this approval process that may actually be streamlined, for example, through online completion of Form CIC36 to facilitate the registration of CICs and thereby encourage the increase in the number of CIC registrations. Therefore, registration of a CIC can take 8-10 days.

Apart from the forms IN01 and CIC36, there are two other documents – the Memorandum of Association and the Articles of Association – which comply with requirements under section 32 of the Companies Act 2006 and part 3 of the CIC Regulations 2005. CIC applicants are not allowed to adopt the Model Articles provided by the Companies Act 2006 but are instead required to attach bespoke articles to the application. They are encouraged, for this purpose, to use the model constitutions provided by the CIC Regulator (to be discussed below).

Parts A and B of the CIC36 form require the applicants to declare that they will carry on their activities for the benefit of the community, or a section of the

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<sup>18</sup> Companies House, ‘Form: Register a Private or Public Company (IN01)’ (*GOV.UK*, updated 28 October 2015) <[www.gov.uk/government/publications/register-a-private-or-public-company-in01](http://www.gov.uk/government/publications/register-a-private-or-public-company-in01)> accessed 10 March 2016

community; to explain what and how their activities can benefit the community; and to clarify whether their activities would generate surpluses and how to manage them (e.g. reinvestment). This is the community interest test, which is a statutory requirement under section 35 of the CAICE Act 2004 and regulations 3-5 of the CIC Regulations 2005. The test will enable the CIC Regulator to make an informed decision about whether a company being submitted for registration is eligible to become a CIC.

The community interest test, which will be further dealt with in section 5.5.2.2 below, is one of the most important and necessary requirements for being a CIC. Though the form provides some explanatory notes, they are not very clear. Further information on this matter can be found in the CIC Regulator's *Information and Guidance Notes*.<sup>19</sup> The document explains what the test is and how to satisfy it. It is important that the applicants understand the test well, because if they fail the test, they are not permitted to register a CIC.

Clearly, it is relatively easy and cheap to set up a CIC. However, the approval process seems inefficient. When the social enterprise sector grows larger, this might cause a problem. The issue here is whether there should be the "two approvals" required both by Companies House and the CIC Regulator, or only a "one shop" process; or whether, perhaps, there should be automatic approval, but with the right of the CIC Regulator to quash registrations after the event if she subsequently decides they should not have been registered in first place. In my understanding, a two-approval process might be unavoidable: CICs operate under the Companies Act 2006 (this requires approval by Companies House) and, as a special type of companies, they need a regulator – hence, the "two approvals". Moreover, for a regulator of public affairs a *post ante* strategy is not advisable. Thus, in so far as this matter is concerned, we need just a quicker turnaround by the CIC Regulator in approving *ex ante*. This is possible, particularly through online completion of the CIC36 form, and in cases where the model constitutions provided by the CIC Regulator are adopted.

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<sup>19</sup> Office of the Regulator of Community Interest Companies, *Information and Guidance Notes – Chapter 4: Creating a Community Interest Company (CIC)* (BIS 2013).



## **5.4 Rules facilitating the operation of the CIC**

The model legal form for social enterprise comprises three main components functioning as default rules facilitating the running of this type of business, namely legal personality, limited liability, and rules facilitating the raising of capital. All these components are covered in the Model Memorandum and Articles constituting a CIC, which have been prepared by the CIC Regulator. So it is appropriate that we begin this sub-section by gaining an overview of the model CIC constitutions.

### **5.4.1 Model Constitutions**

Six model constitutions for CICs can be used mainly in accordance with the company format (by share or by guarantee), the company's size (having small or large membership) and profit distributions (whether profits can be distributed to private investors, but with restrictions). The models prescribe all the things required by the CAICE Act 2004 and the CIC Regulations 2005, so they greatly save time and cost. CIC applicants can easily adopt one of the models even though they have limited legal knowledge. However, no model constitution is available for a public company, even though it is possible for a CIC to be registered as a public limited company.<sup>20</sup>

A model constitution consists of the model memorandum and articles of association. The model memorandum provides a short form which confirms that the subscribers wish to form a company and agree to become a member of the company. If the company is limited by shares they agree to take at least one share in the company. In contrast, the model articles supply detailed information about the internal allocation of powers between the directors and members of the company, rules governing a company's internal affairs, such as appointment and powers of directors, conduct of meetings and rules for the transfer of shares. These are details on how to run a traditional company, but CICs are different from for-profit companies, in that they must operate under certain restrictions, particularly

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<sup>20</sup> In such a case the CIC will be called "a community interest public limited company (community interest plc)". Office of the Regulator of Community Interest Companies, *Leaflets: Frequently Asked Questions* (BIS 2013) 21.

the asset lock and the limits on profit distribution. The model articles cover such restrictions in the form of statutory rules.

The availability of the model constitutions greatly facilitates the creation of a CIC. CIC applicants are thus encouraged to use one of the model constitutions, though its adoption is not compulsory. Amendments to the models are allowed with the CIC Regulator's approval in order to make sure they comply with the law. The following discussion is based mainly on Model 6,<sup>21</sup> which is targeted at companies limited by shares, and which permits dividend payments to shareholders who are not asset-locked bodies, including private investors, though the payment of a dividend to a private financial investor is subject to a dividend cap.

#### **5.4.2 Legal personality and limited liability**

It is widely accepted that the two outstanding qualities of the company form are the legal personality and the limited liability. We have engaged in in-depth discussion of these two components of a corporate legal form in Chapter 3. Here I shall simply measure the provisions contained in the model constitution against the principles and rules proposed in Chapter 3.

The CIC model constitution adopts such a form in order to obtain those benefits. The model articles clearly prescribe that the CIC has a legal personality, in that 'To further its objects the Company may do all such lawful things as may further the Company's objects and, in particular, but, without limitation, may borrow or raise and secure the payment of money for any purpose including for the purposes of investment or of raising funds'.<sup>22</sup> With regard to limited liability, it also clearly specifies that 'The liability of the shareholders is limited to the amount, if any, unpaid on the shares held by them'.<sup>23</sup>

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<sup>21</sup> Office of the Regulator of the Community Interest Companies, 'Community Interest Companies: Model Constitutions - CIC Model Constitution 6: Private Schedule 3 Company Limited by Shares with a Large Membership' (*GOV.UK*, updated 1 August 2013) <[www.gov.uk/government/publications/community-interest-companies-constitutions](http://www.gov.uk/government/publications/community-interest-companies-constitutions)> accessed 10 March 2016

<sup>22</sup> Articles of Association of Community Interest Company, article 6: Powers (n 21).

<sup>23</sup> Articles of Association of Community Interest Company, article 7: Liability of Shareholders (n 21).

### 5.4.3 Financing CICs

Before we proceed to consider the issue of financing the CIC, we should note one important aspect of the CIC, which is related to this issue. This involves the choice remaining available to social entrepreneurs of two limited company forms. The CIC has been designed to be able to operate like for-profit companies. One of the good things about the CIC is that it retains that choice: social entrepreneurs are permitted to create a CIC as either a company limited by guarantee (CLG) or a company limited by shares (CLS). Such a choice facilitates social enterprises. Moreover, the very fact that today we have thousands of each type suggests that this is important – social enterprises clearly are not all the same; one size does not fit all – some want guarantee CICs; others share CICs. This is really a positive aspect of the CIC.

It should nevertheless be noted that during the decade following the initiation of the CIC the CLG form has been far more popular than the CLS. Though the CLS is the most used form in the mainstream market and CIC applicants are encouraged to adopt this format, the number of CICs with the CLG form is much greater than the number of those adopting the CLS. According to the CIC Regulator's *Operational Report Fourth Quarter 2014-2015*, the total number of CICs up to that time was 10,639, of which 8,322 are CLGs and only 2,317 are CLSs.<sup>24</sup> However, the CIC Regulator confirmed that she started to see small increases in the number of CLS CICs and would work hard to raise social entrepreneurs' awareness of the potential of this form.

Does the comparatively lower take-up of the CLS suggest that this particular form has not been well designed for social enterprises and is thereby not attractive enough? The CIC Regulator urges that CIC applicants consider carefully the company form they consider most appropriate for their proposed CIC. Once incorporated a company limited by guarantee *cannot be converted* into a company limited by shares (or *vice versa*).<sup>25</sup> Each of the two forms is good in its way; however, their differences and the implications thereof should be noted here.

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<sup>24</sup> Office of the Regulator of Community Interest Companies, *Operational Report: Fourth Quarter 2014-2015* (BIS 2015) 17.

<sup>25</sup> Office of the Regulator of Community Interest Companies, *Information and Guidance Notes – Chapter 3: Limited Companies* (BIS 2012) 3.

#### 5.4.3.1 The CLG: Poor at raising finance

A CLG represents a traditional form of organisational set up without a profit-sharing motive. This fact has nevertheless led to a surprisingly common misconception that a company which aims to benefit the community in some way *must* be formed as a CLG. Such a misconception sometimes leads to funding agencies such as local authorities insisting on an organisation being registered as a CLG.

A social enterprise established as a CLG can be exempted from having the word “Limited” (or “Ltd”) attached to its name, if it is set up for certain objects, i.e. the promotion of commerce, art, science, education, religion, charity or any profession. This has become a signal to the public that such a company is “public-oriented” and not “profit-oriented”.

Generally speaking, this is because of the fact that shares are associated with profit and, in particular, the individual shareholder's ability to take profit out of a company, for personal gain, in the form of dividends. As most social enterprises exist to benefit a community or charitable cause rather than to make money for the people who run them, such a constitutional form is sometimes seen to be incongruous to the overall aims of the business, and the guarantee model is in turn seen as providing a more suitable framework.<sup>26</sup>

A major difference between a company limited by share and a company limited by guarantee is that the latter does not have a share capital or any shareholders; they only have “members” who control it. The members will be entitled to attend member meetings and vote with a “one member one vote” system, which is considered more democratic than “one share one vote”. This better reflects the equal member ethos of not-for-profit. This may be regarded as the real advantage of forming a CLG.

It is easier to leave a CLG, that is, by simply ending the membership without having to find a new member as a replacement. In a CLS, one needs to find someone to buy one's shares. In addition, the members of a CLG do not have to invest anything

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<sup>26</sup> Company Law Solutions, ‘Companies Limited by Guarantee’ (*Company Law Club*) <[www.companylawclub.co.uk/companies-limited-by-guarantee](http://www.companylawclub.co.uk/companies-limited-by-guarantee)> accessed 11 February 2015

upfront. They simply promise to pay when they are requested to do so, normally during winding up. But shareholders have to pay share prices upfront fully or partly.

However, a major disadvantage of CLGs is that they are not allowed to raise capital (in a form of equity finance) from their members or private investors. That is why CLGs, including CICs limited by guarantee, are poor at raising finance. Most guarantee companies depend mainly on grants and donations. It is also important to note that adopting the ordinary, non-CIC company limited by guarantee does not, in itself, give any assurance that the company will operate on a “not for profit” basis. If one wants to ensure that one’s company is “not for profit”, either in the sense that it does not aim to make a profit, or in the sense that its profits will not be distributed to its employees or members, one will need to insert appropriate provisions into the company’s constitution. Incorporating as a CIC limited by guarantee will achieve this result, because of the asset lock rules – to which we shall shortly turn.

#### 5.4.3.2 The CLS: Good enough at raising capital?

In view of the fact that guarantee CICs have so far greatly outnumbered share CICs, I would now like to answer the question raised above by asserting that there is actually nothing wrong with the CLS version that is putting people off, forcing them to opt for the CLG. One reason why most CIC operators have opted for the CLG might be just the misconception mentioned above. Even though CICs can trade in much the same way as for-profit companies do, most of them still rely on grants and donations and forming as a guarantee CIC might facilitate them in getting those funds.

However, we still need to ask: what is peculiar about this form that could prevent people from adopting it? The answer might lie in the restrictions that come with such a form – dividend cap in particular. Is it because they are too strict? Another explanation might be that there is nothing wrong with the CLS; it is just that the CLG is *more familiar*, and the form also provides most of the other characteristics and obligations of other forms of limited companies including the ability to pay directors. So to put it simply, why bother with the share CIC which comes with

complicated and unattractive rules. However, in the long run the CLG might not be as flexible and can be a burden when CICs become bigger and seek more capital.

In so far as the financing need of the CICs is concerned, the CLS form is, in my view, more *practical*. I shall now consider the extent to which the CIC, particularly if it is incorporated as a CLS, provides the rules which facilitate the raising of capital. Two types of funding will be touched upon here – share capital and debt finance.

The CIC model constitutions for company limited by share prescribe all the necessary things relating to shares of the CIC, that is, share issues and share transfers.<sup>27</sup> This facilitates CIC operators when raising funds from private investors, because the familiarity and credibility of the rules could ensure investors that they will be treated in the same way as when dealing with ordinary companies though the reward such as a dividend might be limited and the potential for both “upside” and “downside” with equity investment is therefore greater than it is with debt finance.

Another way to raise funds is to borrow from financial institutions such as banks. However, being a CIC is not entitled to a privilege in the form of special treatments, such as lower interest rates. However, the CIC Regulator recommends a number of financial institutions that look particularly favourably on social enterprises. These include Charity Bank, Triodos Bank, Co-operative & Community Finance, The Prince's Trust and the Unity Trust Bank.<sup>28</sup>

In conclusion, there are no specific/default rules which facilitate the raising of loan capital of the CICs. Adopting a company form with separate legal entity as well as limited liability provides familiarity to lenders who deal with CICs. In addition, the CICs are permitted to use their assets as collateral for normal trading.

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<sup>27</sup> Articles of Association of Community Interest Company, articles 27-36 (n 21).

<sup>28</sup> Office of the Regulator of Community Interest Companies, *Information and Guidance Notes – Chapter 7: Financing Community Interest Companies* (BIS 2016) 7.

## 5.5 Regulatory/Governance Rules of the CIC

As we have seen in Chapter 4, several components are required to function as mandatory governance rules for social enterprises, particularly those ensuring their accountability to their stakeholders. There is also the issue of reducing agency costs, which needs to be only briefly mentioned below because it has been sufficiently addressed in Chapter 4 (section 4.2) and will form part of the discussion of other related matters.

### 5.5.1 Reducing agency costs

Provisions for the reduction of agency costs actually form part of some other regulatory strategies to be addressed shortly, in particular the *disclosure of information* and the *directors' duties and competence*. Still another strategy, the *protection of minority owners*, is well covered by English Company Law, under which CICs operate. The mention of agency costs in this sub-section is to re-emphasise that this is a problem in the social enterprises as in private and public companies in general (though social enterprises are mostly small enterprises), and hence must be accounted for in their governance.

Given its full corporate form governed by English Company Law, which contains provisions covering the three regulatory strategies already identified in Chapter 4 (sub-section 4.2.2) for the reductions of agency costs, there is no need for the CIC legal form to be incorporated with specific mechanisms for this purpose. However, as also suggested in the same sub-section, particularly important to social enterprises is the need to assure that the social enterprises, as the “agents”, do not behave opportunistically towards the “principals” (or, in this case, their “stakeholders”) by expropriating creditors, exploiting employees, misleading customers, or, most significantly, exploiting or neglecting the welfare of the community. The mechanisms for assuring accountability to stakeholders to be discussed below in sub-section 5.5.2 are thus generally relevant to the need to reduce the agency costs.

## 5.5.2 Assuring accountability to stakeholders

Given the importance of stakeholder involvement and other aspects of accountability to the stakeholders, governance rules on these matters are designated as mandatory rules. However, as we shall shortly see, not all these components of accountability are incorporated in the CIC as mandatory rules.

### 5.5.2.1 Asset lock and dividend cap

The “asset lock” is the generally known term in the UK for the non-distribution constraint concept, which was dealt with in Chapter 4. The term is used to cover all the provisions designed to ensure that the CIC assets (including any profits or other surpluses generated by its activities) are used for the benefit of the community.<sup>29</sup> It is thus a central feature of the CIC. Like all other companies, the accounts of CICs are open to stakeholders and the public, which can be checked whether CICs are complying with the *statutory* lock.<sup>30</sup>

A statutory asset lock results from an organisation choosing to operate within a legal vehicle that statutorily requires an inclusion of this mechanism in its governing document.<sup>31</sup> With regard to the CIC, the general provisions for the asset lock can be found in the CIC Regulations 2005. Let us briefly review some of these.

It is required that the organisations opting to incorporate as a CIC include in their memorandum or articles the provisions on asset locks on their residual assets prescribed by schedules 1, 2 or 3, depending on whether they are companies limited

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<sup>29</sup> The asset lock helps to protect the assets of social enterprises by preventing the members or shareholders from voting to sell or dissolve the enterprises and from sharing among themselves the proceeds from the sale of the assets.

<sup>30</sup> However, CICs have an ability to use their assets in the normal course of their business despite a lock on profits and assets. For example, they will be able to use their assets as collateral for finance and if they do so the assets will be available to creditors in the event of default.

<sup>31</sup> An example of the asset lock which is a *default rule* can be found in the principle of “common ownership” in worker-controlled businesses and the co-operative movement. The principle of “common ownership” comes from the Industrial Common Ownership Act 1976, which sets out a number of conditions relating to ownership. In particular, in the case of the organisation being dissolved, its members may not distribute its residual assets (i.e. the assets still left in its possession after its liabilities have been settled) among themselves but must transfer them to another common-ownership body, or otherwise retain them for the benefit of the common-ownership sector; or, in the case of either of these two possible courses of action not being followed, the assets may be donated to charity.



by guarantee without a share capital, company limited by shares or a company limited by guarantee with a share capital. Assets here include profits or other surpluses generated by the CICs' activities.<sup>32</sup>

The general provision laid down in Schedules 1 and 2 is that the CICs cannot transfer any of their assets other than for full consideration. The companies may set out, elsewhere in the memorandum or articles, restrictions on the transfer of assets for less than full consideration; hence, in compliance with these restrictions, a transfer of assets may be made to any asset-locked body specified in their governing document, or (with the consent of the CIC Regulator) to any other asset-locked body; and a transfer of assets may also be made for the benefit of the community other than by way of a transfer of assets to an asset-locked body. The point of all these provisions is that assets of the CICs may be transferred at any time, provided that the specified requirements are satisfied.

Schedule 3 covers permissible asset distributions in a CIC. In compliance with conditions set out in sub-paragraph 3 of this schedule,<sup>33</sup> transfers of assets, apart from the cases mentioned above, are permitted in the following matters: 1) payment of dividends in respect of shares in the company, 2) distribution of assets on a winding up, 3) payments on the redemption or purchase of the company's own shares, 4) payments on the reduction of share capital, and 5) extinguishing or reduction of the liability of members in respect of share capital not paid up on the reduction of share capital. Some of these matters, including the distribution of assets on a winding up, the redemption and purchase of shares, and the reduction of share capital, are covered in part 6 (Restrictions on distributions and interest) of the CIC Regulations 2005, together with other cases of restrictions on distribution such as those relating to dividends and interest. Moreover, part 8 (Remuneration) permits payment of a manager out of the income of the CIC. I shall here limit my discussion to only on the cases of payment of directors, payment of dividends, and distribution of assets upon winding up.

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<sup>32</sup> CIC Regulations 2005, regs 8 and 9.

<sup>33</sup> '3) The conditions are that the transfer of assets must (a) comply with any restrictions on the transfer of assets for less than full consideration which may be set out elsewhere in the memorandum or articles of the company; and (b) must not exceed any limits imposed by, or by virtue of, Part 2 of the Companies (Audit, Investigations and Community Enterprise) Act 2004'.

The payment of directors for their services to the company is permissible. However, their remuneration should never be more than is reasonable, and arrangements to this effect should always be transparent. The CIC Regulator, or the company's members, may take action if a director's remuneration appears to be too high.<sup>34</sup> With regard to the payment of dividends, if the company is a CIC limited by shares, and if provided for in the governing document (adopting schedule 3), the payment of dividends to shareholders who are not asset-locked bodies, including private investors, is permitted. The payment of dividends to private investors is nevertheless subject to a dividend cap.<sup>35</sup> However, a CIC which is a company limited by shares adopting Schedule 2 may only pay dividends to specified asset-locked bodies or other asset-locked bodies with the consent of the Regulator.<sup>36</sup>

In the case of the distribution of assets upon winding up, the CIC's residual assets may be distributed as prescribed by Regulation 23 of the Community Interest Company Regulations 2005 "to those members of the community interest company (if any) who are entitled to share in any distribution of assets on the winding up of the company according to their rights and interests in the company". However, this distribution of residual assets to members is limited to no more than the paid up value of the shares which they hold in the company. After any distribution to members has been made in accordance with this rule, any remaining residual assets of the company are to be distributed to an asset-locked body (or bodies) specified in its governing document. If the document does not specify any asset-locked body, the remaining residual assets will be distributed to such asset-locked body (or bodies) as the CIC Regulator will direct.<sup>37</sup>

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<sup>34</sup> Office of the Regulator of Community Interest Companies, *Information and Guidance Notes – Chapter 9: Corporate Governance* (BIS 2013) 9.

<sup>35</sup> Office of the Regulator of the Community Interest Companies, 'New Dividend and Performance Related Interest Caps Now in Place' *CIC News Story* (1 October 2014) <[www.gov.uk/government/news/new-dividend-and-performance-related-interest-caps-now-in-place](http://www.gov.uk/government/news/new-dividend-and-performance-related-interest-caps-now-in-place)> accessed 20 January 2015. The new caps take effect from 1 October 2014, according to the Community Interest Company (Amendment) Regulations 2014, draft SI 2014/2483.

<sup>36</sup> Office of the Regulator of Community, *Interest Companies Information and Guidance Notes – Chapter 6: The Asset Lock* (BIS 2014) 5.

<sup>37</sup> Office of the Regulator of Community Interest Companies, *Information and Guidance Notes – Chapter 10: Transfer of Assets and Ceasing to Be a CIC* (BIS 2013) 11.

There is no question about the need for the asset lock in the CIC. The problem rather involves the extent of the non-distribution constraint.<sup>38</sup> Of course, the limits should not be absolute; otherwise, this would make it even more difficult for social enterprises to attract investors. But to what extent should distribution be constrained? Cross pointed out this fundamental issue at the creation of the CIC:

If the cap is overly restrictive there is the risk that no new market will open up for potential investors and only those who are already motivated to invest in such activities and organisations on a largely philanthropic basis will find investment in CICs attractive. If the cap is unduly lenient the market for investors may be larger but the resulting distinction between CICs and unregulated companies may be so minimal that those contemplating a new community venture may choose not to opt for CIC status, particularly given the increased regulatory burden associated with such status.<sup>39</sup>

There used to be three elements of the dividend cap in the CIC. The first element was called the “maximum dividend per share”,<sup>40</sup> which limited the amount of dividend that can be paid on any given share. The second element involved the maximum aggregate dividend,<sup>41</sup> which limited the total dividend declared in terms of the profits available for distribution. Finally, the capacity to carry forward unused dividend capacity<sup>42</sup> from year to year was limited by the third element of the cap.

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<sup>38</sup> In Europe the constraint ranges from *limiting* to *prohibiting* distribution. There are cases of both *total* distribution lock in the Portuguese and Polish social (solidarity) co-operatives (that is, prohibiting distribution of profits and other resources to members, including, in some cases, directors, employees, and financiers) and greater freedom in the distribution of profits or what they call “a partial derogation” of such total constraints. Frabrizio Cafaggi and Paola Iamiceli, ‘New Frontiers in the Legal Structure and Legislation of Social Enterprises in Europe: A Comparative Analysis’ (2008) European University Institute Working Papers Law 2008/16, 31  
<[http://cadmus.eui.eu/bitstream/handle/1814/8927/LAW\\_2008\\_16.pdf?sequence=3&isAllowed=>](http://cadmus.eui.eu/bitstream/handle/1814/8927/LAW_2008_16.pdf?sequence=3&isAllowed=>) accessed 12 February 2015

<sup>39</sup> Stuart Cross, ‘The Community Interest Company: More Confusion in the Quest for Limited Liability?’ (2004) 55 Northern Ireland Legal Quarterly 302, 311.

<sup>40</sup> CIC Regulations 2005, reg 18(1): ‘The maximum dividend per share for a financial year is the dividend which a relevant company declares on a share when the total amount of dividend declared on that share for that year (when expressed as a percentage of the paid up value of the share) equals that share’s applicable share dividend cap’. This regulation is now revoked.

<sup>41</sup> CIC Regulations 2005, reg 19: ‘The maximum aggregate dividend for a financial year of a relevant company is declared when the total amount of all dividends declared on its shares for that year, less the amount of any exempt dividends, equals (when expressed as a percentage to the relevant company’s distributable profits) the aggregate dividend cap which had effect in relation to that company on the first day of the financial year in respect of which the dividends are declared’.

<sup>42</sup> CIC Regulations 2005, reg 20(2): ‘For the purposes of this regulation, a share’s unused dividend capacity is A minus B where -

A is the aggregate of any sums by which, for any of the four financial years immediately preceding the financial year for which a dividend is to be declared under this regulation, the total amount of dividend declared and paid on the share for that financial year was less than the maximum dividend per share for that financial year; and

These restrictions were criticised for being too harsh and thereby failing to strike the right balance yet between having some lock on assets and also allowing appropriate rate of return to investors. Hence, in October 2014, changes were made by the Secretary of State, which removed the dividend per share cap linked to the paid up value of the share, as well as the capacity to carry forward unused dividend payment to future years, though it was decided that the maximum aggregate dividend cap was retained at the current level. This means that CICs are no longer subject to the maximum dividend per share cap which restricted dividend payments to 20 per cent of the paid up value of a share. As explained by the CIC Regulator, this cap was now seen as complex and restrictive and prevented shareholders from sharing in the success of the CIC. Moreover, it also discouraged investors from investing in CICs. The maximum aggregate cap is nevertheless retained at 35 per cent. The dividend cap thus now has a single element – the maximum aggregate dividend cap. On this occasion, the Regulator also took the opportunity to increase the performance related interest (any rate which is linked to the company's profits or turnover to any item in the balance sheet of the company) from 10 to 20 per cent.<sup>43</sup>

These changes plainly show that the caps must not be too restrictive. But it remains difficult to determine an optimal extent of the constraint. In case of the CIC, the current constraint following the latest changes, which ‘...ensures that 65% of the CICs profits are reinvested back into the company or used for the community it was set up to serve’,<sup>44</sup> is in my view acceptable. The law has been trying to strike a balance between protecting the public through a strong asset lock and fostering the social enterprises through facilitating the raising of finance. However, there might be no perfect answer, i.e. what the ideal rate of permissible dividend and interest payment should be. Time will tell whether the new balance is yet right, and this will be demonstrated by the rate of future take-up of share CICs and any evidence that the public is being misled, believing that they are dealing with more tightly

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B is any part of A which has already been distributed by way of a dividend declared and paid for a previous financial year’.

<sup>43</sup> Office of the Regulator of CICs (n 36) 6-9.

<sup>44</sup> *ibid* 6.

constrained than they in fact are.<sup>45</sup>

#### 5.5.2.2 Community Interest Test

The social benefit requirement involves restrictions on the activities any social enterprise can pursue. Hence, in creating the CIC the UK government designated the public and community interest as the defining characteristic at the heart of this new legal form for social enterprise.<sup>46</sup> It is thus important to emphasise that this is one of the *positive* aspects of the CIC.

The CIC Regulations 2005 contains provisions on political and other activities not to be treated as being carried out for the benefit of the community.<sup>47</sup> The CIC incorporates a mandatory rule for “community interest test”, which as stated by the CIC Regulator ‘...is a test of the motivation or underlying purpose of a CIC’s activities and how they will benefit its community’.<sup>48</sup> The importance of this rule is also clearly stated in a document of the CIC Regulator Office:

Community interest test is the heart of the community interest company (CIC) and the community interest test is what differentiates CICs from other not-for-profit organisations... To become a CIC, an organisation would need to satisfy the Regulator as being in the community or wider public interest. It will be asked to confirm that the access to the benefits it provides will not be confined to an unduly restricted group...<sup>49</sup>

To become a CIC, an organisation would thus have to satisfy the Regulator that its purposes are beneficial to the community or wider public. ‘A company satisfies the community interest test if a reasonable person might consider that its activities (or proposed activities) are carried on for the benefit of the community’.<sup>50</sup> Moreover, it needs also to confirm that the benefits it provides will be widely available, not only to certain groups of people. The Regulator needs to apply a robust test at the

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<sup>45</sup> The CIC Regulator has noted that the number of CICs registering with the share model is already on the rise, with figures of 2,020 for the UK overall (prior to March 2014) compared to 2,317 recorded in the last quarter of that year. ‘Although we cannot be certain, we believe that the changes in the dividend cap have had an impact on this’. Office of the Regulator of CICs (n 2) 16 and 38.

<sup>46</sup> The government proposed the community interest test in the consultation paper in March 2003, which stipulated that the Regulator should apply a “reasonable person” test of community interest. DTI (n 3) 16.

<sup>47</sup> The CIC Regulations 2005, regs 3-6.

<sup>48</sup> Office of the Regulator of CICs (n 19) 17.

<sup>49</sup> Office of the Regulator of CICs (n 20) 11-12.

<sup>50</sup> Office of the Regulator of CICs (n 19) 17.

time of registration of CICs to make sure that their objectives are beneficial to the community or wider public. However, whereas this is the ‘most obvious manifestation of the new regulatory regime’, what is not clear from the very beginning is ‘the fundamental reason why the Community Interest Test and the Regulator are the only and most effective mechanisms which should be adopted’.<sup>51</sup>

According to the *Explanatory Note* to the CIC Regulations 2005, a company which is to become, or to be formed as, a community interest company must not only satisfy the “community interest test” but must also not be an “excluded company” which will never satisfy the community interest test. The CIC Regulations 2005, reg 6 provides that: ‘For the purposes of section 35(6) of the 2004 Act,<sup>52</sup> the following are excluded companies:

- (a) a company which is (or when formed would be) a political party;
- (b) a company which is (or when formed would be) a political campaigning organisation;  
or
- (c) a company which is (or when formed would be) a subsidiary of a political party or of a political campaigning organisation.

The purpose of this regulation is to ensure that the CIC Regulator does not get involved in debates about whether particular political purposes are beneficial or have to reach any views on the merits of particular political aims or campaigns. In addition, to satisfy the test, all companies wishing to be incorporated as CICs must provide the Regulator with evidence by delivering a community interest statement<sup>53</sup> to the Registrar.<sup>54</sup> Though not every activity a CIC undertakes might in itself be directly beneficial to the community, everything it does should somehow contribute towards achieving a purpose beneficial to the community. It must also continue to satisfy the test for as long as it remains a CIC.

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<sup>51</sup> Cross (n 39) 307 and 309.

<sup>52</sup> CAICE Act 2004, s 35(6) provides ‘A company is an excluded company if it is a company of a description prescribed by regulations’.

<sup>53</sup> CIC Regulations 2005, reg 2 defines “community interest statement” as a statement in a form approved by the Regulator which (a) contains a declaration that the company will carry on its activities for the benefit of the community or the section of the community; and (b) indicates how it is proposed that the company's activities will benefit the community (or a section of the community).

<sup>54</sup> Office of the Regulator of the Community Interest Companies, *Leaflet: Information Pack* (BIS 2013) 10-12.

Because the community interest purpose is a crucial condition for the existence of a CIC, social entrepreneurs need to understand the definition of “community”.<sup>55</sup> Before creating a CIC, the entrepreneurs should have a clear picture of the community they intend to serve. The community for CIC purposes can embrace either the community or population as a whole or a definable sector or group of people either in the United Kingdom or elsewhere. Moreover, the CAICE Act 2004 provides that for the purposes of the community interest test, it includes a “section of the community”.<sup>56</sup>

Activities a reasonable person may consider to benefit only the members of a particular body or the employees of particular employers without contributing towards any wider community do not meet the community interest test. It is therefore expected that the community will usually be wider than just the members of the CIC. For example, the community for which a CIC is formed to run a community bus service would include the whole of the population of the area served, not just those residents who had invested in the company.

Finally, it should be noted that “social benefits” can actually take numerous forms and the activities undertaken to create them are wide-ranging. It is therefore legitimate to ask whether this mandatory rule for the community interest test for the CIC are adequate for the purpose of assuring the CIC’s accountability to the community by operating to the latter’s benefit. On the other hand, it is also important to ensure, as has been suggested above, that the community interest test should not, in practice, affect the flexibility of CICs.

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<sup>55</sup> *ibid* 8.

<sup>56</sup> CIC (Amendment) Regulations 2009, reg 4 provides the amended definition of “Section of the community”. For the purposes of the community interest test, any groups of individuals may constitute a section of the community if (a) they share a common characteristic which distinguishes them from other members of the community; and (b) a reasonable person might consider that they constitute a section of the community.

### 5.5.2.3 Stakeholder participation

Neither the Companies Act 2006 nor the CIC Regulations 2005 contains mandatory rules on stakeholder participation.<sup>57</sup> Nonetheless, the CIC Regulator reaffirms the importance of stakeholders by clearly stating that ‘...it is an important principle that a CIC should have particular regard to its major stakeholder i.e. the community, which is intended to benefit from its activities’.<sup>58</sup>

With such a confirmation of the importance of stakeholders, the CIC Regulator provides a crucial voluntary rule that ‘The involvement of stakeholders...be integrated in the corporate governance of the CIC’.<sup>59</sup> However, recognising the vast differences among the social enterprises operating with the CIC form, the Regulator allows that ‘The extent of this will clearly vary according to the size, purpose, geographical extent etc of the CIC and the cost needs to be proportionate to the scale of the operation’.<sup>60</sup>

A basic operation to effect stakeholder participation involves providing adequate information. This is a starting point for the consultation process, which can be easily effected by methods of feedback ranging from circulating newsletters and holding stakeholder meetings to setting up an interactive website or issuing formal consultation documents before initiating a major policy. Alternatively, other stakeholders (i.e. those apart from members and directors) could be given an official standing under a company’s constitution that might require, for example, that they are consulted before the directors or members of the company make certain types of decisions, and/or be invited to attend an open forum linked to the company’s annual general meeting.<sup>61</sup>

It is a good idea to have “non-executive” directors, though if things go wrong (particularly if they have not performed their duties diligently) they may well be

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<sup>57</sup> According to Cross, both ‘clear practical difficulties’ and ‘the lack of a consensus about the need for a statutory requirement’ accounted for the law being ‘largely silent’ on this issue. Cross (n 39) 312-313.

<sup>58</sup> Office of the Regulator of CICs (n 34) 5.

<sup>59</sup> *ibid.*

<sup>60</sup> *ibid.*

<sup>61</sup> *ibid.*



held equally liable for any consequences with the “executive” directors. By implication, it is advisable that stakeholders are encouraged to participate in running the organisation. In many organisations the setting up of user and advisory groups or a club committee separate from the board of directors can be an effective way of bringing stakeholders into the running of the organisation.

Many other methods and procedures could be used to this effect. It is important, in so far as corporate governance is concerned, to make a clear distinction between the directors’ roles and responsibilities and those of others who are *involved* in running the organization. This is because, apart from the appointed directors, there might be *de facto* or “shadow” directors – those stakeholders who are very influential in the affairs of a CIC.<sup>62</sup>

It should be also noted that though stakeholder participation is not mandatory, the CIC Report, which is a statutory requirement, has to show specifically what the company has done to benefit the community and how it has consulted those affected by its activities and the outcome of such consultation. As clearly indicated in the CIC Regulator’s *Information and Guidance Note*,

The purpose of the CIC Report is to show that the CIC is still satisfying the community interest test, and that it is engaging appropriately with its stakeholders in carrying out activities, which benefit the community.<sup>63</sup>

Hence, though not being a mandatory feature of the CIC, stakeholder participation as strongly recommended for incorporation in its governance may be regarded as a positive aspect of this legal form for social enterprise. Even though, in view of the differences among the CICs in various respects, it might not be possible for all of them to accept the same extent and depth of stakeholder involvement, the Regulator’s guidance reaffirms a very important principle – that is, the CIC governance needs to be *inclusive* in the sense that CIC must demonstrate its awareness of the community and constituents – both who benefit from, and who are affected by, its activities – by seeking information from multiple sources and

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<sup>62</sup> *ibid* 5-6.

<sup>63</sup> Office of the Regulator of Community Interest Companies, *Information and Guidance Note – Chapter 8: Statutory Obligations* (BIS 2013) 4.

establishing policies and structures to foster stakeholder involvement. The CIC Regulator makes this point very clear:

A wide view should be taken of who may be affected by your activities and should include not only those who currently benefit but also potential beneficiaries. You should also consider those indirectly affected such as the other residents of the area of your operations.<sup>64</sup>

Of course, having already given my preference for a mandatory requirement for stakeholder participation, I naturally feel that the voluntary rules for this CIC governance need are *not* sufficient. In so far as they remain voluntary, the rules can always be ignored; and in so far as stakeholder involvement is central to social enterprises, failure to abide by this principle is a serious deviation from the crucial normative requirement for this type of organisations. Such a failure thus implies a “mission drift”.

#### 5.5.2.4 Stakeholder board

The idea of having a stakeholder board is clearly one specific way of catering for stakeholder participation in social enterprises. In this case, it involves participation in their governance – i.e. *representation* at the board level. I have argued in Chapter 4 that an ideal social enterprise legal vehicle requires a “stakeholder board”, one which is represented by various stakeholder groups.

Neither the Companies Act 2006, nor the CIC Regulations 2005 provides a mandatory rule for this aspect of CIC governance. The Act only requires that there is at least one director in a private company or at least two in a public company. Hence, as in the case of stakeholder participation, a stakeholder board may only be put in place as a result of default rules to this effect being included into the governing documents of a CIC. The CIC Regulator only advises that ‘...it is often a good idea to have “non-executive” directors, who do not work fulltime in the business, but who have particular skills and experience and can contribute an independent perspective to the management of the company’.<sup>65</sup>

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<sup>64</sup> Office of the Regulator of CICs (n 34) 6.

<sup>65</sup> *ibid* 4.

This, in my view, is not sufficient. Therefore, I consider it unfortunate that a mandatory rule for a stakeholder board has not been included in the CIC structure, which would otherwise have made it most distinct from other legal forms adopted by social entrepreneurs. Although the inclusion of a default rule to this effect in the CIC governing document might serve this purpose, as such it can always be omitted, and thereby makes the assurance of accountability of social enterprises to stakeholders less strong.

#### 5.5.2.5 Directors' duties and competence

UK company law, particularly the Companies Act 2006, designates for the directors of *all* types of companies, including public, private and community interest companies, a range of powers and duties, their extent and limitations, and related rights, remedies and liabilities. Specifically, '[a]t the most abstract and general level, UK company law imposes on directors the duties to be *loyal to the company* and *to be competent* when acting as a director.'<sup>66</sup> This general duty of loyalty is referred to as the duty to promote the success of the company under section 172 and the duty to avoid conflicts of interest under section 175, whereas the degree of competence required of directors can be seen through the duty to exercise reasonable care, skill and diligence under section 174.<sup>67</sup>

In Chapter 4 (sub-section 4.3.2.5), I nonetheless raised two issues particularly relevant to directors of the social enterprises. These were:

- the duty to balance the interest of owners (in maximising profits) with the interest of other stakeholders; and
- the appropriate duty of care and skill for directors (and especially the level of competence properly demanded).

I therefore propose, in this sub-section, an analysis of UK company law (especially sections 172 and 174) with a view to finding out whether, or to what extent, it effectively deals with the two issues.

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<sup>66</sup> David Kershaw, *Company Law in Context: Text and Materials* (2<sup>nd</sup> edn, OUP 2012) 315.

<sup>67</sup> *ibid* 316-17.

### 5.5.2.5.1 Section 172

This states that:

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (among other matters) to

- a) the likely consequences of any decision in the long term,
- b) the interests of the company's employees,
- c) the need to foster the company's business relationships with suppliers, customers and others,
- d) the impact of the company's operations on the community and the environment,
- e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

From a glance, particularly at the wording of sub-paragraphs (b) and (c), we might think that under section 172 directors of all companies are expected to always take stakeholder interests into account. However, it is important to realise that there has been an ongoing debate<sup>68</sup> over whether directors should adopt a more inclusive consideration of stakeholder interests when exercising corporate powers. Even though the debate mainly focuses on for-profit companies whose main purpose is profit maximisation, the importance of the directors' duty to balance interests of different interested groups is particularly relevant to not-for-profits. In Chapter 4 (sub-section 4.3.1), I discussed the shareholding and the stakeholding concepts and concluded that social enterprise is, by its very nature, a stakeholder entity. It needs to be, and actually strives to become, financially viable, but it must in any case adopt a stakeholder approach – that is, no matter whether this approach results in greater or lesser financial success. Now let us see if section 172 truly represents a concern for stakeholder interests.

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<sup>68</sup> Andrew Keay, *Directors' Duties* (2<sup>nd</sup> edn, Jordan Publishing 2014).

During the reform process preceding the Companies Act 2006, the Company Law Steering Committee proposed two approaches to stakeholder interests, i.e. the enlightened shareholder value approach and the pluralist approach.<sup>69</sup> The first approach prioritises the maximisation of shareholder value but at the same time requires the consideration of other stakeholders' interests, believing that attention to the stakeholder interests could increase the shareholder value. The second approach on the contrary argues that the shareholder-value maximisation goal will not lead to 'maximum prosperity and welfare'. Company law should be modified by including other goals, obliging a company to meet a wider range of interests. For this purpose it should not be subordinate to, or serve as a means of achieving, shareholder value. This inevitably involves balancing potentially conflicting interests – a situation resulting in 'some sacrifice of the interests of shareholders...in favour of some other interests'.<sup>70</sup>

It seems clear that the pluralist approach better suits the social enterprises. However, with the domination of for-profits in the business sector, the Committee unsurprisingly recommended a rejection of pluralism in favour of the enlightened shareholder value for the reason that pluralism 'would create a dangerously broad and unaccountable discretion, unless sufficient additional safeguards can be devised.'<sup>71</sup>

I shall not address the issue of whether the pluralist approach would lead to such a broad and unaccountable discretion for directors of for-profits. It is nonetheless clear that section 172 prioritises the enlightened shareholder value approach,<sup>72</sup> according to which shareholder interests always come first.<sup>73</sup> This is apparently in conflict with the CIC's community-benefit objective. That is, though the duty requires directors to take into account stakeholder interests when making decisions regarding the success of the company, it does not seem to allow the decisions to be

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<sup>69</sup> Company Law Review Steering Committee, *Modern Company Law for a Competitive Economy: The Strategic Framework, Chapter 5.1* (1999).

<sup>70</sup> *ibid* 37-38.

<sup>71</sup> *ibid* 45.

<sup>72</sup> Companies Act 2006: Explanatory Notes, para 325.

<sup>73</sup> Even though section 172 does not explicitly say that the directors must act in ways to maximise the shareholder value, the duty clearly establishes the priority of the shareholder interests as can be seen from the wording "to promote the success of the company **for the benefit of its members** as a whole".

made to the detriment of shareholders' interests. According to Kershaw, '[i]f enlightened shareholder value means that the directors may act to promote the interests of non-shareholder groups to the extent that so doing promotes the interests of shareholders, then section 172 does not explicitly confirm this.'<sup>74</sup> What is certain is that section 172 does give the priority to members/shareholders.

CIC directors are certainly required to assume the duty under section 172 of the Companies Act. Though the CIC's Model Articles cover many important issues on directors, particularly the directors' powers and responsibilities and decision-making by the directors, they do not explicitly mention anything about their duties. With regard to the issue of whose interests CIC directors must serve, there is no question that the CIC was designed to serve the community interest; the directors have mandatory direct duties and responsibilities to the community – their most important stakeholder. In other words, the priority must be given to the community, not the members/shareholders as required by section 172. This is clearly explained by the CIC Regulator:

In addition to...general responsibilities, CIC directors (and, when they take collective decisions about the company, members) are also responsible for ensuring that the company is run in such a way that it will continue to satisfy the community interest test. In practice, this will mean having regard to the interests of the community the CIC is intended to serve, and in some cases giving more weight to those interests than to generating financial returns for investors in the company.<sup>75</sup>

Will this then be problematic as section 172 expects directors to prioritise shareholder value whereas the CIC directors' duties are *mandatorily* directed towards community interests? This was a problem Cross identified at the initiation of the CIC. As he argued,

Retention of the proposed stakeholder engagement mechanism would have given rise to a number of difficult issues in respect of the interaction of existing directors' duties and the stakeholder mechanism. Directors at present owe their duties to the members of their companies and even under the present proposals for a statutory statement of directors' duties that position remains unchanged. A statutory engagement mechanism would have placed directors of CICs in a position where their duties as directors were clearly not the same as those owed by directors of non-CIC companies.<sup>76</sup>

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<sup>74</sup> Kershaw (n 66) 382.

<sup>75</sup> Office of the Regulator of CICs (n 34) 4.

<sup>76</sup> Cross (n 39) 313.

The law says practically nothing about how directors should balance differing and sometimes conflicting interests.<sup>77</sup> Of course, in case of the conflict between the owners (shareholders or investors) and the community/stakeholders, it is the community interests that take precedence over those of the owners. But how should the CIC directors balance interests of the various stakeholder groups – still not to mention the more complicated issue of individual directors themselves representing certain specific groups, who naturally expect them to “champion” their respective interests?

It is not easy to answer this question. The CIC is a new corporate legal form, and problems associated with it are still not clearly understood, with not sufficient case law to substantiate such understanding. Moreover, if a problem actually arises, it could be referred to the CIC Regulator for assistance in dealing with it. Section 172 (2) makes it appear that the law cares about companies having “unselfish” objectives, especially charitable companies and CICs, by functioning as a default rule.<sup>78</sup> This means that the priority given to shareholder value can be changed to stakeholder interests by stating it in the constitutional documents. In fact, the community interest test amounts to saying that CICs’ priority is community interest, by which CIC directors have to abide. Hence, with the law covering this matter (though not explicitly), there seems to be no need to specifically make it a mandatory duty of CIC directors.

#### 5.5.2.5.2 *Duty of care and skill*

I pointed out in Chapter 4 two different issues here, one involving “care” and the other relating to “skills”.

On the first issue, I was in favour of the law recognising that different directors are appointed to assume different roles. The law should not burden those appointed for “non-governance roles” (i.e. to perform the functions of “stakeholder directors”)

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<sup>77</sup> The model articles of association cover the “conflicts of interest”, in which the directors themselves are involved, in para 20. In certain circumstances, especially in case of the “stakeholder directors” advocating some specific groups they represent, provisions on “conflicts of interest” may be applicable.

<sup>78</sup> Companies Act 2006: Explanatory Notes, para 330.

with governing functions. For this purpose, the CIC, which is likely to have both governance and stakeholder directors, should have at least some guidelines for directors' activities, which allow for some form of "division of responsibilities" among the directors, so that they can perform their respective functions more efficiently.

The second issue regarding the skill requirement of directors follows from my argument on the "division of responsibilities". As I have also argued in Chapter 4, we expect a governing director to demonstrate the skills of a reasonably competent governing director – at least, a reasonable ability to read and understand accounts, to spot fraud, etc; whereas a "stakeholder director" would not be expected to engage in governance, and would therefore not need to demonstrate the skills required for a governing director.

As in the case of the competence of CIC directors, the CIC Regulations, the model articles or the CIC Regulator's *Information and Guidance Notes* do not offer any specific mention of this matter. This means that CICs follow the general duties of directors under section 174 of the Companies Act 2006 on the duty of care, skill and diligence in particular.<sup>79</sup> Now let us see if this section can meet the requirements set out in Chapter 4.

174 Duty to exercise reasonable care, skill and diligence

(1) A director of a company must exercise reasonable care, skill and diligence.

(2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with—

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and

(b) the general knowledge, skill and experience that the director has.

Section 174 seems to recognise that different directors have different roles, which is inherent in the word "functions". According to Kershaw, '[c]learly directors have different functions. Some are executive directors; others are non-executive directors

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<sup>79</sup> According to Davies, this Section on the general duties of directors, which provides for the standard of competence they are expected to meet in the course of carrying out their functions, incorporates into the Act a recent theme of the common law, '...namely that the law should impose on directors a higher standard of skill and care than has traditionally been expected of them by the UK courts'. John Davies, *A Guide to Directors' Responsibilities under the Companies Act 2006* (Certified Accountants Educational Trust 2007) 37.



who are not involved in the operational aspects of the company's business. Some non-executive directors will receive specific roles such as serving on the audit committee or acting as the senior independent director.'<sup>80</sup> Although the law does not say this straightforwardly, it should be sufficient for CICs. However, as mentioned earlier, the Regulator should clarify these different functions in her guidance.

In addition, section 174 also covers the issue of how well directors should perform their functions. It adopts the dual objective/subjective standard,<sup>81</sup> meaning that the qualities of the hypothetical director who sets the benchmark of care include the attributes of the average director carrying out the same function (objective test); where the director possesses the skill, knowledge, and experience above that level, such additional skill, knowledge, and experience amount to a subjective test.<sup>82</sup>

Therefore, in view of the law's substantial coverage of the director's competence, especially with the imposition of the dual standard test, we might argue that there is no need for the CIC to incorporate additional rules or regulations. If the CIC is subject to too many rules and regulations, few people would want to become CIC directors. By the nature of the CIC, it is not easy to recruit skilled directors for it; this may be because they cannot expect as much financial reward for their services as they would receive from a for-profit company.

However, Kershaw has raised an interesting point which could involve the appointment of stakeholder directors in a CIC board. He notes that though the law recognises that directors have different functions, the appointment of directors with no business skills and experiences might result in the court concluding that the CIC could not satisfy the standard of care test under section 174.<sup>83</sup> This means that whereas it is possible to determine specific functions for directors, for example, giving stakeholder directors the responsibility to take care of stakeholder groups with a view to making sure there would be no mission drift, in practice the directors

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<sup>80</sup> Kershaw (n 66) 449.

<sup>81</sup> Companies Act 2006: Explanatory Notes, para 337. On the issue of objective and subjective standards, see CA Riley, 'The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard (1999) 62(5) *Modern Law Review* 697.

<sup>82</sup> Kershaw (n 66) 449.

<sup>83</sup> *ibid.*

have to make decisions, including business decisions and to vote. Allowing directors with no business skills to do this could have an impact on the operation of the organisation. CICs pursue both social and commercial objectives. Therefore, to appoint stakeholder directors without any decision-making authority would defeat the real objective of CIC stakeholder boards. Eventually, such a CIC board would be dominated by directors with business skills and interests. The law functions in this way because it clearly focuses on for-profit companies.

In summary, we have seen that the CIC Regulator sees the benefit of having “non-executive” directors. By implication this would also mean having stakeholders involved in running the organisation with a clear division of responsibilities between the governance functions of executive directors and those of other directors who are *involved* in running the organisation in other capacities. This more or less amounts to the same arrangement I proposed in Chapter 4 (though the Regulator indicates that if things go wrong, particularly if the “non-executive” directors or those involved in running the organisation have not diligently carried out their duties, they may be held equally liable for any consequences with the “executive” directors). Even though the Regulator’s recommendation does not carry the weight of a mandatory rule, I accept this “default” provision, especially in view of the vast differences, especially in size, among CICs. Though, in view of our ideal-type corporate legal form for social enterprise, the CIC’s lack of a mandatory provision for this aspect of its governance is a “flaw”, it is, in my view, not a serious one.

#### 5.5.2.6 CIC Regulator and public disclosure

The mandatory provisions for these two elements of the CIC governance are contained in the CAICE Act 2004 and the CIC Regulations 2005. With such provisions the CIC may be said to have come up with still another positive aspect. The Act has established the Regulator as an independent statutory office-holder appointed by the Secretary of State.<sup>84</sup> The CIC Regulator can be expected to assume a more or less ideal role envisaged in Chapter 4 (sub-section 4.3.2.6).

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<sup>84</sup> Office of the Regulator of Community Interest Companies, *Information and Guidance Notes – Chapter 11: The Regulator* (BIS 2013) 4.

The Regulator's independence is fundamental to the CIC regulatory regime but the exercise of CIC Regulator's functions must also be transparent. For this latter purpose the Regulator is required to prepare an annual report for the Secretary of State, who will lay it before Parliament, and a copy of it will then be placed on the Office of the CIC Regulator's website. In addition, the Secretary of State may direct the Regulator to prepare financial accounts, which will be examined and reported upon by the National Audit Office and included in the report. Moreover, the Parliamentary and Health Service Ombudsman can also consider and investigate complaints of alleged maladministration about the Regulator and the Regulator's Office. Such complaints can only be considered if they are submitted to the Ombudsman by the complainant's Member of Parliament.<sup>85</sup>

The CAICE Act 2004 provides the Regulator with a wide range of enforcement powers but constrains the use of these powers to the extent necessary to maintain confidence in CICs. The government has thus indicated its aspiration for a "light touch" Regulator with a view to encouraging the development of the CIC "brand" and providing guidance and assistance on matters relating to CICs. The Regulator emphasises that 'The light touch approach to regulation does not envisage proactive supervision of individual CICs by the Regulator'.<sup>86</sup> Instead, the Regulator sees his or her task as facilitating the formation of CICs, hence avoiding a "bureaucratic approach".

I presented, in Chapter 4 (sub-section 4.3.2.6), the profile of an ideal-type external regulator, whose main characteristics include the regulator's independence, accountability, roles and responsibilities, as well as other aspects of the regulator's duties and functions. I have found that the law governing the CIC Regulator practically covers all of these features. Apart from the CIC Regulator's independence, accountability, and approach to the regulatory functions, all of which are, in my opinion, the central aspects of the Regulator, the law also provides the Regulator with wide powers of investigation<sup>87</sup> and enforcement (ranging from

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<sup>85</sup> *ibid* 9-10.

<sup>86</sup> *ibid* 4.

<sup>87</sup> 'These powers enable the Regulator to investigate the affairs of the company in relation to its CIC status; they do not replace the Companies Act powers. Where the Regulator considers that wider issues are raised, the case may be referred to CIB [Companies Investigation Branch]'. *ibid* 6.

bringing civil proceedings in the name of the CIC to appointing and removing directors and manger). The law also lays down a framework for appeals against the Regulator's decisions.

In my view, all these provisions represent a reasonable basis for the CIC regulatory regime. Moreover, in carrying out his/her functions, the Regulator has also assumed a valuable role in promoting the social enterprise sector, especially by providing advice and guidance (which would minimise the need to seek costly professional advice), facilitating the incorporation of CICS, as well as undertaking activities such as attending meetings and publicising the CIC on various occasions.

Another important role prescribed in the model external regulator is that of the protector of CICs – which presumably has implications for the social enterprise sector as a whole. This, in my view, particularly involves the Regulator's role in preventing and eradicating fraudulent practices to protect the image of, and maintain confidence in, CICs. However, one cannot but wonder how this role could be really *effective* if, in adopting the “light touch” approach to regulation of CICs, the Regulator “does not envisage pro-active supervision of individual CICs”. The promoting and protecting roles must go hand in hand, and a flaw in one could adversely affect the other.<sup>88</sup> This issue deserves further elaboration here.

I shall focus on the way the Regulator deals with complaints. As the Regulator has herself emphasised, ‘...it is complaints that help the Regulator to challenge activity that is being questioned’.<sup>89</sup> As the Regulator's intervention ‘to challenge activity that is being questioned’ is still not published, we need to rely on the information the Regulator has provided on the way he or she has tackled this matter.<sup>90</sup> Two aspects of this *modus operandi* can be identified.

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<sup>88</sup> In February 2014 Social Enterprise UK wrote to the CIC Regulator expressing its ‘concerns’ about ‘the strength of procedures for protecting and enforcing the asset lock’ after it had received complaints from its members about the breaches not being properly investigated. Though the Regulator saw that Social enterprise UK's portrayal of her ‘light-touch’ approach as ‘not getting involved at all’ was ‘inaccurate’, we cannot deny a potential flaw in this approach. David Ainsworth, ‘SEUK ‘concerned about CIC regulation’ Civil Society 4 February 2014. <[www.civilsociety.co.uk/finance/news/content/16837/seuk\\_expresses\\_concerns\\_on\\_robustness\\_of\\_cic\\_regulation](http://www.civilsociety.co.uk/finance/news/content/16837/seuk_expresses_concerns_on_robustness_of_cic_regulation)> accessed 3 March 2016

<sup>89</sup> Office of the Regulator of CICs (n 2) 10.

<sup>90</sup> See the section on “Complaints” in *ibid* 26-27.

The first aspect involves the Regulator's *general approach* to complaints. In this respect, it is stressed that each and every complaint is considered, with most complaints being resolved very quickly. Given the light-touch approach, the Regulator's enforcement powers are used sparingly, but these powers will be used if the Regulator deems it necessary to take action against a CIC. The Regulator has criteria for consideration when deciding whether to take action<sup>91</sup> and for the types of complaints that the Regulator is not likely to pursue.<sup>92</sup>

The second aspect involves *actual cases* in which the Regulator has intervened,<sup>93</sup> and how certain types of cases have been dealt with.<sup>94</sup> 178 complaints were filed against CICs from 2006 to 2014;<sup>95</sup> many of them were of relatively minor nature. The Regulator has explained the way complaints have practically been dealt with, as follows:<sup>96</sup>

As a matter of routine, we draw the director's attention to the concerns raised and we give the CIC an opportunity to address them. The Regulator considers the CICs response and determines whether it has acted appropriately, if not we will offer guidance on the way forward with a view to resolving the issue...The small percentages of CICs that have acted in a more serious manner are carefully considered and appropriate action is taken.<sup>97</sup>

Now we have a clearer picture of what the CIC Regulator's light-touch approach looks like in practice – especially in so far as this involves complaints. Needless to say, without further information on how specific cases have been dealt with (the Regulator maintains a policy of not revealing full information about such cases), it is not possible to assess the *overall* effectiveness of the light-touch Regulator.

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<sup>91</sup> Five key areas are identified that the Regulator considers when deciding whether to take action: 1) there is evidence of misconduct or mismanagement, 2) there is a need to protect the assets, 3) the CIC is not satisfying the community interest test, 4) the CIC is not pursuing any activities in pursuit of its community interest objects, and 5) the CIC is engaging in political activities and/or political campaigning. *ibid* 26.

<sup>92</sup> Examples of such complaints include complaints that concern contractual obligations or property rights, which are properly matters between the CIC and a third party, and complaints that would involve the Regulator as a referee to solve differences between factions within a CIC. *ibid* 26-27.

<sup>93</sup> FOI Release (Information released under the Freedom of Information Act), *Complaints about CICs* (28 July 2014) 2-3.

<sup>94</sup> See *ibid* 1-3 and, in particular, Office of the Regulator of Community Interest Companies, *Annual Report 2012/2013* (BIS 2013) 26-29.

<sup>95</sup> For a breakdown of the year in which the complaints were received, see *Complaints about CICs* (n 93).

<sup>96</sup> For further detail on how certain specific types of complaints have been tackled, see *ibid* 29.

<sup>97</sup> *ibid* 2.

However, given that the number of complaints has remained more or less steady, or proportionally decreasing, the light-touch approach can be interpreted to be effective at least in so far as it has been able to steer CIC activity in the right direction.

Now we turn to the last component envisaged in the model legal form for social enterprise – public disclosure. As I have pointed out in Chapter 4 (sub-section 4.3.2.6), “disclosure” for the social enterprises is aimed to cater for the stakeholder interests rather than mainly to protect investors and creditors. A CIC is therefore statutorily required to prepare and deliver annually, to the Registrar of Companies: (i) annual accounts, (ii) annual CIC report, and (iii) annual return.<sup>98</sup>

- 1) Annual accounts: The directors of CICs are obligated, in much the same vein as their counterparts in ordinary companies, to deliver copies of their accounts for each financial year to the Registrar of Companies who will place them on the public file.
- 2) Annual CIC report: The directors of a CIC are statutorily required to prepare an annual CIC report to be filed with their accounts. The purpose of this report is to show that the CIC is still satisfying the community interest test, and that it is engaging appropriately with its stakeholders in carrying out activities, which benefit the community.
- 3) Annual return: The annual return is in effect a snap shot as at the made up date of the essential information about the company. This must be submitted in an annual return form to Companies House.

Clearly, apart from the financial report companies are normally required to submit, it is the “annual CIC report” that is central to the CIC as a social enterprise. The CIC Regulator really expects that ‘...CICs should aspire to provide the fullest possible information rather than simply comply with the minimum requirements’.<sup>99</sup> Moreover, the Regulator also expects that the CIC report ‘...be sent to shareholders and other stakeholders with the directors’ report and annual accounts’. Indeed, as the Regulator emphasises, ‘[c]onsideration of CIC Reports is an important element

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<sup>98</sup> Office of the Regulator of Community Interest Companies, *Information and Guidance Notes – Chapter 8: Statutory Obligations* (BIS 2013) 3-6.

<sup>99</sup> CIC Regulations 2005 prescribe the following as “minimum requirements”: 1) details of what the CIC has done to benefit the community; 2) details of how it has consulted its stakeholders on its activities; 3) details of dividends declared (or proposed) on shares and performance related interest paid and their compliance with the capping rules; and 4) information on the transfer of assets to another locked body or otherwise at less than market value for the benefit of the community. *ibid* 4.

in the Regulator’s monitoring role’,<sup>100</sup> in so far as they provide an ‘insight into the ways CICs are operating...’<sup>101</sup>

I accessed 12 CIC annual reports (CIC 34) covering the period from 2009 to 2015, with the majority (5 out of 12) being the reports lodged in 2014.<sup>102</sup> The form CIC34 is a template, and all 12 CICs practically fulfilled the minimum requirement by filling the form, especially its part 1 (general description of the company’s activities) and part 2 (consultation with stakeholders), only a few CICs failing to supply information on part 3 (directors’ remuneration) and part 4 (transfers of assets other than for full consideration).<sup>103</sup> Notably, many CICs have not simply perfunctorily fulfilled this statutory requirement but also taken advantage of this opportunity to ‘showcase the fantastic work that they have involved in’.<sup>104</sup>

In view of the information I have seen in the reports, I cannot help but share the Regulator’s enthusiasm about the usefulness of these documents.<sup>105</sup> Most significantly, of course, the CIC reports provide a good *practical* means whereby the Regulator can monitor CICs’ activities – and, by this means, to determine whether they are still satisfying the community interest test, being accountable to their stakeholders and carrying out activities that benefit the community.

It is the CIC Regulator’s role in this latter respect that is of particular importance. As I have noted in Chapter 4, preparing public benefit report, as statutorily required in the form of the CIC report, is much more complicated than managing financial disclosures. Public disclosure, in other words, is susceptible to uncertainty and fuzziness both in terms of which issues are to be considered important and which

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<sup>100</sup> *ibid.*

<sup>101</sup> Office of the Regulator of CICs (n 2) 10.

<sup>102</sup> These include the reports of Achieving for Children Community Interest Company; Bewdley Development Trust CIC; Book Donors Community Interest Company; Bristol Bike Café Community Interest Company; Bristol Together CIC; Central Bedfordshire Canine Retail & Services Community Interest Company; Cycle Hub Lincs CIC; Domestic Violence UK CIC; Make It Macclesfield Community Interest Company; Peninsula Community Health CIC; Sandbag Climate Campaign CIC; and The Quest for Gay Men CIC.

<sup>103</sup> It is possible that some of the reports I gained access to are not the full versions or, perhaps, some of their pages are missing. Some CICs do not have information on these matters (no directors received remuneration and there were no transfers of assets), or the information on directors’ remuneration was already included in the financial reports.

<sup>104</sup> Office of the Regulator of CICs (n 2) 18.

<sup>105</sup> The CIC Regulator has confirmed that only less than five per cent of CICs did not take advantage of this opportunity by providing limited or no information in their reports. *ibid.*

measure better depicts the performance of firms. This has a potential effect on the reliability of such disclosures, which are thus harder to discuss and evaluate than financial accounts. To ensure such a disclosure, we need an effective regulator. Hence, to the extent that the CIC Regulator carries out her work efficiently, I accept the mandatory provision on this matter and consider it still another positive aspect of the CIC.

## 5.6 Conclusion

Although the CIC as a legal form for social enterprise does not fully incorporate the features of the ideal-type legal vehicle for this type of business proposed in Chapters 3-4, it most closely satisfies the latter's normative requirements. Hence, while the "model legal form" mapped out there provides a *normative* guideline for the development of a legal form for social enterprise in a country like Thailand, which still does not have one, the CIC most usefully serves as a *practical* guide for the same purpose. In particular, the practical experiences in implementing the CIC form in the UK enable us not to lose sight of what is possible in our search for what is normatively desirable. In concluding this chapter, by way of a recap, an overall view of the strong and weak points of the CIC as a legal form for social enterprise.

First, with regard to the asset lock, the strong point of the CIC is that this governance need is statutorily provided. However, problems remain as to whether the asset lock rule is so harsh, particularly in so far as this involves the non-distribution constraint. Although new dividend and performance-related interest caps have recently been introduced, further adjustments are possible to maintain a balance between the need to attract investment in CICs and compliance with the central CIC concept that the assets and profits of the CIC should be distributed to the benefit of the community.

Second, whereas the statutory provision for the community interest test more or less satisfies the social benefit requirement of the ideal-type legal form and thereby represents a positive aspect of the CIC, rules on stakeholder participation and board composition are not sufficient. Even though the CIC Regulator's recommendation on stakeholder involvement is particularly strong (and various aspects of the



Regulator's activities are also closely involved with CIC stakeholders), this, in principle as well as in practice, is not a substitute for statutory rules to this effect.

Third, that the directors are mandatorily oriented towards stakeholder interests represents another strong point of the CIC. However, with regard to the issue of directors' competence, relevant provisions are clearly inadequate. As I have pointed out above, without sufficient rules on this issue, the governance structure of the CIC is not as effective as it should be as a *stakeholder organisation*.

Finally the statutorily provided external regulator for the CIC may be regarded as still another strong point of this legal form. In my view, the CIC Regulator closely resembles the model external regulator presented in Chapter 4. Nonetheless, as I have noted above, it is the "light touch" approach to regulation that could be problematic. While this approach may actually promote CICs by facilitating their creation and providing various types of assistance to CIC operators, the Regulator's role as a CIC protector is still in doubt, particularly whether the Regulator sufficiently engaged in CIC supervision and investigation.

## **Chapter 6**

# **Main Legal Forms for Social Enterprises in Thailand**

### **6.1 Introduction**

Like its UK counterpart, the Thai social enterprise sector relies on a variety of legal vehicles. There are social enterprises operating as sole traders, which are not governed by any specific law but are only subject to general law such as the law of contracts and obligations, and community enterprises under the Community Enterprise Promotion Act 2005,<sup>1</sup> which permits them to rely on any legal vehicle, or none at all. A new legislative project being considered by the National Reform Council – the Social Enterprise Promotion Bill – also does not designate any specific legal form for social enterprises in Thailand, though it formally posits certain specific features directly relevant to this type of business. We shall consider this legislative project in Chapters 7 and 8.

I propose to evaluate the legal forms for Thai social enterprises in this chapter before considering the Thai social enterprise landscape in the next one. The purpose is to complete the evaluation of the existing legal forms for social enterprises in this part of my thesis, following the evaluation of the CIC in Chapter 5. Legal forms for social enterprises do not represent a prominent subject in the Thai social enterprise landscape; this means that its understanding is hardly a prerequisite to the analysis of the legal forms for social enterprises in Thailand.

According to my findings, social enterprises in Thailand now operate within six main legal forms: 1) partnership, 2) limited company, 3) co-operative, 4) foundation, 5) association, and 6) private school. Governed by specific laws which define them as particular legal entities, these six main types may be subsumed under three categories: (1) for-profit organisations under the Civil and Commercial Code

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<sup>1</sup> Community Enterprise Promotion Act 2000 (B.E. 2548), *Royal Gazette*, Volume 122, Part 6.

1992 (B.E. 2535),<sup>2</sup> (2) non-profit organisations under the same Code, and (3) organisations governed by other laws.<sup>3</sup>

There is insufficient space to address all aspects of those forms. Two for-profit forms and one non-profit type will be assessed here. The main point here may be summarised as follows. As I have noted before, a good legal form for a social enterprise must meet *both* the business aspects of social enterprises, and their social objectives. For Thailand, the for-profit legal forms meet business needs. Their non-profit counterparts meet social needs. But no single form successfully comprises both elements of the social enterprise.

## 6.2 For-profit legal forms under the Civil and Commercial Code

A social enterprise may adopt any of the legal forms of for-profit or business organisations under the Civil and Commercial Code 1992. Thai for-profit organisations can be categorised into: (1) partnership and (2) limited company. This section offers a brief account of each of these forms and a review of their advantages and disadvantages as legal vehicles for social enterprises.

The core criteria for the establishment of each of these legal forms are specified by section 1012 of the Civil and Commercial Code 1992, providing an overall requirement that at least two persons (or three for a limited company)<sup>4</sup> must enter into a contractual agreement to set up a partnership or a limited company with the purpose of sharing profit.<sup>5</sup> Section 1012 makes it clear from the very beginning that the partnership and company are for-profit legal forms with the profit-maximising objective. It is therefore not surprising that their legal provisions do not include

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<sup>2</sup> For the translation version, Kamol Sandhikshetrin, *The Civil and Commercial Code: Books I-VI and Glossary* (6<sup>th</sup> edn, Nitibannagarn 1999).

<sup>3</sup> It must be noted that apart from the law governing the specific legal structure adopted by a social enterprise (in case it opts to operate within a legal structure at all), the latter is usually subject to other laws and regulations. An association, for example, operates under three main Acts, together with ministerial orders and other regulations. Of course, it is not my intention to account for all these legal aspects of a social enterprise in this chapter.

<sup>4</sup> Civil and Commercial Code 1992, s 1097.

<sup>5</sup> Civil and Commercial Code 1992, Book III Specific Contracts, Title XXII Partnerships and Companies, specifies sections relating to the establishment, management, dissolution, etc. of partnerships and companies. However, since setting up a partnership or company is a type of contract, Part 1 Title VI Juristic Acts and Part 2 Title II Contract will be applied in case it is not specified in the partnership and company sections.

social or stakeholder elements, which are regarded as the central features of a social enterprise legal structure.

In view of this shortcoming alone, we might assume that the partnership and company forms are not suitable for social enterprises. But this does not mean that they are unworkable or unusable. This rather means that these two for-profit legal forms do not have the right qualities, thus making it difficult for social enterprises to run efficiently and grow.

### 6.2.1 Partnership

There are two main types of partnership in Thailand, namely, ordinary partnership and limited partnership. A partnership is simply set up by at least two persons agreeing to run a business together and to share profits. Such an agreement can be made either explicitly or implicitly, and no formal or written contract is required.<sup>6</sup>

#### 6.2.1.1 Start-up process

The creation of an ordinary partnership is very simple and cheap. Only a verbal contract is sufficient for this purpose with any need for registration, so its creation is very simple and cheap, and only a verbal contract is sufficient for this purpose. But since all types of partnerships are for-profit entities, they have a duty to pay tax. Ordinary partnerships thus need to apply for personal income tax<sup>7</sup> and sign an ordinary partnership agreement with a stamp duty of 100 baht (around £2)<sup>8</sup> as required by the Revenue Department.<sup>9</sup>

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<sup>6</sup> Sophon Ratanakorn, *Textbook on the Civil and Commercial Code: Partnerships and Companies* (12th edn, Nitibannakarn 2010) 14.

<sup>7</sup> Since ordinary partnership is not a juristic person, it is treated as an ordinary person meaning that it has a duty to pay personal income tax. The Revenue Department has recently introduced a new regulation on income tax on ordinary partnership. From 1 January 2015, the new rule has cancelled the tax exemption on the profits shared among the partners, which was used as a way to avoid tax. This newly introduced tax status of the ordinary partnership seems to affect the current popularity of this legal form. Income Tax of Ordinary Partnership or Non-Juristic Group of Persons (Amendment of Tax Exemption) Revenue Department Order 2015, Por 149/2558 (20 January 2015).

<sup>8</sup> Bank of England, £1 can be exchanged for 50.43 Thai Baht (10 March 2016).

<sup>9</sup> Ordinary partnership agreement form can be downloaded free of charge at the Revenue Department website <[http://download.rd.go.th/fileadmin/tax\\_pdf/request/promise02\\_040652.pdf](http://download.rd.go.th/fileadmin/tax_pdf/request/promise02_040652.pdf)> accessed 3 March 2015

Nonetheless, if ordinary partnership decides to register, it will be provided with the legal status of a juristic person (hereafter “registered partnership”), just like limited partnership and limited company.<sup>10</sup> Section 1016 of the Civil and Commercial Code 1992 requires a partnership or a company to be registered at a local registration office in the area where its main office is located. The Department of Business Development (DBD), Ministry of Commerce, is in charge of the registration process. The registration of registered partnerships and limited partnerships undergoes the same process of filling application forms and supplying required documents and fees. The fees vary with the starting capital contributed by the total amount of the contributions subscribed by the partners but these add up to no more than 5,000 baht (around £100)<sup>11</sup> for the maximum capital of 5,000,000 baht (around £100,000),<sup>12</sup> plus document fees of a few hundred baht.<sup>13</sup> Thus, the registered partnership and limited partnership are more expensive to set up than ordinary partnership, and they are also more costly to operate as they have accounting and auditing burdens. In addition, as a juristic person, they are subject to corporate income tax.

#### 6.2.1.2 Legal personality and limited liability

Ordinary partnerships are non-juristic persons and thereby have no legal personality separate from the partners. They are treated like ordinary persons, who can enjoy greater simplicity, flexibility and confidentiality than any incorporated legal vehicles, for which a minimum requirement is that their profiles appear on the public register. For enterprises relying on unincorporated legal forms, disclosure requirements are far less. A major disadvantage for social enterprises adopting the ordinary partnership is that it does not give their partners limited liability. As a result, the partners’ personal assets are always at risk.

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<sup>10</sup> Civil and Commercial Code 1992, s 1064 provides registration requirements for registered partnerships; and s 1078 for limited partnerships.

<sup>11</sup> Bank of England (n 8).

<sup>12</sup> *ibid.*

<sup>13</sup> Registration application forms can be submitted either online or at one of the 87 registration offices nationwide. The detailed guidance on how to register partnerships and all the application forms are provided online free of charge. DBD, ‘Partnership Registration According to the Civil and Commercial Code’ <[www.dbd.go.th/dbdweb\\_en/ewt\\_news.php?nid=3973&filename=index](http://www.dbd.go.th/dbdweb_en/ewt_news.php?nid=3973&filename=index)> accessed 18 August 2014

We might presume that the law allows ordinary partnerships to register in order to better protect the partners in the following ways. First, registered partners' liabilities against creditors of the partnership will remain for two years after they resign,<sup>14</sup> whereas ordinary partners have to be liable until the debts are fully paid off.<sup>15</sup> Second, if any partners, who are requested by the creditors of the partnership to pay off debts, can prove that the registered partnership still has sufficient assets to cover the debts, the court may enforce such assets before the partners' personal assets.<sup>16</sup> Finally, if a registered partnership is still in operation, the creditors of the partners are not able to request their debts to be paid off from the partners' shares in the partnership.<sup>17</sup> These benefits nevertheless provide very little protection for partners, compared with benefits of limited liability. Under Section 1025, both registered partnership and its partners have to be liable to the creditors of the partnership unlimitedly, even though the partners may be able to *delay* their liabilities for a while. In theory, all partners of a registered partnership still have to bear unlimited liability.<sup>18</sup>

Let us now consider the protection against risk provided by a *limited* partnership. Under section 1077 of the Civil and Commercial Code 1992, a limited partnership has two kinds of partners. The first type consists of one or more partners whose liability is limited to such an amount as they may respectively undertake to contribute to the partnership, and the second type is composed of one or more partners, who are jointly and unlimitedly liable to all the debts of the partnership. Also called managing partners, they have full authority to manage the partnership.<sup>19</sup> But if a partner with limited liability interferes with its management, she becomes jointly and unlimitedly liable to all the obligations of the partnership.<sup>20</sup>

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<sup>14</sup> Civil and Commercial Code 1992, s 1068.

<sup>15</sup> Civil and Commercial Code 1992, s 1051.

<sup>16</sup> Civil and Commercial Code 1992, s 1071.

<sup>17</sup> Civil and Commercial Code 1992, s 1072.

<sup>18</sup> Civil and Commercial Code 1992, s 1070: The creditor of an obligation due by a registered ordinary partnership is entitled, as soon as the partnership is in default, to demand the performance of the obligation from **any** of the partners (emphasis added).

<sup>19</sup> Civil and Commercial Code 1992, s 1087.

<sup>20</sup> Civil and Commercial Code 1992, s 1088. This is similar to the limited partnerships which may be formed in the UK under the Limited Partnership Act 1907.

The partners with unlimited liability have to face the same legal consequences as the ordinary partners do.<sup>21</sup> That is, the managing partners are not well protected by law and their personal assets will always be at risk. In contrast, the partners with limited liability are protected by section 1095, which stipulates that as long as the partnership is still in operation, the creditors of such a partnership can take no legal action against the partners with limited liability even though they have partly-paid contributions.<sup>22</sup> The creditors can only force the partnership and its managing partners to be liable. But as soon as the partnership is dissolved, legal actions may be taken by the creditors of the partnership against the partners with limited liability. However, their liability will be limited to (1) contributions that are still unpaid, (2) contributions that have been withdrawn from the partnership's assets, and (3) dividends and interests which the partners have received in bad faith and contrary to section 1084.

If we compare a registered partnership with its ordinary counterpart, it is evident that the registered form is better since it comes with separate legal personality as well as some protection for partners under sections 1068, 1071 and 1072. However, an ordinary partnership is in fact more popular than registered partnership.<sup>23</sup> A main reason for this preference might be that entrepreneurs see tax benefits (which have been revoked) and the maintenance of secrecy as more important than the benefits of limited liability. Registering an ordinary partnership incurs time and cost for little additional advantage.

Is limited partnership, which is seen as a mix between ordinary partnership and limited company,<sup>24</sup> a suitable legal form for social enterprises? In fact, despite the limited liability it provides, limited partnership has its disadvantages as a legal vehicle for business in general as well as for social enterprises. First and foremost, it does not provide limited liability protection for *all* partners. Second, since the

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<sup>21</sup> Civil and Commercial Code 1992, s 1080 provides that ordinary partnership law will be applied to limited partnership (particularly to the partners with unlimited liability), if the limited partnership law does not suggest otherwise.

<sup>22</sup> Civil and Commercial Code 1992, s 1083 provides that contributions provided by the partners with limited liability can be in a form of either money or assets.

<sup>23</sup> Yos Nakakes and Kritika Limlawan, 'Types of Business Organizations under Civil and Commercial Code' (2010) 30(2) Executive Journal 132, 134.

<sup>24</sup> Ratanakorn (n 6) 177.

legal provisions for the ordinary partnership also generally apply to the limited partnership, the latter actually operates in much the same manner as an ordinary partnership, especially entailing the same disadvantages for social enterprises.

Another related aspect of partnerships should also be noted here. That is, partnership can easily terminate. Apart from the possibility of being terminated under contractual conditions or by court order, an ordinary partnership is dissolved if a partner dies, becomes bankrupt or incapacitated, or withdraws.<sup>25</sup> This also applies to the registered and the limited partnerships.<sup>26</sup> Thus, the “legal personality” of the registered partnership does not give it the “perpetual succession”. Even the status of the limited partnership is not particularly stable, as this can be affected by the death, bankruptcy, or incapacitation of unlimited liability partners. Given these shortcomings of the partnership, limited company seems to be a more popular and probably more suitable legal form for mainstream businesses and even social enterprises, which we shall shortly turn in sub-section 6.2.2.

#### 6.2.1.3 Raising of finance

Ordinary partnerships have two capital raising problems.<sup>27</sup> First, they may struggle to find new partners to put more, new capital into the partnerships since section 1040 forbids them from introducing new partners without consent from all other partners. Second, potential partners know they cannot easily sell their shares,<sup>28</sup> so it is harder to persuade anyone to become an investing partner in the first place.

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<sup>25</sup> Civil and Commercial Code 1992, s 1055.

<sup>26</sup> Civil and Commercial Code 1992, s 1069 states that apart from the reasons in s 1055 a registered ordinary partnership terminates if it goes bankrupt. For limited partnership, s 1080 stipulates that ordinary partnership law will be applied unless otherwise specified by limited partnership rules. The limited partnership law does not provide reasons causing its termination. Therefore s 1055 applies, but only to partners with unlimited liability since s 1092 specifies that the death of the partners with limited liability or them becoming bankrupt or incapacitated does not terminate the limited partnership.

<sup>27</sup> Ordinary partnerships might be more favourable than sole traders in terms of raising finance from partners and dispersing risks among them. Prachuab Permsuwan, *An Introduction to Business* (6<sup>th</sup> edn, Bangkok University 2010) 24.

<sup>28</sup> Civil and Commercial Code 1992, s 1041 stipulates that even if a partner transfers all or part of her share of profits to a third party, the transfer without consent from all other partners will not make such a third party a new partner. This means that with only one partner refusing to give consent, recruiting new partners or transferring shares to other people is invalid. However, this section is a default rule which can be amended.



A limited partnership has better prospects of recruiting people with investment capital and/or professional expertise as limited liability partners from among wider groups of prospective partners than an ordinary partnership can normally do.<sup>29</sup> This could attract private investors since the contributions provided by limited liability partners can be transferred without consent from other partners<sup>30</sup> and can also be transmitted to the heirs of the partners who pass away.<sup>31</sup> Despite some benefits<sup>32</sup> and protection, limited partnerships still suffer from certain shortcomings, which make them unattractive to investors (we shall consider this issue below). This type of legal form has been popular among relatives and acquaintances, or among professionals such as lawyers and medical doctors, who want to set up a business venture.

#### 6.2.1.4 Controlling agency costs

The ordinary partnership law provides certain packages of rules facilitating the controlling of agency costs. Section 1033 of the Civil and Commercial Code 1992 provides that if not specified otherwise, every partner can manage the ordinary partnership; in other words, they all become managing partners. In principle, there is no separation of ownership and control. Therefore, no agency costs are incurred. They are also being accountable to each other with the law further stipulating that no partners may enter into a contract to which another partner objects.<sup>33</sup> In addition, partners are not entitled to any remuneration in exchange for their part in the management.<sup>34</sup> This makes sense since they are owners of the partnership, not agents.

Nonetheless, allowing all partners to operate an ordinary partnership might not be efficient in practice, especially if the partnership has a complex internal structure, or grows bigger. If the partners agree to relegate management power to a certain

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<sup>29</sup> Civil and Commercial Code 1992, s 1083.

<sup>30</sup> Civil and Commercial Code 1992, s 1091.

<sup>31</sup> Civil and Commercial Code 1992, s 1093.

<sup>32</sup> For example, limited liability partners are allowed to compete with the partnership under s 1090.

<sup>33</sup> This does not mean that they have to ask for other partners' consent before making a decision. However, it is advised that in order to make decisions on important and complex business transactions, partners should adopt a majority rule under s 1034. Pasakorn Chunha-urai, *A Textbook on the Civil and Commercial Code: Partnership and Company* (Nitibannakarn 1988) 612.

<sup>34</sup> Civil and Commercial Code 1992, s 1046.

few with a view to running the partnership more efficiently, to ensure that such power is not abused for personal gains, the law grants monitoring power to the non-managing partners.<sup>35</sup> If the managing partners misuse their power, they could be fired<sup>36</sup> or even sued for damages, though the lawsuit must be filed within one year after the incident is discovered. However, these rules are not a guarantee that partners will not seek personal benefits.

Limited partnership law provides a rather different approach on controlling agency costs. A limited partnership must be managed only by the partners with unlimited liability.<sup>37</sup> If a limited liability partner interferes with the management, she will be liable to all the debts and obligations of the partnership unlimitedly. But this does not give such a partner a right to become a managing partner. Managing partners thus do not have to be accountable to limited liability partners, but only to unlimited liability partners<sup>38</sup> and other managing partners.<sup>39</sup> This gives the managing partners an opportunity to seek personal benefit, causing agency costs. The law provides the managing partners with almost total power as they have to bear unlimited liabilities. Limited liability partners only have the right to give opinion and advice, and vote for the appointment or withdrawal of managing partners without being able to object to any decisions made by managing partners.<sup>40</sup> In conclusion, both ordinary and limited partnerships do not seem to be able to deal with agency problems efficiently, which might be a reason why they are not as attractive as the company form.

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<sup>35</sup> Civil and Commercial Code 1992, s 1037 allows non-managing partners to enquire into the management of the business anytime, and to inspect and copy all files and documents of the ordinary partnership.

<sup>36</sup> Civil and Commercial Code 1992, s 1036.

<sup>37</sup> Civil and Commercial Code 1992, s 1087.

<sup>38</sup> Civil and Commercial Code 1992, s 1037 gives unlimited liability partners monitoring power to inquire about management anytime, to inspect and copy all the files and documents of the partnership.

<sup>39</sup> Civil and Commercial Code 1992, s 1035 provides that if the partners agree to appoint certain partners as managing partners, no managing partners can enter into a contract which is objected by another managing partner.

<sup>40</sup> Civil and Commercial Code 1992, s 1088.

#### 6.2.1.5 Asset lock and non-distribution constraint

Thai partnership law comes with neither the asset lock nor non-distribution constraints. However, one good thing about such law is that most provisions are default rules, thus social entrepreneurs might agree to limit the profit distribution as they wish. An agreement to do so can be achieved verbally in ordinary partnerships, although a written contract is preferable. Registered and limited partnerships are required to register the agreement.

For the liquidation of a partnership, its assets must be distributed respectively as follows: (1) as repayment of the debts to creditors, (2) as reimbursement of advances made or expenses incurred by the partners in managing the business, and (3) as return of the contributions made by the partners when starting the partnership. The residual assets should be treated as profits and shared among the partners.<sup>41</sup> Even though partners are not permitted to agree differently, in my view, partners might agree among themselves that after paying off debts to creditors and effecting the return of contributions, the residual assets would be transferred to, say, a non-profit organisation or a social enterprise, as this is unlikely to affect creditors or third parties. Such an agreement is considered “self-imposed asset lock”. However, this sort of self-imposed asset lock has major weaknesses as already mentioned in Chapter 4 (sub-section 4.3.2.1).

#### 6.2.1.6 Social benefit requirement

The partnership is a business organisation under the Civil and Commercial Code 1992. If social entrepreneurs adopt this business legal form, they must find a way to communicate to the public that their activities are primarily geared towards social benefit. Though partners might be able to insert a social purpose in the partnership’s constitution and even register them, the law does not allow them to amend or deny that partnerships (and also companies) maximise profits and share them among partners, which is acceptable in my view since social enterprises obviously aim to generate income and profit in order to sustain. However, the problem is no matter how much they try to explain that they engage in a business with social mission,

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<sup>41</sup> Civil and Commercial Code 1992, s 1062.

most people in Thailand still believe that business organisations will always seek profit first and foremost. We cannot blame them since the law confirms this too.

#### 6.2.1.7 Stakeholder participation

As the not-for-profit concept is still not a familiar one in Thailand, it is not surprising that the meaning and significance of stakeholders are still rarely recognised among members of the general public or even among Thai social entrepreneurs. Though Thai partnership law has provisions on the relationship between partners and third parties, it aims at protecting the third parties, including stakeholders, who could be affected by a partnership's activities rather than facilitating stakeholder participation.

In fact, since unlimited liability partners are given absolute power in managing a partnership, if they want to have a stakeholder as a partner, they can do so easily. Such a stakeholder partner will be granted the same management and decision-making power, or if she is not a managing partner, she still has monitoring power. If a stakeholder is a limited liability partner, she is not allowed to manage the partnership. However, she is still able to give advice and vote on the appointment or withdrawal of managing partners. This shows that though the law does not facilitate stakeholder participation, it still gives partners freedom to do so via private agreements. However, we have learned from Chapter 3, the benefit of the facilitative role of law, without such a benefit, the partnership form is not desirable for social enterprises.

#### 6.2.1.8 Public disclosure

The minimum disclosure requirements for registered and limited partnerships include their names, objectives and location; the partners' names, addresses and professions; the managing partner(s)' name(s) and the restrictions (if any) imposed upon the powers of the managing partners to bind the partnership. The registration certificate must also be signed by all the partners and affixed with the partnership's seal.<sup>42</sup>

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<sup>42</sup> Civil and Commercial Code 1992, ss 1064 and 1078.

The regulations of the Department of Business Development specify that registered and limited partnerships are among the business organisations required to deliver their annual financial statements, together with a certified auditor's report.<sup>43</sup>

Only ordinary partnerships are exempt from this requirement. Hence, in operating as social enterprises, they tend to suffer from lacking credibility as such ventures. By their very nature, they are close-knit business organisations. Indeed, being not legally subject to “disclosure” or “transparency”, they can keep their affairs secret or confidential. Though they are subject to the accounting and auditing requirements, basically they remain highly close-knit business organisations. Hence, without a legal rule for greater transparency, a registered or ordinary partnership as a social enterprise would hardly sustain a public trust, making it difficult not only to compete with mainstream businesses but also to be recognised as a social enterprise.

Clearly, we can say that the main advantages of partnerships are their flexibility: partners have great freedom in running their business. Although the law more or less provides for the “good governance” of the partnerships, in operating as legal vehicles for social enterprise, they clearly suffer from “gaps” in terms of the lack of legal provisions for disclosure and transparency as well as the social and participatory elements of social enterprises. Together with their other shortcomings, notably their lack of sufficient limited liability protection and perpetual succession, partnerships are not particularly useful for social enterprises.

### **6.2.2 Limited company**

Thailand has only one type of company, the limited company by share.<sup>44</sup> Like the partnership, the limited company is a for-profit venture aiming to maximise profit and share it among shareholders.<sup>45</sup> As a legal form for business organisations, the limited company has many distinct advantages over the ordinary and limited

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<sup>43</sup> The Department of Business Development has prepared a *Manual for the Delivery of Financial Statements* (DBD 2015), which contains all relevant laws and regulations.

<sup>44</sup> Thailand has no “guarantee” company like in the UK, and obviously no CIC.

<sup>45</sup> Civil and Commercial Code 1992, s 1012.

partnerships. It presumably better facilitates and supports the business side of the social enterprise than any other legal forms. I shall also examine whether it would be useful for the social benefit side of the social enterprise.

#### 6.2.2.1 Start-up process

Setting up a limited company in Thailand involves a rather simple process. The Department of Business Development (DBD) provides all the necessary information and registration forms free of charge on its website.<sup>46</sup> To set up a limited company,<sup>47</sup> at least three persons called “promoters”<sup>48</sup> sign their names in a memorandum of association<sup>49</sup> and reserve the purchase of at least one share.<sup>50</sup> The company must divide its investment capital into shares of equal value.<sup>51</sup> The minimum value of one share is five baht (around £0.10);<sup>52</sup> hence, the minimum registered share capital can be as low as fifteen baht (around £0.30).<sup>53</sup> However, in practice no company starts off with just the minimum capital requirement since this can affect its financial status and credibility.

In Thailand, it is a common practice to register a start-up share capital of one million baht (around £20,000).<sup>54</sup> One reason is that the minimum registration fee is 5,000 baht (around £100).<sup>55</sup> This means that whether the registered share capital is 15 baht or one million baht, the minimum registration fee is the same, and that is 5,000 baht. For a registered share capital that is larger than one million baht, a 500-baht (around

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<sup>46</sup> DBD, ‘Company Limited Registration According to the Civil and Commercial Code’ <[www.dbd.go.th/dbdweb\\_en/ewt\\_news.php?nid=3966&filename=index](http://www.dbd.go.th/dbdweb_en/ewt_news.php?nid=3966&filename=index)> accessed 18 August 2014

<sup>47</sup> Civil and Commercial Code 1992, s 1097.

<sup>48</sup> Promoters are like founders of a company. They must be ordinary persons (foreign nationals are permitted), not juristic ones, aged 12 and over.

<sup>49</sup> Civil and Commercial Code 1992, s 1098 provides the list of items to be included in the memorandum: (1) the name of the company ending with “limited”, (2) the address, (3) the objectives, (4) the statement specifying that shareholders have limited liability, (5) the initial share capital and the value of each share, and (6) the names, professions, addresses and signatures of the promoters as well as the number of shares they reserve to purchase.

<sup>50</sup> Civil and Commercial Code 1992, s 1100.

<sup>51</sup> Civil and Commercial Code 1992, s 1096.

<sup>52</sup> Civil and Commercial Code 1992, s 1117.

<sup>53</sup> Bank of England (n 8).

<sup>54</sup> *ibid.*

<sup>55</sup> The company registration fee is 500 baht (£10) for every 100,000 baht (£2,000) share capital. But the minimum fee is 5,000 baht (£100). This means that the maximum share capital for 5,000 baht registration fee is one million baht (£20,000). To put it another way, this minimum registration fee covers as much as one million share capital.

£10)<sup>56</sup> increase in the registration fee for every additional 100,000 baht (around £2,000)<sup>57</sup> of the registered share capital is required. Another reason is that if a company plans to raise the share capital in the future, it has to pay more fees and prepare more documents. Entrepreneurs might not have a cash amount of £20,000 at the time of registration, but before registration all of the shares must be reserved,<sup>58</sup> and a minimum of 25 per cent of the shares must be paid.<sup>59</sup> In addition, from 5 January 2015 a company with a share capital of more than five million baht (around £100,000)<sup>60</sup> is required to provide evidence of the source of such capital to prevent accounting frauds and money laundering.<sup>61</sup>

After the subscription of shares, the promoters must without delay call a general meeting of subscribers<sup>62</sup> to decide on matters such as the company's constitution and the appointment of director(s) and auditor(s) and the specification of their powers.<sup>63</sup> The registration of the memorandum setting up the company can be done on the same day if (1) all the shares have been reserved, (2) the general meeting has been held, (3) the promoters have handed over the business to the directors, and (4) at least 25 per cent of the shares have been paid.<sup>64</sup>

In practice, the promoters are also the main subscribers of the company's shares. Though the law requires that a general meeting on company creation be held, it can be easily done by just filling the meeting report form provided free of charge by the DBD. The registration process takes only a few hours if all the documents are correct and submitted in person at a registration office. Online registration is not yet available.

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<sup>56</sup> Bank of England (n 8).

<sup>57</sup> *ibid.*

<sup>58</sup> Civil and Commercial Code 1992, s 1104.

<sup>59</sup> Civil and Commercial Code 1992, ss 1105 and 1110.

<sup>60</sup> Bank of England (n 8).

<sup>61</sup> 'Regulations on, and Documents Required for, Limited Company Registration and Addition of Limited Company Share Capital', Department of Business Development Order 2014, No 230/2557 (18 December 2014).

<sup>62</sup> Civil and Commercial Code 1992, s 1107.

<sup>63</sup> Civil and Commercial Code 1992, s 1108.

<sup>64</sup> Civil and Commercial Code 1992, s 1111/1.

### 6.2.2.2 Legal personality and limited liability

A limited company must be registered to become a juristic person.<sup>65</sup> Since the law deems that the company and its shareholders are not the same person, even if a shareholder dies or quits, this will not affect the existence of the company, as long as the number of shareholders is not lower than that required by the law.<sup>66</sup> A company is not a property which is owned by the shareholders, and the property of the company is owned by the company, not shareholders: the shareholders actually own the *shares* in the company.<sup>67</sup>

In addition to separate legal personality, a limited company also comes with limited liability. Each shareholder can own any number of shares, and liability is limited to the amount of, if any, the unpaid shares she holds. If a shareholder has already paid the full amount of shares she owns, then she is not liable to the obligations the company has incurred.<sup>68</sup> As basic but necessary protection against risks offered by a limited company, legal personality and limited liability can have the important effect of attracting more investors and facilitating commercial transactions. As we have seen, although the limited partnership also offers such benefits, it does not provide every partner with full protection against risks. In contrast, the limited company can provide limited liability protection for *all* shareholders.

### 6.2.2.3 Raising of finance

Another important reason why the limited company is desirable for traditional business as well as social enterprises is that it is believed to have easier access to finance, particularly the equity finance, by selling or increasing their shares, than any other legal form. Ratanakorn defines shares of a limited company as follows:

Looked at from the company's perspective, shares are the capital the shareholders have brought to the company for the pursuit of its business activities. From the viewpoint of the outsider or the company's creditor, the shares are the guarantee for the payment of its debts. For the individual shareholders, the shares represent their stakes in the company.<sup>69</sup>

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<sup>65</sup> Civil and Commercial Code 1992, s 1015.

<sup>66</sup> Civil and Commercial Code 1992, s 1237(4) specifies that the court can order a company to terminate if the number of the shareholders in the company is less than three.

<sup>67</sup> Ratanakorn (n 6) 209.

<sup>68</sup> Civil and Commercial Code 1992, s 1096.

<sup>69</sup> Ratanakorn (n 6) 279.



A limited company is permitted to issue two types of shares, namely, ordinary shares and preference shares. Ordinary shares generally provide the owners with the right to receive a part of company's profit in the form of dividend, to receive residual assets when the company is dissolved, to vote and to monitor the company's management, and to receive protection involving the company's benefits; whereas preference shareholders have the right to be paid a special or fixed dividend or company assets before ordinary shareholders, but they normally do not have a voting right.<sup>70</sup>

The company must specify the qualifications of such shares in its constitution. After the shares are issued, they cannot be amended.<sup>71</sup> Though the issue of preference shares is aimed at attracting more investors, particularly those who expect a special treatment such as a fixed dividend, such shares are not popular in practice. A fixed dividend is generally distributed with a rather low rate, and the shareholders also lose certain rights such as voting right. Moreover, preference shares cannot be converted into ordinary shares and *vice versa*.<sup>72</sup>

Apart from offering different types of shares, limited company law also ensures that those shares are transferable to prevent shareholders from being locked in the company. This could attract more investors since the law provides them with an exit when they think the company is not operating in a right way. In particular, social investors can leave a social enterprise operating as a limited company which they are supporting, if they think that it is committing a mission drift. Shares are transferable without the consent from the company. However, the transfer must be made in writing, signed by the transferor, the transferee and at least one witness;

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<sup>70</sup> Nonthawatch Nawatrakulpisut, *Partnership, Company and Public Company Laws* (3<sup>rd</sup> edn, Winyuchon 2015) 199-201.

<sup>71</sup> Civil and Commercial Code 1992, s 1142.

<sup>72</sup> This is clearly not suitable for the changing conditions of the commercial sector, and ordinary shares do not always mean inferiority. Ratanakorn argues that section 1142 should not be interpreted as a complete ban on the amendment to preference shares. Since the establishment of a limited company involves a private agreement; hence, if *all* shareholders agree that the qualifications of preference shares be amendable, it should not be against this section. However, section 1142 still requires strict interpretation, but companies can choose to opt out as preference shares are default rules. Ratanakorn (n 6) 287-89. In my view, section 1142 should be brought up to date by transforming into an equivalent of section 65 of the Public Limited Company Act 1992, which allows the conversion of preference shares into ordinary shares, but which stipulates that this be clearly specified in the company's articles.

otherwise it is void.<sup>73</sup> Thailand also has bearer shares.<sup>74</sup> However, though such shares are easy to transfer, most companies do not prefer issuing shares of this type, because they are difficult to check. From 26 May 2005, UK companies are no longer permitted to issue bearer shares in order to prevent illegal activities and promote transparency.<sup>75</sup>

Clearly, not only does the law provide a limited company with an opportunity to raise capital, particularly share capital, but it also facilitates dealings on matters related to shares as well as shareholder protection. Even though some sections of Thai law might not be up to date, the limited company remains most effective for the pursuit of business activities, particularly in so far as capital and financial matters, which represent the artery of business, are concerned.

Apart from share capital, limited company also has a better access to debt finance than any other legal forms (for example, given the familiarity of the form as well as the disclosure rules, which could make lenders especially banks feel assured). Together with both its corporate character and the “professionalisation” of its governance, which will be discussed below, the limited company represents perhaps the most effective means of mobilising both loans and share capital.

#### 6.2.2.4 Controlling agency costs

It is required that a limited company has at least one director to manage the company in accordance with the company’s constitution, but the director(s) will be under the control and supervision of the shareholders.<sup>76</sup> Though the shareholders have the right to appoint directors and even to amend the company’s constitution, they are required to relegate their management power to the directors<sup>77</sup> acting as its

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<sup>73</sup> Civil and Commercial Code 1992, s 1129.

<sup>74</sup> Civil and Commercial Code 1992, ss 1134-1136.

<sup>75</sup> Department for Business Innovation & Skills, *Small Business, Enterprise and Employment Act: Companies: Transparency* (BIS 2015) 3.

<sup>76</sup> Civil and Commercial Code 1992, s 1144.

<sup>77</sup> Civil and Commercial Code 1992, s 1110 requires that the promoters assign directors all the management tasks before registering a limited company.

agents,<sup>78</sup> which could clearly lead to agency problems. Let us briefly take a look at how Thai company law deals with agency costs.<sup>79</sup>

It should be noted again that the law on company management attaches specific importance to the company's internal agreement. Hence, most legal provisions on this matter are in the form of default rules. But if the company does not provide its own regulations on any specific matter, relevant provisions of the Civil and Commercial Code apply. After a company is registered, amendments to its constitution are not permitted<sup>80</sup> unless it is approved by a special resolution; that is, the general meeting decides with at least a three-fourth majority of the shareholders who attend the meeting and who are eligible to vote.<sup>81</sup>

In order to prevent some directors from influencing or monopolising control over a board of directors, one third of the directors must retire from office at the first ordinary meeting every year. In the first and second years the directors may simply agree among themselves, or draw lots to decide, who will retire, and in the subsequent year the directors who have been in office for the longest period will retire.<sup>82</sup> However, the retiring director can be re-elected, and these rules only apply to a limited company having at least three directors.

In addition, directors must manage the company with care, just like a careful businessman.<sup>83</sup> Though company law does not expressly mention the fiduciary duty of directors, section 1167 of the Civil and Commercial Code 1992 allows the law of agency, which stipulates the fiduciary duty of agents, to be applied instead. Section 1168 further requires that directors must not compete with the company and must not become unlimited liability partners in a partnership which has a similar type of business. This prohibits directors from any conflict of interest, but directors

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<sup>78</sup> Civil and Commercial Code 1992, s 1167 clearly states that the relationship between directors, the company and third parties is under the law of agency.

<sup>79</sup> My focus will be on how the law offers company operators in reducing agency costs. I shall not discuss private agreements between directors and the company, such as those relating "executive compensations".

<sup>80</sup> Civil and Commercial Code 1992, s 1145.

<sup>81</sup> Civil and Commercial Code 1992, s 1194.

<sup>82</sup> Civil and Commercial Code 1992, ss 1152 and 1153.

<sup>83</sup> Civil and Commercial Code 1992, s 1168: 'The directors must in their conduct of the business apply the diligence of a careful business man'.

may be allowed to have conflicting interests if the general meeting of shareholders' gives its consent. Finally, if a director incurs damages to the company, the latter might file a lawsuit against her for compensation.<sup>84</sup> And if the company does not want to do so, a shareholder can file a lawsuit on behalf of the company instead.<sup>85</sup> The law even gives creditors the right to sue directors, but only if the company or a shareholder refuses to do so.

Ratanakorn argues that section 1169 aims to clarify who has the right to sue directors, rather than about which actions of directors could cause damages.<sup>86</sup> In my view, this section, in a way, serves as a warning to directors that if they seek personal benefits, they could face legal action. However, in practice, even when damages to the company have been done, it needs to be verified whether the damages occurred while the directors were performing their duty. The directors often receive protection from responsibility for damages to the company. Otherwise, few would be prepared to serve as directors, and those serving as directors would naturally tend to be risk averse.

Clearly, the limited company cannot provide rules that could completely control agency costs. This is nevertheless not beyond expectation. My intention is to confirm that if a social enterprise takes a company form, it has to prepare for agency costs. However, in my view, the Thai limited company structure is likely to provide satisfactory rules on controlling agency costs. Let me move on to what the company form can offer in matters relating to the stakeholder needs of social enterprise.

#### 6.2.2.5 Asset lock and non-distribution constraint

Thai company law permits the distribution of profit to shareholders in a form of dividend as return on their investment. It is a duty of directors to distribute dividends or interests,<sup>87</sup> and the dividends must be paid according to the proportion of paid shares, unless otherwise decided in regard to preference shares.<sup>88</sup> In addition, dividend payments must be approved by the general meeting of

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<sup>84</sup> Civil and Commercial Code 1992, s 1169.

<sup>85</sup> This is similar to a "derivative claim" for the benefit of the company in the UK.

<sup>86</sup> Ratanakorn (n 6) 418-24.

<sup>87</sup> Civil and Commercial Code 1992, s 1168 (3).

<sup>88</sup> Civil and Commercial Code 1992, s 1200.

shareholders, though directors may decide to pay shareholders interim dividends occasionally if it appears that the company has sufficient profits. However, no dividend shall be paid otherwise than out of profits, and when the company is facing loss.<sup>89</sup>

Even though Thai company law does not impose limits on profit distribution like the CIC's dividend cap, the company is required to set up a reserve fund of at least one-twentieth of the profits arising from the business of the company every time the dividend is paid until the reserve fund has at least reached one-tenth of the company's capital.<sup>90</sup> The higher rates are permitted but it must be prescribed in the company's articles. However, the main purpose of the reserve fund is to protect creditors.<sup>91</sup>

The reserve fund requirement might be treated as a constraint on profit distribution, but this would be ineffectual as such a constraint: the minimum rate of 10 per cent of the capital seems too low to make an effective reinvestment in a social business (90 per cent of all the profits will be given to shareholders). If a social enterprise sets the rate much higher, say, the reserve fund of 50 per cent of the capital, it might not be attractive to investors. This is a major drawback of a for-profit from being used by social enterprises.

When a company is dissolved, all costs, charges and expenses incurred during dissolution must be paid before any other debts.<sup>92</sup> Then the residual assets will be shared among the shareholders.<sup>93</sup> Obviously, this means there is no lock on asset transfer in the company form. However, it might be possible to prescribe an asset lock in the company's constitution, for example, by requiring that all the residual assets must be transferred to a non-profit or not-for-profit organisation. It might be useful to provide a shareholder agreement to this effect.<sup>94</sup> In practice, it is unlikely

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<sup>89</sup> Civil and Commercial Code 1992, s 1201.

<sup>90</sup> Civil and Commercial Code 1992, s 1202.

<sup>91</sup> Civil and Commercial Code 1992, s 1203 provides that the breach of ss 1201 and 1202 gives creditors a right to demand the paid dividends back.

<sup>92</sup> Civil and Commercial Code 1992, s 1263.

<sup>93</sup> Civil and Commercial Code 1992, s 1269.

<sup>94</sup> Ratanakorn (n 6) 255-58.

that companies will prepare a privately-drafted contract since it will be costly and unattractive.

#### 6.2.2.6 Social benefit requirement

Thai company law makes it clear that companies are set up for the purpose of “sharing profits” derived from their activities. This might facilitate the entrepreneurial goals of social enterprises but is fundamentally incompatible with their social benefit requirement, which is commonly inherent in non-profit legal forms like the foundation and association. Social entrepreneurs who wish to adopt the company form will face such a dilemma and need to find a way to overcome this legal obstacle.

Thai social enterprises have to use various methods to communicate to the public that they are not-for-profits. In practice, some introduce their not-for-profit position through social campaigns or set up a charitable subsidiary, whereas others can only try to explain to society how they are running social enterprises. They may also try to make their orientation clear by taking part in activities organised by the Thai Social Enterprise Office (TSEO). But it takes time before their companies are generally recognised as social enterprises. Still others avoid calling themselves social enterprises in order to not to create any misunderstanding or any complication and proceed fully as for-profits, even though they are actually social enterprises.

In my view, a most suitable option for companies to deal with this problem is to add a social benefit section to their constitution. Adding a social benefit objective should be done at the statutory meeting, because amendments to the company’s constitution after the registration involve a rather complicated process. The law only permits the amendments by special resolution,<sup>95</sup> which requires a three-fourth majority of those attending the meeting and being entitled to votes.<sup>96</sup> After the social benefit clause is adopted, it must be registered within 14 days.<sup>97</sup> Apart from these few options, the company form does not really offer anything else to facilitate

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<sup>95</sup> Civil and Commercial Code 1992, s 1145.

<sup>96</sup> Civil and Commercial Code 1992, s 1194.

<sup>97</sup> Civil and Commercial Code 1992, s 1146.

the social benefit orientation. This again confirms the need for a legal form specially designed for social enterprises in Thailand.

#### 6.2.2.7 Directors' duties and competence

If a company includes a social benefit requirement in its governing document, it then needs also to prescribe an extra-duty of directors in the constitution, that is, a duty to balance the conflicting objectives – the commercial objectives which are required by law and the social objectives prescribed by its internal regulations. In other words, the directors should be able to, at least in theory, serve both shareholder and stakeholder interests equally – this has already been discussed in detail in Chapter 4.

Clearly, the Thai company form neither supports the hybrid nature of social enterprise nor facilitates directors in dealing with it. Though a company adds an extra duty to balance social and commercial objectives, it is not easy for directors to achieve it in practice. A detailed guideline with legal assistance will be needed, and different companies will devise their own regulations on this matter, which might not be based on the same standards, resulting in directors being unable to manage a social enterprise effectively. What the Civil and Commercial Code offers are section 1144, which requires that directors must manage the company in accordance with the constitution, and section 1168, which stipulates four specific duties of directors, namely, (1) to make sure that share prices are paid properly, (2) to prepare and keep the company's account books and other documents required by law, (3) to distribute dividends or interests, and (4) to comply with the general meeting's decisions.

#### 6.2.2.8 Stakeholder participation

Some companies in Thailand, especially large public companies, are aware of the importance of stakeholder involvement. Some have shown an increasing concern for their public images and have thereby attempted to promote them through corporate social responsibility (CSR)<sup>98</sup> and other activities. This could be

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<sup>98</sup> CSR methods used in Thailand are generally adopted to justify companies' activities, making people feel that they are not always money hungry or sinful (such as cigarette or beer companies).

considered indirect stakeholder participation and it is not legally required. Though most of them are not really social enterprises, it shows that the limited company as a legal structure is, at least theoretically, flexible enough to allow for stakeholder participation.

Though the company law does not really mention anything about stakeholder participation, this means that the law does not forbid it either. If a company wishes to involve stakeholders in its management, it can introduce this as an internal agenda at a general meeting, or make it more formal by inserting a stakeholder participation requirement in the company's constitution, and register it, in much the same way as the asset lock or the social benefit requirement is incorporated into the company's governing documents. Even though it seems that companies have freedom and flexibility to do this, in practice, I doubt how many social enterprises in a company form would bother such complication as well as costs. Also, will shareholders happily allow that?

In Thailand a successful example of stakeholder participation might be found in co-operatives in a form of employee participation. But in a limited company employee participation seems mainly to be used as a way to promote employees' loyalty and devotion. In the end, it still aims for the company's benefit, not a true stakeholder benefit.

#### 6.2.2.9 External regulator and public disclosure

Let me briefly discuss the role of the Department of Business Development (DBD) as the agency overseeing business organisations, especially partnerships and companies. In this case, the DBD may be regarded as their regulator, though it does not function in the same way as the CIC Regulator does. Operating under the Ministry of Commerce, its authority mainly consists in taking care of business organisations, particularly in matters relating to their registration, providing information on how to set up a business organisation, and promoting the business

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CSR normally comes in a form of donations or competition for prizes and lucky-draw activities. This is partly to show that they care about society, but also partly to benefit from tax incentives. Therefore, companies with CSR are not social enterprises. For a brief account of CSR, see Kenneth Kim, John R Nofsinger and Derek J Mohr, *Corporate Governance* (3<sup>rd</sup> edn, Pearson 2010) 169-71.



sector as a whole.<sup>99</sup> It might seem that the DBD performs its functions quite independently of the Ministry of Commerce. Moreover, with fees on its services it might also seem that it does not entirely depend on the state budget. However, the Ministry of Commerce still has the final say on important issues or on dealing with conflicts.

The Civil and Commercial Code 1992 clearly does not want a “regulator” to unduly interfere in the activities of business organisations. This is because in principle business involves private agreements; the regulator mainly attends to damages to the third parties. For example, sections 1215-1219 endow the Commerce Minister with the power to inspect the operation of limited companies, but section 1215 provides that the inspection must be requested by shareholders having at least one-fifth of all the shares. However, if the Minister deems it appropriate to inspect the operation of those organisations with a view to producing a report to the Council of Ministers, it has the power under section 1219 to do so without any request. In practice, the intervention in this manner occurs only in extremely serious cases, such as those threatening the peace of the country. The law however does not mention such inspection by the regulator in partnerships. In my view, it is appropriate the DBD assumes the role and responsibility now formally assigned to it.

To conclude this sub-section, I would like to reiterate that the limited company form seems to provide satisfactory rules facilitating the business side of social enterprise, particularly the protection against risk, the raising of finance and the agency cost control. However, it clearly lacks social and stakeholder elements – which are the defining features of social enterprise. Social enterprises in the company form may have to specify in their constitution their objectives regarding, and regulations on, matters such as the transfer of assets, limited dividends, and stakeholder involvement, which are social enterprise benchmarks. This no doubt involves a

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<sup>99</sup> The DBD’s main services provided are: (1) business registration, (2) certification and search of business registration records, (3) accounting and auditing, (4) delivery of balance sheets and lists of shareholders, (5) business promotion, (6) foreigners’ business enterprises, (7) e-commerce, (8) procurement, (9) regional business promotion, (10) statistics, and (11) service centres. DBD, *Strategic Plan of the Department of Business Development 2016-2019* (Thai and English Version 2015).

complicated process requiring legal assistance and how to explain it to for-profit shareholders.

The strict legal and regulatory control under which limited companies operate is actually a crucial measure for their accountability. The accounting and auditing requirements provide a basis for disclosure and transparency. In practice, of course, the story may be totally different. The biggest shareholder often has dominant control; without built-in mechanisms like those of the CIC there is no guarantee that a social enterprise operating as a limited company will not have mission drift.

All this is the reason why, in the British experience, it was ‘...necessary to use a structure other than a simple registered company to ensure that non-charitable social enterprises would maintain their identity and not be converted out of the social enterprise format.’<sup>100</sup> In other words, to operate as a social enterprise, its credibility in the eye of the public who can then have trust in it is very important. If the public does not trust that a for-profit organisation now operating as a social enterprise would not later become a profit-maximising enterprise, it can hardly be expected to fare well as a social enterprise.

### **6.3 Non-profit legal forms under the Civil and Commercial Code**

Having considered the for-profit or business organisations under the Civil and Commercial Code 1992, we now turn to the opposite end of the traditional dichotomy of legal entities – the non-profit or non-business legal forms, which are governed by the same Code. These are association and foundation. However, only the foundation will be dealt with here to see whether it is suitable as a legal form for social enterprises.

#### **6.3.1 Foundation**

Foundations in Thailand exist in a great number and are socially or community oriented in their goals and activities. They are mostly public charity- and/or public

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<sup>100</sup> Ian Snaithe, ‘Recent Reforms to Corporate Legal Structures for Social Enterprise in the UK: Opportunity or Confusion’ (2007) 3(1) Social Enterprise Journal 20, 21.

service-oriented non-profit organisations. Section 110 of the Civil and Commercial Code 1992 provides the core elements of the foundation, defining it as consisting of properties or assets specially provided for public charity, religious, artistic, scientific, educational or other public purposes, not for profit sharing. The properties or assets must be managed strictly in accordance with the objectives of the foundation, and not for any personal benefit.

The law sees the foundation as properties or assets, rather than a type of organisation. This might be to confirm that the foundation (as a juristic person) and its assets all belong to the public domain. Therefore, they must be managed only for the public benefit. Hence, very strict rules and regulations on foundations are in place to ensure that the public benefit is always prioritised.<sup>101</sup>

#### 6.3.1.1 Start-up process

Despite the registration fee as low as 200 baht (around £4),<sup>102</sup> the establishment of a foundation involves a rather complicated process. Foundation must have its regulations and a board of directors consisting of at least three persons.<sup>103</sup> Provisions on the registration of a foundation and registration fees are provided by the Ministerial Regulations on the Registration, Operation and Registrar of Foundations B.E.2545 (2002)<sup>104</sup> and the Ministerial Regulations on the Registration Fees and Waivers of Fees Relating to Foundations B.E. 2545 (2002),<sup>105</sup>

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<sup>101</sup> The laws and regulations currently govern the establishment and operation of foundations include: (1) Civil and Commercial Code 1992, ss 110-136, (2) the Act Determining Offences Relating to Registered Partnerships, Limited Partnerships, Limited Companies, Associations, and Foundations BE 2499 (1956) with amendments, (3) National Culture Act BE 2485 (1942) and its BE 2486 (1943) Amendment, (4) relevant sections of the Revenue Code, (5) the Ministry of the Interior's ministerial regulations (those on the registration, operation and register of foundations; those on fees and waivers of fees; and those on the identity cards of the foundation registrar and officials associated with foundations), (6) the Ministry of the Interior's Announcement on the Appointment of the Registrar of Foundations dated 10 June BE 2535 (1992), (7) the foundation's regulations. All laws and regulations relevant to foundations are collected in the League of Foundation of Thailand under the Royal Patronage HM the King, *Handbook on the Operation of Foundations: In Commemoration of the 100<sup>th</sup> Birthday Anniversary of the Princess Grandmother* (Thanpakorn Publishing and Consultant 2002).

<sup>102</sup> Bank of England (n 8).

<sup>103</sup> Civil and Commercial Code 1992, s 111.

<sup>104</sup> 'Ministerial Regulations on the Registration, Operation and Registrar of Foundations BE 2545 (2002)', Office of the Council or State 30 July 2002.

<sup>105</sup> 'Ministerial Regulations on the Registration Fees and Waivers of Fees Relating to Foundations BE 2545 (2002)', Office of the Council or State 30 July 2002.

respectively, as well as the *Handbook on the Operation of Foundations and Association*.<sup>106</sup>

A foundation must be provided with a property or an asset that is used as an operating fund in the pursuit of its objectives, that is, a cash asset of at least 500,000 baht (£10,000),<sup>107</sup> or a cash asset of 250,000 baht (around £5,000)<sup>108</sup> plus other assets. For foundations pursuing social welfare objectives, or promoting education, sports, religion, public disaster relief, or the treatment of, as well as research on, drug addicts and HIV/AIDS infected persons, or foundations established by a state agency, the minimum cash asset required for their registration is reduced to 200,000 baht (around £4,000),<sup>109</sup> or a cash asset of 100,000 baht (around £2,000)<sup>110</sup> and other assets. However, foundations not belonging to the cases mentioned above may still submit a request for reduction of the required minimum cash asset to not less than 200,000 baht, which will be considered on a case-by-case basis.<sup>111</sup>

In addition, a foundation must be able to provide evidence as well as supporting documents relating to its property and assets. For example, the foundation must specify the names of the property owner and the list of the property given to it.<sup>112</sup> This means the foundation must provide a bank statement certifying the owners' bank account or a copy of the land title deed (in case the land is to be donated to the foundation). A promise to donate the property and assets to the foundation must also be made in writing signed by the property owner as the promisor, a director of the foundation as the party to which the promise is made, and two witnesses. The same process must be followed, in case the registration of a foundation is the consequence of a will inheriting assets to it.

The requirement for a relatively large cash asset is likely to be beyond the financial means of most prospective social entrepreneurs, especially those of the younger

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<sup>106</sup> Department of Provincial Administration, Ministry of the Interior, *Handbook on the Operation of Foundations and Associations* (Asaraksadindan 2013).

<sup>107</sup> Bank of England (n 8).

<sup>108</sup> *ibid.*

<sup>109</sup> *ibid.*

<sup>110</sup> *ibid.*

<sup>111</sup> Ministry of the Interior's Official Letter on the Application for Registration of Foundations dated 18 December 1991.

<sup>112</sup> Civil and Commercial Code 1992, s 114.

generations who should be encouraged to enter the sector. The complicated and expensive creation of this type of organisation would rather serve as a disincentive to their entrepreneurship.

#### 6.3.1.2 Legal personality and limited liability

The law clearly states that a foundation must be registered,<sup>113</sup> and once registered it becomes a juristic person.<sup>114</sup> However, the law does not mention anything about limited liability. This is because as soon as the registration is completed, the foundation becomes the new owner of the donated property and assets. The former property owner has permanently relinquished ownership of the property; so even if the foundation is dissolved, she will have no right whatsoever on the property. Donors of cash to a foundation are neither investors expecting investment return nor members. They are simply donors or supporters donating cash, or any other type of assets, for public benefit.

#### 6.3.1.3 Raising of finance

Section 110 of the Civil and Commercial Code implies that a foundation can make profit and generate income, but these must not be shared for personal benefit: all of them must be managed in accordance with the objectives of the foundation, which is mainly for public benefit. According to the model regulations, a foundation may acquire more assets and income in the following ways:<sup>115</sup> 1) cash or other assets inherited to it by a will or through other legal transactions without a commitment on its part to the responsibility for debts or any other obligations,<sup>116</sup> 2) donated cash or assets, 3) revenue from its assets, such as interests from cash deposits in banks or rents from the properties it has rented out, and 4) proceeds from activities or events it has organised to raise fund within the objectives of the foundation.

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<sup>113</sup> Civil and Commercial Code 1992, s 110.

<sup>114</sup> Civil and Commercial Code 1992, s 122.

<sup>115</sup> Model regulations are available in Handbook on the Operation of Foundations, Department of Provincial Administration (n 106) 96-102.

<sup>116</sup> In case of an inheritance in the form of a land asset, a property evaluation certificate issued by the local land officials is required.

Foundations are not allowed to raise equity finance, and they also find it difficult to seek debt finance. Being non-profit (or providing social benefit) does not grant them any special privileges; instead this makes it difficult to convince banks that they could generate sufficient income to repay debts. Banks, therefore, are reluctant to give (business) loans to non-business organisations. It is even harder in the foundation case, since foundations are under much stricter rules and regulations. For example, foundations are under strict and direct oversight of the Registrar, whereas associations are mainly under the monitoring of their own members. This issue will be further discussed in the next sub-section. Consequently, most foundations in Thailand are facing the problem in raising finance and have to depend on grants and donations.

#### 6.3.1.4 Controlling agency costs

There is a clear separation of management and control in foundations. Directors are agents of the foundation, but they operate under strict control by the Registrar since foundations have no members or shareholders who can monitor them. The Registrar obtains 'the power to inspect, control and supervise the...activities of the foundation' to ensure that these are 'in conformity with the law and the regulations of the foundation'.<sup>117</sup> For this purpose the Registrar is authorised to ask a director, officer, employee or agent of the foundation to account for the business of the foundation, including summoning her for enquiry or instructing her to provide accounting books and other documents of the foundation for inspection. The Registrar may also enter the office of the foundation between sunrise and sunset for the purpose of inspecting the business of the foundation.

Such strict oversight and control by the Registrar are understandable. On the one hand, as a non-profit organisation, a foundation is strictly required to use its asset only for public charity purposes, particularly those relating to religion, art, science, literature, and education. Its asset can never be used to generate private benefits. It may acquire more assets or income in the ways cited above but, given its non-profit orientation, these must be put to use in accordance with its objectives and can never

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<sup>117</sup> Civil and Commercial Code 1992, s 128.

be shared among its members. On the other hand, without any shareholders or members to monitor its operation, the monitoring and control task is left almost entirely to the state acting in the interest of the general public. This task is particularly important in view of the fact that the committee or board of directors of a foundation has extensive powers and responsibilities as normally specified in its regulations, including those relating to the control of the finance and assets of the foundation. Clearly, even in the case of non-profit organisations, the need to control the agency costs is relevant. However, under such strict state control and intervention, it is definitely difficult for social enterprises operating under a foundation structure to achieve their business goals.

#### 6.3.1.5 Asset lock and non-distribution constraint

Foundations have both cash and other forms of assets, and the assets of some foundations are relatively large. Financial management and control are thus very important matters, for which the foundation committees or boards of directors are responsible.<sup>118</sup> Even though foundations are subject to a total ban on the profit distribution, reasonable remunerations for persons providing services are legal.<sup>119</sup> But unreasonably high remunerations, especially for relatives of the committee members or other officers of the foundations, who have been recruited to work for the organisations, would amount to indirect profit sharing, which is against the law.

Moreover, after the dissolution of a foundation, its remaining assets cannot be shared among the committee members or other officers. Provisions on liquidation of registered partnerships, limited partnerships and limited companies are applicable, *mutatis mutandis*, to the liquidation of a foundation following its dissolution.<sup>120</sup> In addition, its remaining assets must be transferred to a foundation or a juristic person with charitable purposes as specified in its regulations; if such a foundation or juristic person is not specified in the regulations, a court order may be sought by the public prosecutor, the liquidator or any interested person for the

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<sup>118</sup> A foundation normally appoints an auditor who is not a member of the committee or any of its other officers but empowered to perform his or her functions in much the same way as the auditor of a limited company does.

<sup>119</sup> For examples, remunerations for persons such as the foundation's auditor are acceptable; it is the committee that has to determine how much such persons will be remunerated for their services.

<sup>120</sup> Civil and Commercial Code 1992, s 133.

transfer of the assets to another foundation or juristic person, whose object is closely similar to that of the foundation being dissolved.<sup>121</sup>

The rules on the asset lock and non-distribution constraint of our model legal form practically apply in the case of foundations. The applicability of such rules, though largely to non-profit organisations, suggests that they are not entirely unfamiliar in Thailand. Their incorporation into a legal vehicle for social enterprises, which will be proposed in Chapter 8, should thus be acceptable in this country.

#### 6.3.1.6 Social benefit requirement

There is no question about the social benefit requirement of foundations. The law clearly stipulates that ‘a foundation consists of property specially appropriated to public charity, religious, art, scientific, education or other purposes for the public benefit and not for sharing profit’.<sup>122</sup> Moreover, as in the case of the CIC, it is specified in the model regulations of foundations that they are not set up for any political purpose and ‘will not be involved in politics’.<sup>123</sup>

The requirement for a strict adherence to this provision can be seen in official consideration of a foundation’s request to amend its regulations. The proposed amendment would allow it ‘to manage its cash and other forms of its financial assets **in any way** [other than depositing them in well established banks or financial institutions, or purchasing government bonds or bonds issued by state enterprises] with a strong guarantee [against risk], as its committee may unanimously see fit’.<sup>124</sup> In the opinion of the Ministry of the Interior’s Law Review Committee, the foundation could engage in various activities to generate its revenue, but such activities must fall under the scope of the object of its regulations, which must not, in turn, go beyond the object of section 110.<sup>125</sup> In particular, if a foundation can undertake business activities in much the same way as partnerships or companies do, this is not only contrary to the object of the law providing for the establishment

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<sup>121</sup> Civil and Commercial Code 1992, s 134.

<sup>122</sup> Civil and Commercial Code 1992, s 110.

<sup>123</sup> Handbook on the Operation of Foundations (n 109).

<sup>124</sup> Law Review Committee, ‘Minutes of the Meeting of the Ministry of the Interior’ (17 February 2005) 5-8 <[www.law.moi.go.th/22548021705t.doc](http://www.law.moi.go.th/22548021705t.doc)> accessed 1 October 2014

<sup>125</sup> *ibid.*



of foundations but also involves it in risking the loss of all its assets in its possession.<sup>126</sup>

A drift from the social benefit objective of foundations is clearly impossible. This mandatory rule ensures that a social enterprise operating as a foundation would never in practice become a business enterprise. However, this legal vehicle is evidently too restrictive for the business goal of social enterprises.

#### 6.3.1.7 Directors' duties and competence

The directors or committee members of a foundation operate under strict regulatory control. Such control also covers the personal status and conduct as well as qualifications of the individual directors. The Registrar will see to it that 'the would-be directors of the foundation' have both personal status and conduct suitable for the task of carrying out its objectives. If not, 'the registrar shall instruct the applicant to make correction or alteration' before registration of the foundation.<sup>127</sup> Moreover, the appointment of new directors of the foundation or any subsequent change must also be registered, and in this case if the Registrar considers that any of the directors proposed for registration does not have a personal status or conduct suitable for the pursuit of the objectives of the foundation, the registrar may reject the registration of any such director.<sup>128</sup>

Evidently, the law attaches particular importance to the individual directors – especially their personal suitability for “implementing the object” of the foundation. The law presumably meets our requirement for “competence”, though in this case the focus is more on their status and moral character than other aspects of this requirement. Moreover, given the strict control over their activities, it is hardly possible for directors to deviate from their duties to carry out the tasks prescribed by the objectives of the foundation.

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<sup>126</sup> *ibid.*

<sup>127</sup> Civil and Commercial Code 1992, s 115.

<sup>128</sup> Civil and Commercial Code 1992, s 125.

### 6.3.1.8 Stakeholder participation

Being oriented towards the benefit of certain sectors or areas of activity in society, foundations have their clearly identifiable stakeholder groups. The law does not directly refer to the stakeholders of the foundations, but its stipulation that they direct their activities to the “public benefit” unmistakably implies that the general public, or more precisely the people in the specific areas of activity, are their stakeholders.

Remarkably, whereas the law says very little, and only indirectly, about the stakeholders of foundations, the latter’s regulations normally provide for “stakeholder participation”. The model regulations authorise the committee to set up a sub-committee, or a number of sub-committees, to undertake certain specific activities under its control. In addition, it may also invite highly qualified persons, or those who provide support for the foundation, to be its honorary members; invite highly qualified persons to serve as its advisers; or invite a distinguished person to be the patron of the foundation.<sup>129</sup> Those invited to fill the honorary members’ or advisory positions can undoubtedly come from the foundation’s stakeholder groups (foundations in Thailand prefer members of the Royal Family as their patrons).

Foundations tend to invite eminent members of the public to join them in some capacities mainly for the purpose of boosting their image and prestige – and eventually contributing to their effort to raise finance from charitable sources. However, it is the sub-committee(s) that can be expected to make substantive contributions to the work of the foundations. So it is this functional “opening” that should at least be filled by people from the stakeholder groups.

### 6.3.1.9 External regulator and public disclosure

It has been pointed out that the task of monitoring and control of foundations is left almost entirely to the state. This is particularly due to both the nature of their work and the absence of shareholders and members to assume this task. There is not just one regulator as in the case of the CIC Regulator: the Registrar of foundations is

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<sup>129</sup> Department of Provincial Administration (n 106) 98.

rather an “institution” involving *ex officio* responsibility residing in several persons. In Bangkok it is the Permanent Secretary of the Ministry of the Interior who assumes this responsibility; in the provincial areas the provincial governors are the Registrars. However, ultimately, it is the Minister of the Interior who is the real Registrar of foundations.

In this respect, the Registrar of foundations is different from the CIC Regulator; in practical terms the difference is evident in the rather “bureaucratic” orientation of the Registrar versus the so-called “light-touch” approach of the CIC Regulator. Needless to say, the difference has its practical effects.

Like limited companies, foundations are subject to the public disclosure requirement; they are required to be transparent in the pursuit of their activities. It is required that by March every year foundations must submit a report on the results of its activities to the Registrar.<sup>130</sup> The report must contain the following: 1) the activities they have undertaken during the past year, 2) the debit credit account and the balance sheet of the past year, which an auditor has properly certified, and 3) copies of the minutes of all the committee meetings during the past year. Clearly, this mandatory rule satisfies the requirement for both the report on the social benefit foundations have provided and their financial disclosure.

#### 6.3.1.10 Tax incentives

As a legal form for social enterprises, the foundation also has other important advantages. Though foundations have a duty to pay income taxes, including taxes on revenue from rent, sales and services, they seem to enjoy tax incentives more than other forms of organisations. For example, they are exempt from income tax on registration or membership fees, grants, donations and gifts. Moreover, the foundations listed in the Royal Decree No. 317<sup>131</sup> are entitled to VAT exemption

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<sup>130</sup> Ministerial Regulations 2002 (n 112).

<sup>131</sup> The Notification of the Ministry of Finance on Income Tax and Value Added Tax Re: Criteria for Consideration and Announcement of Organisations, Public Charitable Institutions, Clinics and Educational Institutions under Section 47 (7) (b) of the Revenue Code 1938 (B.E. 2481) and Section 3 (4) (b) of the Royal Decree under the Revenue Code Regarding Value Added Tax Exemption (No.239), B.E. 2534 (1991) as Amended by the Royal Decree Issued under the Revenue Code Regarding Value Added Tax Exemption (No.254), B.E.2535 (1992).

and those who make donations to them can have the donated amount deducted from their income as expenses, even though the deductible amount is limited. These are the main sources of income for associations and foundations, and donors are also rewarded with tax reductions. Apart from tax incentives, members, donors or philanthropist investors can at least rest assured that their contributions will not be used for private benefit even after a foundation is dissolved.

A major drawback faced by foundations in operating as social enterprises is that they must be strictly non-profit making in orientation. As non-profit organisations they must be so but as social enterprises they have to suffer from this drawback. Social enterprises relying on such legal forms have much difficulty in coping with this limitation or indeed in struggling for their survival. This is mainly because the foundation as a non-profit legal structure is meant to serve as a business organisation, including a social business like social enterprise.

Nonetheless, the foundation has some advantages over other legal structures. In particular, it meets the requirements for both their social benefit goal and non-distribution constraint.

From our consideration of the main legal forms available to Thai social enterprises, it is clear that despite its disadvantages, the limited company seems to offer the best option among the existing legal forms. This is mainly due to its flexibility as well as credibility. In this country, a social enterprise that operates in some other legal form might *additionally* need this for-profit legal structure to carry out its business activities. This experience was actually shared by social enterprises in the UK in the early 2000s, when different legal vehicles were used in “group or integrated structures”.<sup>132</sup> In the UK and Thailand alike, the need to rely on more than one legal vehicle for the operation of certain social enterprises may reflect the need for operational flexibility.<sup>133</sup> However, in Thailand, this may actually be taken as an indication of the shortcomings of the existing legal regime for the social enterprise sector in this country.

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<sup>132</sup> Bates, Wells and Braithwaite and SEL, *Keeping It Legal: Legal forms for social enterprises* (SEL 2003) 7-8.

<sup>133</sup> In the UK ‘the driving factors for this are usually tax efficiency or ring-fencing risks.’ *ibid* 7.

## **6.4 Conclusion**

I have identified the main legal structures within which Thai social enterprises operate. On the basis of the rules of the model legal form for social enterprise, I have been able to assess whether the existing main legal structures are more or less suitable for social enterprises. Thai social enterprises have actually benefited from the existence of various legal forms. We can even say that the diversity of legal vehicles represents the strength of the social enterprise sector itself. No one legal form adequately caters for the vast diversity of social enterprises. For example, a small community museum might find that it could most effectively operate as an unincorporated community enterprise. Or how could a social enterprise that functions as a provider of education or vocational training, legally do so if it has not been registered as a private school? However, there are limits to the usefulness of this diversity, and, on the basis of these limits, I shall propose in Chapter 8 a legal vehicle specifically designed for Thai social enterprises, together with an alternative arrangement to the same effect.

## **Chapter 7**

# **The Social Enterprise Landscape in Thailand**

### **7.1 Introduction**

As has been indicated in Chapter 2 (section 2.5), social enterprises have been in existence in Thailand for some time. It is mainly through the worldwide expansion of interest in social responsibility and social innovation that social enterprise as an idea has been introduced to Thailand. Given the Thai familiarity with socially and environmentally oriented activities, it has not been difficult for this idea to gain growing acceptance in Thai society. However, to understand the Thai social enterprise, we need to examine how its development has been influenced by foreign as well as domestic ideas and practices. In particular, we need to touch upon the burgeoning public-policy infrastructure governing this movement, as well as support by the social enterprise networks in Thailand and abroad that have served as the backbone for the Thai social enterprise sector.

We have already considered the concept and meaning of social enterprise in Thailand, as well as its problems and needs, in Chapter 2. This chapter thus begins, in section 7.2, with an analysis of the development of social enterprise in Thailand. Then, section 7.3 focuses on what I call the social and international network support for Thai social enterprise. Before the Thai government came up with some limited institutional support only a few years back, its mainstay had been the expanding networks of social and financial support that included those with links with the global social enterprise movement. It is thus necessary that we consider the origin and development of social enterprise in Thailand as being closely associated with these networks. Finally, section 7.4 touches upon the recent development of public-policy infrastructure for this type of business, especially an important legislative development – the Social Enterprise Promotion Bill.

## 7.2 Development of social enterprise in Thailand

Social enterprises have long existed in Thailand in various sectors: health promotion, green-product business, fair trade, welfare of the disabled, community finance, and community-scale renewable energy generation, among others. Pioneering Thai social enterprises (though until very recently they were never recognised as such) include the famous tourist attraction Ancient City, which was launched in 1972, and the Population & Community Development Association (PDA), which was founded in 1974 as an NGO to assist the government in its effort to promote family planning.<sup>1</sup>

The story of PDA is particularly relevant to our understanding of the emergence of social enterprise in Thailand – a history of Thai social enterprise is still to be constructed. Since its inception PDA has expanded its interests to cover many activities, including primary healthcare, HIV/AIDS education and prevention, water resource development and sanitation, income-generation, environmental conservation, small-scale and rural enterprise promotion, gender equality, and education and youth development.<sup>2</sup>

As the most diversified NGO in Thailand, PDA is completely self-sustaining mainly through its own social business, Cabbages & Condoms,<sup>3</sup> whose profits have funded PDA's social development programmes.<sup>4</sup> PDA's other business activity is its Business for Rural Education and Development (BREAD). By offering a logistics framework allowing Thailand's rural poor to sell products and handicrafts to an international market, hence empowering them by income-generation, BREAD

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<sup>1</sup> Profiles of "50 good social enterprises" together with names and addresses of a large number of other social enterprises are available in Sarinee Achavanuntakul (ed), *Thailand Social Enterprise 50* (Krungthepturakit 2010) 10.

<sup>2</sup> PDA, 'Background' (PDA, last update April 2012) <[www.pda.or.th/e\\_index.asp](http://www.pda.or.th/e_index.asp)> accessed 20 August 2014; and Berenzon and others, 'Social Enterprise in Thailand: From Profit to Responsibility' (2011) *Financiers Without Borders* 10.

<sup>3</sup> Set up in part to support PDA's activities, Cabbages & Condoms consists of restaurants and resorts in several locations around Thailand, for example, the Cabbages & Condoms Restaurant and Birds & Bees Resort situated on Hu-Kwang Bay, in Pattaya, which is Thailand's most famous seaside resort less than two hours drive from Bangkok; and the C&C Khao Yai Resort at Ban Saptai in Pak Chong District, Nakhon Ratchasima Province.

<sup>4</sup> These programmes include the Population and Development International (PDI), Mechai Pattana School, the Village Development Partnership (VDP), Mechai Viravaidya Foundation, and the Green Village Toy Library.

at the same time provides PDA with funding to maintain its financial viability. It also provides professional consulting, such as CSR Advisory Services.<sup>5</sup>

The importance of PDA to the development of social enterprise in Thailand can hardly be over-emphasised. Not only do its ‘history and diverse programmes offer lessons from its tried and tested practices...[especially in]...building sustainable social enterprises by recovering costs and generating revenues’,<sup>6</sup> but its story also represents the early development of social enterprise in Thailand – that is, the development *prior to* the adoption of this very concept in this country. Hence, its founder has been recognised in the Special Agenda as being part of Thailand “social capital” for social enterprise.<sup>7</sup>

It has been pointed out in Chapter 2 that the development of social enterprise in the UK essentially involved the institutionalisation of this type of business. With regard to Thailand, various types of social and public-oriented organisations, including the Buddhist monasteries and other religious institutions, have been identified as the social foundation for social enterprises in Thailand. This essentially represents local practices and innovations constituting the country’s “social capital”.<sup>8</sup> It is upon this social capital that social enterprise as derived from ideas and practices developed elsewhere (especially, as we shall shortly see, the UK) has recently grown. Viewed in this way, the development of social enterprise in Thailand can be said to have resulted from the institutionalisation of *both* local practices and the imported concept and some forms of practice.

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<sup>5</sup> The person who has assumed a pivotal role in initiating and promoting these activities is Mr. Mechai Viravaidaya, well-known figure in Thailand, who has been a major force behind social activism and many NGO activities in this country. He has been persistently active all these years in his effort to envision social innovations and promote social enterprise in Thailand. Mechai Viravaidaya and his social and business activities have admittedly contributed to the development of social enterprise in Thailand by at least serving as models as well as inspiration.

<sup>6</sup> INSEAD Knowledge, ‘Cabbages, Condoms and Bamboo Schools’ <<http://knowledge.insead.edu/node/1015/pdf>> accessed 24 January 2016

<sup>7</sup> National Reform Council, *Special Agenda 1: Social Enterprise* (Secretariat of the House of Representatives 2015) 2.

<sup>8</sup> In addition to serving as a “social capital”, what I call the “social foundation”, actually has a very large financial asset. According to surveys by the Office of the National Economic and Social Development Board (NESDB) and the National Statistical Office, the civil society sector and non-profit organisations together have savings of 70 billion baht (about US\$1.94 billion) and an annual revenue of 200 billion baht (about US\$ 5.56 billion), which mostly comes from donations. This is still not to mention a number of state-sector funds such as the 6,000 million baht (about US\$166.96 million) Fund for the Development of the Quality of Life of the Disabled and the private sector CSR budget which currently stands at more than 10 billion baht (about US\$278.28 million). *ibid* 12.



Local practices in the form of various types of social enterprises being in existence in Thailand prior to 2010 have now been *formally* identified and categorised by publications such as *Thailand Social Enterprise 50, Master Plan* and *SE Catalog*. *Master Plan*, in particular, has categorised social enterprises in Thailand into six main types, according to their “ownership type”:<sup>9</sup>

Type of owner	Type of social enterprise	Example of social enterprise
Community network and organisation	Community-based social enterprise	Khlong Pia Savings Group
Non-governmental organisation	Business set up by and/or whose shares are owned by non-governmental organisation	Cabbages and Condoms Restaurants and Resorts
Government agencies/state enterprises	Business set up by and/or whose shares are held by state agencies/state enterprises	Chaophraya Abhaibhubejhr Hospital Foundation
New social entrepreneur	Business initiated and operated by new social entrepreneur	OpenDream Co., Ltd
Private business	Corporate enterprise	Lemon Farm
Others	Business set up by and/or in monasteries, educational or religious institutions, etc., are share-holders	Thai Tribal Crafts Fair Trade (TTC)

How social enterprise is defined and “institutionalised” is of special importance.<sup>10</sup> In particular, should social enterprise be defined in such a way as to incorporate a *dividend cap* and *asset lock*?<sup>11</sup> The Social Enterprise Promotion Bill contains provisions for both social enterprises with a non-distribution constraint and those not subject to such a constraint.<sup>12</sup> This means that both types of social enterprises are entitled to benefit from promotion under this law (following its enactment).

<sup>9</sup> Thailand Social Enterprise Office (TSEO), *Social Enterprise Promotion Master Plan 2010-2014* (September 2010) 4-5. It should be noted, however, that *Thailand Social Enterprise 50* has adopted a slightly different categorisation. Its four types of social enterprises are: 1) social enterprises set up by private sector organisations, including those growing out of their CSR activities; 2) social enterprises initiated by NGOs; 3) community-based enterprises; and 4) triple bottom line businesses. Given the great diversity of social enterprises, differences in their categorisation are understandable. It is simply impossible to work out a generally accepted categorization, Achavanuntakul (ed), *Thailand Social Enterprise 50* (n 1) 24-25.

<sup>10</sup> *Special Agenda* proposes a similar line of thought on the development of social enterprise in Thailand. That is, three factors have been identified: (1) how social enterprise is defined – particularly whether it is defined in such a way to include a dividend cap and asset lock, or whether to focus mainly on social purpose and re-investment; (2) support by the public sector; and (3) social awareness and enthusiasm. National Reform Council (n 7) 38-48.

<sup>11</sup> *ibid* 38-39.

<sup>12</sup> We still do not know how the law will eventually come out on this issue, but it is very unlikely that the “strict” definition of social enterprise (i.e. it must be statutorily incorporated with a non-distribution constraint will be finally adopted. More discussion on the Bill is the subject of the next chapter.

Though the law is unlikely to impose a statutory requirement for a non-distribution constraint, the enactment of this law should be regarded as marking crucial progress in the development of social enterprise in Thailand. That is, following its enactment in the near future, non-distribution constraint will be *formally recognised* as forming part of social enterprise, even though its incorporation will still remain optional.

Now we can see a much brighter prospect for the development of Thai social enterprise than even in only a few years back. Some critical analyses of the Thai social enterprise landscape dating back to only the early 2010s now seem to be not entirely justifiable.<sup>13</sup> As will shortly be shown, local expertise in social entrepreneurship is now being developed, together with other types of government support and a growing enthusiasm for social entrepreneurship, especially among members of the younger generation.

Problems and obstacles still exist in the development of social enterprise in Thailand. Thai cultural characteristics may have some influence,<sup>14</sup> and other problems, including government policy inconsistency and the difficulty in gaining access to funding, might further dampen the prospect for this development. However, the growth of the sector so far, the basis now being laid for its further development and the strength of the existing social capital,<sup>15</sup> all warrant optimism for this development.

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<sup>13</sup> According to Berenzon *et al*, ‘the concept of Social Entrepreneurship is mostly foreign to the Thai business community’ ... ‘There are few professors in entrepreneurship in Thailand, and, in particular, there is very little published academic literature and local expertise in social entrepreneurship. As a result, there is virtually no training and little awareness of the concept at present’. Berenzon and others (n 2) 1, 4 and 14.

<sup>14</sup> Most fundamentally, the lack of public mindedness and volunteerism of the Thai people in general, and the Thai business culture that tends to focus on short-term financial returns with a blatant disregard for any social and environmental impact in particular, might not augur well for the promotion of social enterprise in Thai society. Said Irandoust has bluntly observed that ‘Thailand is by far one of the least developed countries in Southeast Asia in regards to corporate social responsibility, social enterprise and environmental sustainability’. Berenzon and others (n 2) 22, citing Said Irandoust of the Asian Institute of Technology in a meeting with the authors (date not provided).

<sup>15</sup> The surveys referred to in (n 8) by NESDB and the National Statistical Office reveal that Thai society is endowed with both preparedness and potential for the growth of a large number of quality social enterprises. National Reform Council (n 7) 12.

The sector has grown spectacularly. It has been estimated that now there are about 116,000 social enterprises in Thailand.<sup>16</sup> A social enterprise certification system has already been in place, and there are now more than 400 formally certified social enterprises.<sup>17</sup> This type of business is present in every region of the country, where a variety of social enterprises can be found. Social enterprises in each region have their own goals and characteristics developed in response to the specific problems and local contexts of specific regions.<sup>18</sup> The most dominant areas of Thai social enterprises are sustainable tourism, healthcare, alternative energy and recycling.<sup>19</sup> According to Change Fusion's Thailand Social Enterprise Landscape Report, the highest numbers of Thai social enterprises are in the agricultural and forestry sectors.<sup>20</sup>

### **7.3 The Support by Social and International Networks**

Many factors have understandably contributed to the growth of the social enterprise sector in Thailand. The most significant of these is the support by the social enterprise networks – domestic as well as international. Moreover, I would also like to mention in this connection the support provided by the British Council as well as certain activities now organised rather regularly to promote social enterprise in this country.

#### **7.3.1 Support by social networks and activities**

In recent years Thailand has experienced the build-up of networks of individuals and organisations with shared concerns. An expanding social enterprise network is

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<sup>16</sup> Claudia Cahalane, 'Thai Social Enterprises are Booming Thanks to Strong Government Support' *The Guardian* (Social Enterprise Blog, 7 September 2012)

<[www.theguardian.com/social-enterprise-network/2012/sep/07/social-enterprise-thailand-strong-government](http://www.theguardian.com/social-enterprise-network/2012/sep/07/social-enterprise-thailand-strong-government)> accessed 15 February 2015

<sup>17</sup> National Reform Council (n 7) 2.

<sup>18</sup> Sarunyikha Thiemboonkit, 'An Exploratory Study of the Development of Social Entrepreneurship: Key Concepts, Characteristics, Roles and Success Factors of Social Enterprise in Thailand' (DPhil thesis, National Institute of Development and Administration 2013) 43.

<sup>19</sup> Mike Britton, 'Making our World a Better Place: Social Enterprise Changing our World' (Presentation held by Northampton University, Goodwill Solutions CIC, British Council Thailand and others for Thai social entrepreneurs, Northampton University 9 December 2015)

<[www.britishcouncil.or.th/sites/default/files/goodwill\\_solutions-mike\\_britton\\_0.pdf](http://www.britishcouncil.or.th/sites/default/files/goodwill_solutions-mike_britton_0.pdf)> accessed 15 January 2016

<sup>20</sup> *ibid.*

one such network, which has provided a vital support for the incubation and of growth of social enterprises during the past decade or so. Moreover, the past few years have also witnessed important initiatives taken by the public sector in promoting Thai social enterprise. We focus now on the growing social enterprise network.

The growth of social enterprises in Thailand during the past decade owes much to the work of a number of organisations that now represent a social network functioning as a crucial support mechanism for social enterprise in this country. This social network has provided guideline as well as financial support for social entrepreneurs, and served as a crucial social infrastructure for the incubation as well as operations of many new businesses in this sector. This network has indeed not only contributed to the development of the social enterprise sector in Thailand but actually formed part of it. The following are some of the most active supporters of Thai social enterprises.

**Change Fusion** A non-profit organisation based in Thailand, Change Fusion operates with a mission is to foster innovative solutions to increasingly complex social and environmental challenges. It pursues this mission through the provision of social innovation design and investment services with a specific focus on high-impact, scalable and sustainable social innovations and social enterprises.<sup>21</sup>

Working in alliance with numerous partners,<sup>22</sup> Change Fusion has now become ‘a major branch of a rapidly growing Social Enterprise network of innovative and socially responsible businesses’.<sup>23</sup> In addition to building networks, particularly between financial investors and social entrepreneurs, Change Fusion also actively invests in social businesses. Its financial support for such businesses is provided mainly through UnLtd Thailand.

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<sup>21</sup> Change Fusion Institute, ‘About Us’ <<http://changeofusion.org/about-us/?lang=en>> accessed 15 January 2016

<sup>22</sup> These include both Thailand-based organisations (Ayudhya Auto Leasing, the Central Group, the Moral Centre, NECTEC, National Science and Technology Development Agency, the Office of the Prime Minister, the Securities and Exchange Commission, the Stock Exchange of Thailand, and Thai Health Promotion ) and foreign-based agencies (Enviu, FAO, Friedrich Naumann Foundation, the Global Knowledge Partnership, Google.org, InSTEDD, Microsoft, Swiss Agency for Development Cooperation, Unreasonable Institute, and the World Bank, among others).

<sup>23</sup> Berenzon and others (n 2) 9.

**UnLtd Thailand** UnLtd Thailand operates under Change Fusion with the support of the TSEO.<sup>24</sup> It also works in partnership with many organisations and networks, both inside and outside Thailand.<sup>25</sup> In addition to financial assistance, social entrepreneurs also receive business consulting and knowledge provided by the UnLtd Thailand team and specialists in social entrepreneurship, covering business development, financial planning, financial mobilisation, human resource management, legal structure, corporate governance, marketing, social and environmental impact assessment. Moreover, they benefit from networking with other social entrepreneurs, consultants, social investors, and experts, as well as preparation for financial resource mobilisation, especially from social investors.

**Ashoka Thailand** Ashoka Innovators for the Public was founded in 1980 in Washington, D.C., by Bill Drayton, and has since then established programmes in more than 60 countries and supported the work of over 2,000 fellows.<sup>26</sup> Ashoka pursues its mission by searching the world over for leading social entrepreneurs. Called Ashoka Fellows,<sup>27</sup> these entrepreneurs are provided with a living stipend for an average of three years, so that they can focus full time on building their institutions and spreading their ideas. Ashoka Fellows also benefit from access to a global support network of social entrepreneurs and partnerships with professional consultants.

Based in Bangkok, Ashoka Thailand operates as a foundation. It started its operation with the election of its first Ashoka Fellows in 1989, and by the end of the 2000s it has had eighty Fellows, the fifth largest national fellowship in the world. These are individuals with diverse backgrounds, including those who are just launching their ideas and those who are more senior and are recognised

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<sup>24</sup> UnLtd Thailand 'About Us' <[www.unltd.in.th/](http://www.unltd.in.th/)> accessed 15 January 2016

<sup>25</sup> Its Thailand-based allies include the TSEO, Change Fusion, Social Enterprise Thailand, Social Enterprise Business Plan Competition (SEBP), Asian Knowledge Institute (AKI), and Opendream; its foreign-based partners are UnLtd UK, UnLtd South Africa, and UnLtd India.

<sup>26</sup> The organisation was named after King Ashoka (ca 304-232 B.C.), who, having unified the Indian sub-continent in the 3<sup>rd</sup> century B.C., renounced violence and dedicated his life to social welfare and economic development. For further information, see Ashoka, 'Frequently Asked Questions' <<https://www.ashoka.org/facts>> accessed 15 December 2015

<sup>27</sup> On Ashoka Fellows see Ashoka, 'Venture and Fellowship' <[www.ashoka.org/support/venture](http://www.ashoka.org/support/venture)> accessed 15 December 2015

nationally for their contributions. During 2000-2006, three Ashoka Fellows served as elected Senators in the Senate, a prestigious body in the legislative branch of the country. Other Ashoka Fellows have served as advisors to the Thai government, helping to shape national social and economic policies.<sup>28</sup>

To conclude this sub-section, I would like to briefly touch upon certain activities that are in my view contributing to the development of social enterprise in Thailand. These activities are of various types, and I shall mention only a few of them. One type of such activities involves seminars, workshops or similar functions – such as the one presented by Bob Doherty which has been referred to above (sub-section 7.2.1).<sup>29</sup> Another type of activity covers the more or less regular events.<sup>30</sup> Still another type of activity I would like to mention here is the publication of “SE Magazine”,<sup>31</sup> and “SE Catalog”,<sup>32</sup> which can be regarded as another important “handbook” on Thai social enterprises.

Together with press reports and comments (some of these have been reports and comments on activities such as seminars and social enterprise weeks), all these activities have had the important effect of disseminating the knowledge and understanding, and raising awareness, of social enterprise among the interested members of the public, especially those of the newer generations. According to Tommy Hutchinson, the founder of i-genius, a global network of social entrepreneurs, it is the younger generation of the Thai people that seems to be really

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<sup>28</sup> On Thai Ashoka Fellows, see Ashoka Thailand, ‘Ashoka Fellows’ <<http://thailand.ashoka.org/fellows>> accessed 15 December 2015

<sup>29</sup> Other examples of this type of activity include: Change Fusion, ‘Social Enterprise Seminar’ (Bangkok, 26 January 2010), the seminar was opened by Mr Apirak Kosayodhin, the Governor of Bangkok at that time and one of the important figures who actively supported the development of social enterprise in Thailand; TSEO, ‘Strategy for the Development of Social Enterprise in Thailand Seminar’ (Bangkok, 20 October 2010), with the support of the British Council, Change Fusion, and Bangkok Business Newspaper, among others; Srinakharinwirot University, ‘Social Impact after the Social Enterprise Approach Seminar’ (Bangkok, 27 November 2013); TSEO and Stock Exchange of Thailand, ‘Thai Social Enterprise Forum 2014: Asian Social Investment Forum’ (Bangkok, 3 March 2014).

<sup>30</sup> TSEO, ‘Social Enterprise Week Thailand 2015’ with the support of the British Council (Bangkok, 7-14 March 2015); and the Thai social enterprise awards: “Thai Social Enterprise Awards 2015” offered “Think Awards”, “Do It Awards” and “Change Awards”.

<sup>31</sup> SE Magazine is published by the TSEO. The current issue is ‘Social Innovation’ (2013) 4 SE Magazine.

<sup>32</sup> TSEO, *SE Catalog* (TSEO 2012) <<http://www.tseo.or.th/article/1527>> accessed 30 December 2015

enthusiastic about social enterprise.<sup>33</sup> He has also claimed that the king is also an important backer of the social enterprise movement.

### **7.3.2 Support provided by the British Council**

A special mention should be made of the contributions of the British Council in Thailand to the development of social enterprise here.<sup>34</sup> The contributions have taken various forms. In October 2009 the Skills for Social Entrepreneurs (SfSE) programme was initiated, which has sought to develop new relationships and partnerships for Thai social entrepreneurs across the public, private and non-governmental sectors in Thailand and the UK. Aiming to enable social entrepreneurs to address social, economic and environmental challenges, SfSE draws on UK expertise through efforts to share best practice and create opportunities between the UK and Thailand and other countries.

During the past several years training programmes have been organised to empower Thai social entrepreneurs to enhance the impact of their work. For example, the “Unltd Campus & Skills for Social Entrepreneurs Capacity Building and Training Workshops” taught aspiring and practicing social entrepreneurs how to develop effective sales presentations, write strong business plans, gain advantages from social media, add value to products and services and raise funds. These workshops were held in collaboration with the TSEO and Change Fusion.<sup>35</sup>

Networking for innovation represents another crucial contribution by the British Council in Thailand. For example, in March 2012 the British Council and i-genius organised an Asia Summit on Social Enterprise in Bangkok, in which 70 delegates

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<sup>33</sup> In January 2015, a young Thai social entrepreneur, Arch Wongjintawes, founder of “Socialgiver”, was selected to represent the younger generation of Southeast Asia at the World Economic Forum. He took part in a panel on “Thinking ahead with the New Champions” and made a presentation on “A Revolution in Fund Raising”. On this occasion he also met Al Gore, the former Vice-President of the United States. Suwatana Thongthanakul, ‘A Thai young man brought SE to a world forum: A good sign of the thriving social enterprise movement’ *ASTV Manager Online* (Bangkok, 3 March 2015) <[www.manager.co.th/iBizChannel/ViewNews.aspx?NewsID=9580000025384](http://www.manager.co.th/iBizChannel/ViewNews.aspx?NewsID=9580000025384)> accessed 20 September 2015

<sup>34</sup> British Council Thailand, ‘The Impact of our Work’ <[www.britishcouncil.or.th/en/programmes/society/social-enterprise/impact](http://www.britishcouncil.or.th/en/programmes/society/social-enterprise/impact)> accessed 15 January 2016

<sup>35</sup> *ibid.*

from governments, NGOs, corporations, financial institutions, universities, and social enterprises in China, Indonesia, Myanmar, the Philippines, Singapore, South Korea, Thailand, and Vietnam participated. In addition to deliberating numerous issues, the event also witnessed the launch of the East Asian Enterprise Network. Also in March 2012 the British Council and CSR Asia co-hosted a separate event in Bangkok called “Strategic Partnerships: New Opportunities in CSR”, in which 40 social enterprises, as well as a number of corporations, foreign chambers of commerce, cultural and educational institutions, and international NGOs, among other organisations, participated.

The British Council attaches much importance to the role of higher education in nurturing social enterprise. In an effort to help Thailand develop its social enterprise sector, the British Council has fostered UK-Thailand cooperation on not only social enterprise policy support (which will be later touched upon) and social investment but also social enterprise education, especially at the higher educational level.<sup>36</sup> Activities to promote social enterprise education have so far included seminars and other functions.

A British Council awareness raising programme organised university road shows promoting social enterprise and UK best practice. A Social Enterprise Job Forum was also held in 2011 that introduced social innovation and UK best practice to Thai audience. And in the past few years two important seminars have already been staged. Like those mentioned in the previous sub-section, the seminars sponsored or co-sponsored by the British Council have contributed much to cultivating knowledge and understanding and raising awareness of social enterprise in Thailand.

One seminar was entitled “A Socially Enterprising University”, which was jointly organised by the British Council, the Knowledge Network Institute of Thailand (KNIT) and TSEO with the support of Global Social Venture Competition, Ashoka,

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<sup>36</sup> British Council, ‘Why Universities are Embracing Social Enterprise, from London to Chiang Mai: Five questions for Ana Lemmo Charnalia, UCL Business’ social enterprise business manager’ *The Guardian* (Social Enterprise British Council Partner Zone, 29 October 2014) <[www.theguardian.com/british-council-partner-zone/2014/oct/29/why-universities-are-embracing-social-enterprise-from-london-to-chiang-mai](http://www.theguardian.com/british-council-partner-zone/2014/oct/29/why-universities-are-embracing-social-enterprise-from-london-to-chiang-mai)> accessed 3 September 2015



CSR Club, Chang Fusion, CPF (Thailand's largest agro-industrial group), and the University of Northampton. Participants in the seminar, which was staged in Bangkok in May 2013, included those from the major academic authorities, institutions, and universities. They were provided with an opportunity to benefit from the expertise of a leading British scholar, Professor Simon Denny, Social Enterprise Development Director at the University of Northampton, and to look at the ways in which social enterprises in Thailand could be developed through the academic sector.<sup>37</sup>

The other seminar, "Thailand-UK University Dialogue on Social Enterprise and the Role of Higher Education Institutions", was held in March 2015 at Srinakharinwirot University in Bangkok. Featuring both Thai and UK speakers, the seminar probed important issues, particularly what role can universities play to support the social enterprise sector?<sup>38</sup>

The British Council has also provided social enterprise policy support for Thailand. In 2010 it arranged a study tour in the UK for Thai government officials and reporters with a view to enabling them to learn about the development and impact of social enterprise in this country. Following this study visit, we have seen crucial developments, especially in relation to policy support for social enterprise in Thailand (to be dealt with in section 7.4). Most importantly, the Thai government established a Thai Social Enterprise Board, of which a British Council representative was invited to be a member. This national board then created the Thai Social Enterprise Office (TSEO) as a result of the British Council's advisory work. The British support for the development of Thai social enterprise has continued since this crucial move on the part of the Thai side. In November 2011 a Social Enterprise UK delegation came to Thailand, and in June 2012 a delegation of Thai business leaders and an official from the Ministry of Commerce paid a visit to the UK. The purpose of this visit was to study British models of social enterprise and social finance and how the British social enterprise sector has contributed to its country's economic development and how to integrate the social enterprise concept

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<sup>37</sup> British Council Thailand, 'The Impact of our Work' (n 34).

<sup>38</sup> *ibid.*

into Thai SMEs and prepare them for the ASEAN Community,<sup>39</sup> which formally came into being at the end of 2015.<sup>40</sup>

The British Council's support for the development of Thai social enterprise, which has been evident throughout the latter half of the 2000s, has naturally resulted in British influence in shaping the direction of this development. According to Change Fusion's *Thailand Social Enterprise Landscape Report* of September 2012, most Thai social enterprises are set up "in a similar way to UK social enterprises", though, in a definite departure from the British model, some social enterprises have been formed by the Thai government itself.<sup>41</sup> No matter how much Thai social enterprise has been influenced by the British social enterprise concept and practice, its development owes much to the British support.

#### **7.4 Policy Support for Social Enterprise in Thailand**

Another type of support for the development of Thai social enterprise is the policy support by the Thai government itself. In this respect, it is gratifying to note that there have appeared encouraging signs of progress. Tommy Hutchinson, I-genius founder, who I have mentioned in sub-section 7.3.1, considers the government backing for social enterprise as a factor setting Thailand apart from the rest of East Asia. '...perhaps outside China and India, it has the most sophisticated structural support for social enterprise. There are lots of people building the sector'.<sup>42</sup>

This section focuses on the development of the public-policy support for social enterprise in Thailand. We begin, in sub-section 7.4.1, with the consideration of what can be regarded as perhaps the most important development so far in so far as the public-policy support for Thai social enterprise is concerned, namely, the initiation of the Social enterprise Promotion Bill in 2015. I shall then proceed to

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<sup>39</sup> A component of the Blueprint of the ASEAN Economic Community (AEC), which is one of the three pillars of the ASEAN Community, is "equitable economic development". This component outlines the framework for SME development in the ASEAN region as means to achieve its equitable economic development. Association of Southeast Asian Nations (ASEAN), *ASEAN Economic Community Blueprint* (ASEAN Secretariat 2008) 24.

<sup>40</sup> British Council Thailand, 'The Impact of our Work' (n 34).

<sup>41</sup> Cahalane (n 16).

<sup>42</sup> *ibid*, citing Tommy Hutchinson without identifying the source.

explore, in sub-section 7.4.2, what has been achieved in this respect, especially other policy measures that have been taken to promote social enterprise.

#### **7.4.1 An overview of the Social Enterprise Promotion Bill**

As pointed out above, perhaps the most crucial move now taking place in the development of Thai social enterprise is the initiation of a legislative project on social enterprise – the Social Enterprise Promotion Bill. It is important to note that though the Social Enterprise Promotion Bill does not satisfy the need for a specific legal form for social enterprise, as far as I can see from the Bill and the rationale for its introduction, it goes some way (once it is enacted) towards regulating social enterprises in such a way that they more or less meet both social entrepreneurs’ needs and stakeholding requirements as specified in our legal blueprint for social enterprise, especially if they incorporate as limited companies.

As the Bill has not yet become law, and we cannot expect what the final legislative product would be like, I shall only very briefly touch upon some of its features, those I consider most directly relevant to my thesis. A critical analysis will be presented in the next chapter.

Social enterprise has been conceived of by this legislative project as being incorporated with *either* “no-dividend and asset-lock” rules *or* social purpose and re-investment requirements. The no-dividend and asset-lock conception (the so-called Social Enterprise Type A) must certainly have the social purpose and re-investment objective as its characteristics, but social enterprises may also opt only for these characteristics (Social Enterprise Type B).<sup>43</sup>

Clearly, the Bill formally provides for social enterprises operating with no-dividend and asset lock; in this case, they must be set up as limited companies under the Civil and Commercial Code 1992.<sup>44</sup> It nevertheless recognises that social enterprises registered under this law may not opt for any agreement on non-distribution of profits to shareholders or partners. That is, they can distribute profit, and whether,

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<sup>43</sup> National Reform Council (n 7) 38-39.

<sup>44</sup> *ibid* 64.

in doing this, they still remain entitled to benefit from the promotion under this law depends on the criteria, methods, and conditions to be set out and announced by the Social Enterprise Board.<sup>45</sup>

The social purpose and re-investment type thus represent the fundamental requirements for an organisation to qualify as a social enterprise. Under the social enterprise certification scheme operated by the Thai Social Enterprise Office (TSEO) these are the requirements for a social enterprise to be formally certified as such. They are operationalised to include the following five social enterprise qualifications:<sup>46</sup>

- 1) having a social purpose as the main goal of the enterprise;
- 2) having the sale of goods or services as the main sources of its income (i.e. more than 50 per cent of the income coming from this source);
- 3) relying on fair employment and trade, as well as a standard production process that is environmentally friendly;
- 4) re-investing the majority of its profits back into the business in accordance with its social purpose or devoting them to activities that benefit society (not more than 30 per cent of the profits being allowed to be distributed as dividends); and
- 5) having good governance and transparency.

*Special Agenda* initiating the Social Enterprise Promotion Bill provides further detail on these five qualifications of social enterprises<sup>47</sup> and reaffirms that the Social Enterprises Type A to be incorporated as limited companies ‘are easy to set up and flexible in its operation’ and at the same time have ‘mechanisms for easy monitoring and control’. In particular, they must be characterised by the following features: being formally certified as social enterprises, incorporated with rules on no-dividend distribution and an asset-lock mechanism.<sup>48</sup>

The Bill provides for the registration of social enterprises by the TSEO; once a social enterprise has been formally registered as such, it must have a “social enterprise” tag attached to its business name. Under Section 8 of the Bill, no

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<sup>45</sup> *ibid.*

<sup>46</sup> Thai Social Enterprise Office (TSEO), ‘Application for Social Enterprise Certification’, *TSEO News* (Bangkok, 26 August 2015) <[www.tseo.or.th/news/231672](http://www.tseo.or.th/news/231672)> accessed 20 December 2015

<sup>47</sup> For example, employment of the disadvantaged in society, such as the disabled, ex-convicts, those who have been unemployed for more than two years, those aged more than 65, and others; and not less than 75 per cent of business activities must contribute to social promotion and a better environment. National Reform Council (n 7) 41-42.

<sup>48</sup> *ibid.* 42.

organisation that has not properly been registered as a social enterprise or properly permitted by the TSEO can legally use the “social enterprise” tag attached to its business name.<sup>49</sup>

It is clear that in initiating this legislative project on social enterprise promotion, the Thai Government does not opt for a new legal form for social enterprises but rather regulations that seem to amount to more or less the same effect. Particularly in so far as the provisions for the not-for-profit social enterprise, or Social Enterprise Type A, are concerned, this can certainly be regarded as an alternative to a new legal form for social enterprise. In Chapter 8 I shall actually propose such an alternative.

The legislative project significantly supports my analysis in this chapter and Chapter 8 that the limited company form can best serve as the basis for both the proposed legal form for social enterprise and the proposed alternative to it. That is, it is my argument, which will be presented in Chapter 8, that in case it is not yet possible to introduce a legislation creating a specific legal form for social enterprise, an alternative is to rely particularly on the limited company form. Of course, this legal vehicle must be incorporated with a governing document providing for the stakeholder rules of social enterprise similar to those contained in our legal blueprint. As will become evident, my proposal for this alternative arrangement is in line with the legislative project being currently considered by the National Reform Council.

It is important to emphasise in this connection that this legislative project does not invalidate my proposed need for a specific legal form for social enterprise. The argument presented in Chapters 3-4, in particular, has hopefully sufficiently explained why such a legal vehicle is required. I shall reaffirm such a need in Chapter 8.

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<sup>49</sup> *ibid.*

#### **7.4.2 Development of public-policy infrastructure for social enterprise in Thailand**

It must have become clear by now that much progress has been made in the development of social enterprise in Thailand. This sub-section explores what has been achieved, especially in terms of the development of public-policy support for Thai social enterprise. *Special Agenda* has identified various types of government policy support for social enterprise, namely,<sup>50</sup> social entrepreneurship education, social innovation research system, social enterprise start-up grant programme, social enterprise certification system, social enterprise funding, social enterprise legal forms, sustainable procurement programme, tax relief for social enterprise and social investors, and social enterprise support organisations. I shall not go into detail on all these forms of government for policy support; only what has been achieved so far will be highlighted.

Much progress has already been made during the past half decade or so. The years 2010-2011, in particular, witnessed several public-sector initiatives that have had the important effect of laying the vital public-policy groundwork for the promotion of social enterprise in Thailand. The organisation that assumed a pivotal role in mobilising the efforts in laying this public-policy groundwork for social enterprise in this country is the Thai Health Promotion Foundation.<sup>51</sup> Now let us take a look at some of the recent developments.

Social enterprise education has made inroads into the basic as well as higher educational system. Mechai Patana Secondary School (or “Bamboo School”) in Buriram province focuses on social entrepreneurship at the secondary school level.<sup>52</sup> Its 15 small affiliated schools have also offered this type of business education on an experimental basis. Arsom Silp Institute of the Arts in Bangkok offers an undergraduate programme in social entrepreneurship.<sup>53</sup> Thammasat

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<sup>50</sup> *ibid* 39-47.

<sup>51</sup> Established in 2001, the Thai Health Promotion Foundation (Thai Health) was the first organisation of its kind in Asia. It was created under the Health Promotion Foundation Act 2001 as an autonomous state agency outside the official bureaucracy and is funded by “sin taxes” collected from producers and importers of alcohol and tobacco.

<sup>52</sup> Mechai Patana Secondary School, Lamplimat, Thailand.

<sup>53</sup> Arsom Silp Institute of the Arts.

University's Global Studies School launched its undergraduate programme in social entrepreneurship in 2014.<sup>54</sup> Finally, Srinakharinwirot University currently provides an eight-month social entrepreneurship incubation programme; those attending the programme are not required to have any formal educational qualification. An undergraduate programme on the same subject has been planned for delivery in 2015.<sup>55</sup>

While formal study programmes in social entrepreneurship have already begun to take shape, research on social enterprise in general, and research oriented towards social innovation and social impact assessment in particular, remain insufficient. No research grant scheme for this specific purpose is currently available, apart from possible financial support from existing granting agencies like Thailand Research Fund. A social enterprise start-up grant programme also still does not exist, except in the form of support for social enterprises which have been successful in their application for certification (this type of support has been considered in relation to legal forms for social enterprises in the previous chapter). Now a 2 billion baht (about £39.7 million) Social Enterprise Credit fund has been set up to provide social enterprises with low interest rate credits (credits can be obtained with only 1 per cent interest rate if the repayment is made on schedule).<sup>56</sup> Other major financial schemes to support social enterprise development now being planned include an Endowment Fund using unclaimed assets and a tax relief for social enterprises and social investors.<sup>57</sup>

A very significant progress so far in the government policy support for social enterprise in Thailand has been the development of an institutional structure for this purpose since the early 2010s. A crucial move, which has already been pointed out in sub-section 7.3.2, was the establishment of the Thai Social Enterprise Board in 2010 as a governing body of the social enterprise sector. Chaired by the Prime

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<sup>54</sup> School of Global Studies, Thammasat University.

<sup>55</sup> National Reform Council (n 7) 26.

<sup>56</sup> TSEO, 'Application for Social Enterprise Certification' (n 46).

<sup>57</sup> National Reform Council (n 7) 43-46. On the tax relief measures, see an interview given by the Director of the Revenue Department, in Thai Rath, 'The Ministry of Finance is drafting a law on tax relief measures for social enterprises and inducing giant companies to provide support for the community', *Thai Rath News Online*, 28 August 2015 <[www.thairath.co.th/content/521292](http://www.thairath.co.th/content/521292)> accessed 2 October 2015>

Minister,<sup>58</sup> the Board assumes policy, governing as well as consulting role. In the policy realm, its task is to prepare policy, strategies, and master plans for the promotion of social enterprise and submit them to the cabinet for endorsement. Of particular interest here is that, among other competences and functions, the Board is to propose to the cabinet *new laws on social enterprise as well as revisions of existing laws, orders, regulations, or relevant cabinet decisions* in line with the government policy to promote social enterprise in Thailand. As we have seen, a crucial development in this respect is the Social Enterprise Promotion Bill already submitted to the National Reform Council for consideration and enactment.

Another crucial development, which has also been mentioned earlier, was the creation, also in 2010, of the TSEO. Operating under the Thai Social Enterprise Board, the TSEO has been meant to serve as an engine to move national policy on social enterprise ahead. For this purpose, it is tasked with the following functions:<sup>59</sup> (1) to implement the *Master Plan* in collaboration with partners in the various sectors, (2) to cooperate in setting out guidelines for efficient and sustainable management of social enterprise promotion funds, (3) to contribute to fostering an environment congenial to the development of social enterprise, (4) to assume responsibility for social enterprise certification, and (5) to link the needs, problems and obstacles to the policy level for additional support.

Like the CIC Regulator Office, the TESO is a very small organisation headed by a director; the current director is Nathapong Jaruwannapong. His staff is comprised

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<sup>58</sup> Under section 10 of the Social Enterprise Promotion Bill the Thai Social Enterprise Board will be chaired by the Prime Minister or a highly qualified person appointed by the Prime Minister, who has extensive experiences in social enterprise affairs and who does not occupy any political or government official position with a regular salary. Eight Board members are representatives of relevant government and related agencies, namely, the Ministry of Finance, the Ministry of Social Development and Human Security, the Ministry of Natural Resources and the Environment, the Ministry of Commerce, the Board of Trade of Thailand, the Federation of Thai Industries, the Stock Exchange of Thailand, and the Thai Bankers Association. In addition, the Board also includes eight highly qualified persons appointed by the Prime Minister. Not less than three of them must be selected from among social entrepreneurs, and not less than three more must be those with expertise in finance and investment, law, mass media, natural resources and the environment, public health, education, social development, marketing, or creative design, with each of these areas of specialisation being represented by no more than one person. All of these eight highly qualified persons must not be government officials. TSEO Director is a member who serves as the secretary of the Board. National Reform Council (n 7) 65.

<sup>59</sup> *ibid* 46.



of six members,<sup>60</sup> who assume functions relating mainly to policy advice, finance, international cooperation, and social enterprise development.<sup>61</sup> For the first phase of its operation roughly coinciding with the duration of the Master Plan, it was in 2011 endowed with a 96 million baht (around £1.9 million)<sup>62</sup> budget, which came from the Thai Health Promotion Foundation.<sup>63</sup>

The TSEO's work during this period consisted mainly of public relations campaigns to raise an awareness of, and create enthusiasm for, social enterprise and social entrepreneurship,<sup>64</sup> and efforts to coordinate activities with various parties to promote social enterprise in Thailand. These include the universities, starting with Srinakharinwirot University, which has provided support and cooperation in several projects; NGOs and non-profit organisations, as well as community enterprises, especially in an effort to promote the social enterprise business model among these organisations.<sup>65</sup> TSEO has also been collaborating with the Stock Exchange of Thailand (SET), and the fruit of this cooperation is SET's plan 'to promote social enterprise to become a feature of SET-listed companies and to launch new rules for asset management firms creating the Social Enterprise Fund in the next few years'.<sup>66</sup> A major function of TSEO is to provide certification for social enterprises. Now, as has been indicated in sub-section 7.2.2, more than 400 social enterprises have been formally certified. This aspect of TSEO's work is very important, because the certification system as envisaged under the Social Enterprise Promotion Bill has implications for how a social enterprise is to be incorporated.

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<sup>60</sup> Thiemboonkit, 'An Exploratory Study of the Development of Social Entrepreneurship' (n 18) 51.

<sup>61</sup> TSEO's job advertisement in early 2015 invited applications for the following positions: social business development leader, social communication and marketing leader, senior accountant, social marketer, and senior programme coordinator. TSEO, 'Job Advertisement' <[www.tseo.or.th/about/job](http://www.tseo.or.th/about/job)> accessed 30 October 2015.

<sup>62</sup> Bank of England, £1 can be exchanged for 50.30 Thai Baht (14 March 2016).

<sup>63</sup> Cahalane (n 16). See also Thiemboonkit, 'An Exploratory Study of the Development of Social Entrepreneurship' (n 18) 52.

<sup>64</sup> In *formally* identified social enterprises in Thailand, the two publications already mentioned, *Thailand Social Enterprise 50* and *SE Catalog*, have been significantly instrumental in raising awareness of this type of business in this country.

<sup>65</sup> Thiemboonkit, 'An Exploratory Study of the Development of Social Entrepreneurship' (n 18) 51-52.

<sup>66</sup> 'SET promotes social enterprise among listed companies' *The Nation* (Bangkok, 8 June 2014) <[www.nationmultimedia.com/business/SET-promotes-social-enterprise-among-listed-compan-30235372.html](http://www.nationmultimedia.com/business/SET-promotes-social-enterprise-among-listed-compan-30235372.html)> accessed 5 November 2015

It can be seen from the above brief survey of the social enterprise landscape in Thailand that a possible and hopefully appropriate direction for the development of social enterprise in this country has already been *officially* mapped out. Though how far the country could go in this direction in the near future remains to be seen, the fact that such a direction has been mapped out is a very encouraging development. Of course, like in most other countries in Southeast Asia, many other challenges still exist in Thailand. But in the past few years the country has been able to meet many of these and prove certain critical comments wrong, especially in so far as the government policy support is concerned.<sup>67</sup>

## 7.5 Conclusion

Clearly, a number of important components of a social and institutional infrastructure for social enterprise in Thailand have already been put in place. With regard to its social aspect we have seen the crucial role of social networks and support mechanisms. Most fundamental on the institutional side is the availability of a definition of social enterprise and strategies for its development. This is a vital step in the effort to promote this business. That is, not only has it been officially recognised as a new sector that needs public as well as private support but is also hopefully more *recognisable* as a new type of entrepreneurship in Thai society, especially among young people.

The institutional infrastructure for social enterprise in Thailand, in particular, is certainly only at its formative stage. Nevertheless, we can say that a crucial initial groundwork has already been laid down for its further development. The Thai Social Enterprise Board with its policy-making, governing and consulting functions has as its executive arm TSEO. Designed to be in touch with all possible entrepreneurs and interested partners who have a particular interest in social and environmental issues, the TSEO aims to inspire social responsibility, stimulate cooperation among social enterprises and develop country-wide networks. It can

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<sup>67</sup> Another example of such comments runs like this: 'Existing social enterprises and entrepreneurs who want to step into this field...must surmount new challenges, including lack of funding, weak capacity, lack of government support and lack of networks'. Pred Evans and Sumalee Annuaiporn, 'Social Entrepreneurship in Southeast Asia' 9 *Trendnovation Southeast Asia* 3.

thus be hoped that with both enabling social networks and mechanisms, together with this inchoate public policy framework, social enterprise is hopefully viable in Thailand. However, it must at any rate be admitted that major obstacles to the development of social enterprise in Thailand still exist. Most fundamental, from my point of view, is the lack of an appropriate legal and regulatory framework for this type of business. I shall try to make this clear in the next chapter.

## **Chapter 8**

### **Developing a Legal Form for Thai Social Enterprises**

#### **8.1 Introduction**

I have made it clear that as stakeholder business organisations social enterprises require a legal form specifically designed to meet both their business and stakeholder needs. However, as we have seen in Chapters 6 and 7, Thai social enterprises, despite their existence going back several decades, still operate without a specific legal form and have to rely upon several legal structures. In particular, I have clearly demonstrated in Chapter 6 that none of the main existing legal forms currently used by Thai social enterprises is particularly suited to their stakeholder business orientation. Hence, in the present chapter, I shall propose a specially designed legal form for social enterprises based on the model legal vehicle I have developed in Chapters 3 and 4.

While the requirement for such a legal form to meet the business-stakeholder needs of social enterprises has been made abundantly clear, I deem it necessary to provide further explanation for the importance of the legal form to the development of the social enterprise sector in Thailand. For this purpose, I shall focus mainly on the problem of social enterprise “branding”.

My principal task in this chapter is thus twofold: (1) to propose a new legal form for social enterprises modeled upon the legal blueprint developed in Chapters 3 and 4; and (2) to explain why such a legal vehicle is important to the development of the Thai social enterprise sector. I shall propose a new legal form and an alternative legal arrangement to more or less the same effect, in case it is still not possible to introduce a legislation creating such a legal form, in section 8.2. Then, in section 8.3, I shall explain how such a legal form, or the alternative legal arrangement, provides a solution to the main problem facing social entrepreneurs in Thailand, that of “branding”.

A reference was made in Chapter 7 to the new legislative project on social enterprise – Social Enterprise Promotion Bill. A regulatory arrangement forming part of this

project is for social enterprises to incorporate as limited company under the Civil and Commercial Code 1992 and operate as not-for-profits. This arrangement is essentially similar to the one I already have in mind – what I shall shortly propose as an alternative to my proposed new legal form for social enterprises. In discussing the problem of “branding”, I shall present a critical analysis of this legislative project, reaffirming, in particular, that the project does not invalidate my argument for developing a new legal structure for social enterprises. As indicated, its plan for social enterprises to incorporate as limited company and operate as not-for-profits actually supports my idea of using this corporate form as an alternative to my proposed development of a new legal form for social enterprises.

## **8.2 For a new legal form for social enterprises in Thailand**

This section is devoted to the development of a legal form for Thai social enterprises based upon our ideal-type legal vehicle. An alternative legal arrangement will also be provided in case it is not possible to introduce a legislation creating a new legal entity. Even though it is designated as an optimal type, it has particularly been developed to meet the needs of Thai social enterprise. It is aimed, in other words, to serve as a blueprint, or a rational guideline, for the construction of a legal form for Thai social enterprise. Without such a model, needless to say, the development of a legal vehicle for Thai social enterprise would be rationally ungrounded. However, the legal blueprint I have developed can be expected to be applicable, *mutatis mutandis*, to other national contexts.

This does not mean that a legal development project can ignore the peculiar national contexts and slavishly imitate a presumably “good” model. We have seen in Chapter 5 that the CIC does not fully match our legal blueprint. Hence, in contemplating the use of the blueprint as a model for developing a Thai legal form (or an alternative legal operational mode) for social enterprises, we need to carefully take the peculiar Thai national context into consideration.

In proposing that Thailand develop a legal form for social enterprises to foster its social enterprise sector, I shall not suggest how a legislative initiative be taken for this purpose. The initiation of a legislative measure requires a political decision,

and this depends, in turn, on whether or not the government sees the need and has a clear rationale for such a measure. However, I do hope that this thesis goes at least some way towards clearly explaining the need, and thereby providing a *rationale*, for such a law.

To my knowledge, only very few academic studies have been produced which touch upon the need for a legal form specifically designed for social enterprises in Thailand.<sup>1</sup> Academic studies hopefully represent a first step towards expanding the public as well as official awareness of such a need, and my thesis will be by far the most substantive contribution to this still limited academic literature on social enterprises in Thailand.

While not directly addressing the issue of initiation and legislation of the law, discussing the development of a legal form for social enterprises cannot avoid that of the architecture of legislation creating the legal form. This issue was touched upon in Chapter 3, where it was argued that the proposed legal form be created as a variant of the main corporate form rather than a “stand-alone” legal entity. In the UK the main corporate form is the limited liability company, and its Thai equivalent is the limited company. Following this strategy, I propose here that a legal form for social enterprises in Thailand be constructed as a variant of the country’s “core” corporate form – the limited company.

In Chapter 7, I presented an overall picture of the Thai social enterprise landscape, and I shall not go over the specific conditions in Thailand again. I shall directly propose a new legal form for Thai social enterprises, starting in sub-section 8.2.1, with the issue of using the limited company as the basis for the new legal vehicle.

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<sup>1</sup> The only academic work I am currently aware of is Park Kanjanapaibul, ‘Legal Entity for Social Enterprise’ (LLM thesis, Thammasat University 2011). This thesis nevertheless provides no model legal form for social enterprise (though it proposes a new legal form called “public interest company”); nor does it engage in any in-depth analysis of social enterprise legal forms of other countries. It merely touches upon such legal forms in the United States and a few European countries. Its main analysis is devoted to the legal forms under the Civil and Commercial Code – both for-profits and non-profits – and how these would serve as legal forms for social enterprises. My thesis goes beyond this scholarly work in at least three respects. First, it provides a blueprint of legal forms for social enterprises. Second, it engages in in-depth discussion of the “stakeholder” nature of social enterprises. Finally, it presents an evaluation of the CIC and main legal forms available for Thai social enterprises (especially those under the Civil and Commercial Code) against the legal blueprint.

Sub-section 8.2.2 then examines the components of the proposed legal form. Finally, a strategy for using an existing legal form – one which is expected to more efficiently cater for the needs of social entrepreneurs – will be proposed in sub-section 8.2.3.

### **8.2.1 Limited company form as the basis for the new legal vehicle**

Our blueprint of a legal form for social enterprise is based on the corporate form, and in Thailand such a form already exists. Thus, at least in principle, creating a variant of this form seems to entail no major problem. Under the Civil and Commercial Code 1992, as we have seen in Chapter 6, there are already several types of business organisations; it thus should not be impossible to add another type of a similar nature. Clearly, as a matter of principle – and for all practical purposes – the proposed legal form for social enterprises in Thailand should be created as a variant of the country’s main corporate legal form – the limited company.

As a business organisation, the proposed legal form will operate in much the same way as the existing limited company. In matters relating to governance, relevant provisions of the Civil and Commercial Code 1992 will apply, and, like the limited company, it will be subject to insolvency and tax laws. Only in matters relating to its social mission will the new legal form be governed by another set of rules – which are mostly mandatory in nature.

The proposed legal form may be created by incorporating new sections into the Civil and Commercial Code 1992 or through the legislation of a new Act on social enterprise,<sup>2</sup> in much the same way as the Public Limited Company Act 1992 was legislated to govern the public limited companies. Both options are acceptable in my view, but I prefer adding new sections: for reasons given in Chapter 3, it is preferable for the new legal form not to be a “stand-alone” one.<sup>3</sup> These additional sections in the Code will provide the mandatory rules to ensure the orientation of

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<sup>2</sup> Office of the Council of State, *Legislative Drafting Manual* (Office of the Council of State 2008).

<sup>3</sup> Kanjanapaibul proposes that a separate Act should be legislated because the new legal form could be adopted by both the private and public limited companies. The Act, in other words, would govern both types of companies operating as social enterprises. Kanjanapaibul (n 1) 108.

Thai social enterprises relying on the new legal form towards social and community benefits.

However, given the traditional legislative process in Thailand, adding new sections to the Civil and Commercial Code is likely to be difficult. This is because, though social enterprises can be governed by the provisions on the limited company, by their nature they are not-for-profits, whereas the Code clearly states that there are only for-profit and non-profit entities. Hence, introducing amendments to the Code might be more complicated than initiating a new law, since this involves not only adding stakeholder elements to the Code but also amending or revoking certain sections which are in conflict with these elements. In fact, the initiation of the Social Enterprise Promotion Bill clearly signals that the social enterprise law is a stand-alone one. Thus, it would not be surprising if a new legal form for social enterprise would eventually be introduced, it would be a new law.

It is really not difficult to see how this proposed legal vehicle would look like. I have already characterised the ideal-type legal structure for social enterprise as a *corporate-plus form* consisting of a number of default and mandatory rules. The proposed legal form would thus basically contain all these rules. Moreover, in view of the problem of “branding” to be shortly dealt with, the new legal form should have a name that will make Thai social enterprises *formally recognisable* and at the same time give it a sense of familiarity in Thai society and the business community. I shall thus provisionally call this proposed legal form a “Social Interest Company” (SIC). While “social interest” clearly identifies its social mission, “company” is a more familiar term in use in Thailand. As in the case of the CIC, SIC must appear at the end of the names of social enterprises adopting this legal form. We can presume, indeed, that this “social interest company” tag is not simply a legal technicality, but, more significantly, it will make social enterprises in Thailand formally recognisable, giving the public a sense of familiarity with its nature and functions, and providing it with efficiency and legitimacy in functioning in Thai society.



## **8.2.2 Basic components of the Social Interest Company (SIC)**

The basic components of the proposed legal form, the SIC, are actually those of our blueprint of legal forms for social enterprises. However, we cannot presume that all these components are familiar features in Thailand. We shall thus need to examine if these components are more or less acceptable in Thai society.

### **8.2.2.1 Legal personality and limited liability**

Both legal personality and limited liability are the principal features of Thailand's main corporate form, the limited company. Being based upon this legal structure, the proposed legal vehicle for Thai social enterprises contain these two basic components, which form the basis of the country's main business organisation. Businesspeople opting to operate within this legal structure actually require both the liability protection and perpetual succession it provides; they also need its flexibility and the opportunity for raising both loan and share capital which come with it.

Many social enterprises in Thailand, including those formed as other legal entities, have adopted the limited company form (some social enterprises operating as other legal entities have also created a limited company as their commercial subsidiary). They presumably see the usefulness of this form as a legal structure within which to pursue their business objectives. These two basic components of the SIC will thus definitely be accepted as its essential part.

### **8.2.2.2 Raising of finance**

Those who have chosen to pursue their business activities within the limited company form expect to benefit from the opportunity to raise both loan and share capital. Not only does the law permit a limited company to access private capital by issuing shares, but given its familiarity, credibility and hence "legitimacy" as Thailand's main corporate legal structure, this legal form presumably functions more effectively than most other legal entities in acquiring loans from private sources – particularly banks and other financial institutions.

Of course, whether or not a business firm can obtain loans from a private source depends on many other factors, but operating within the limited company structure can be expected to provide one with a better opportunity for achieving this goal. Being based upon this structure, the SIC can be expected to meet this important need of social entrepreneurs as well.

In Thailand a major problem for social enterprises is basically the same as that being faced by social enterprises in many other countries. This is related to social enterprises being mostly small businesses, which generally encounter difficulty in raising finance. As will be shown in the next section, this problem for Thai social enterprises has been exacerbated by that of social enterprise “branding”. Therefore, to the extent that the SIC can be expected to solve this problem, it can presumably relieve, at least to some extent, Thai social enterprises of the difficulty they encounter in raising finance.

#### 8.2.2.3 Asset lock and non-distribution constraint

The asset lock and non-distribution constraint are central features of social enterprise; they must thus be incorporated into the SIC as one of its mandatory rules. This mechanism is understandably not part of the legal forms for for-profit organisations. However, the asset lock concept is actually *not* foreign to Thai society, particularly believed to be non-profit concepts.<sup>4</sup>

The problem is thus how to incorporate these mechanisms, which the Thai people generally regard as being relevant only to *non-profit* organisations into the SIC, the new type of *not-for-profit* entity being proposed as a legal form for Thai social enterprises. This again confirms the importance of the SIC and social enterprise branding, which will be discussed later. In this respect, it is proposed that the SIC follow the CIC format; that is, not only are the asset-lock mechanisms designated as statutory requirements but they must also be included in its governing documents. This is because, as Kanjanapaibul has pointed out, general provisions

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<sup>4</sup> For example, the Civil and Commercial Code 1992, s 134 requires that foundation specify its asset-locked body in the constitution. After liquidation, the foundation must transfer its residual assets to the specified body. If the foundation has not specified any, the court can order a transfer of such assets to any foundation or legal person whose objectives are most compatible with the foundation being liquidated.

in company law are default rules, while the governing documents such as the memorandum or articles of association are genuine governing regulations. Hence, requiring a company to incorporate statutory clauses into its governing documents is a more effective measure than directly including such clauses in the law itself.<sup>5</sup> This leads to the way in which our new legal vehicle for social enterprises should be legislated:

...the legislation of the new legal entity should create model provisions to be contained in the companies' articles of association. Furthermore, the legislation must clearly state that such clauses cannot be amended or abolished, except in case...[of the clauses being amended to be more rigid]...<sup>6</sup>

The main purpose of the asset lock and non-distribution constraint is to ensure that the assets are managed in a proper manner and for the benefit of stakeholders and the community. The assets here include income, profits or other surpluses generated by the SIC's activities. The asset lock thus involves the transfer of assets under certain conditions. With regard to the transfer of the SIC's assets, I do not intend to provide full details at this stage on how these rules be formulated but rather propose them as core concepts.

In this regard, the CIC offers both a general principle and a practical guideline; that is, any of its assets cannot be transferred other than for full consideration to ensure that it receives a fair market value for the assets, and upon winding up, the residual assets must be transferred to specified asset-locked body (bodies), not shareholders. As in the case of the CIC, there are exceptions to this principle; for example, a transfer of assets may be made for less than full consideration to any specified asset-locked body or made in any other way that amounts to a transfer of assets for the benefit of the community or society at large.

It is also important to place a constraint on payment of dividends to shareholders as part of a lock on asset distribution/transfer. The constraint is designed to work in much the same way as the CIC dividend cap. However, not only are there different types of shareholders, but, in practice, it is difficult to determine the extent of such a constraint. The cap must not be too restrictive. In Thailand, where a cap on private

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<sup>5</sup> Kanjanapaibul (n 1) 110.

<sup>6</sup> *ibid.*

profit sharing is still not a familiar practice,<sup>7</sup> particularly among for-profit companies, a too restrictive cap would have an important effect of deterring private investors. But too generous distribution of dividends is not acceptable either. In my view, the dividend cap is not completely foreign to Thai social investors. There are cases where some shareholders, particularly social investors, agree to receive no dividend at all. However, I fear the dividend cap would become a major obstacle to attracting private investors into the social enterprise sector. That is why a scheme for the caps on payment of dividends must be carefully worked out, which also requires empirical research and state support. For practical purposes, I shall adopt the criterion for the CIC following the latest changes in 2014, which ensures that 65 per cent of the SIC's profits be retained for reinvestment back into the company or used for social benefits. Incidentally, this criterion is roughly in line with the cap on the distribution of profit stipulated by the Thai Social Enterprise Office (TSEO) for social enterprises applying for formal certification.

Let us now turn to the issue of remuneration of directors. In this case, I shall again follow the general principle adopted for the CIC, which prescribes that the remuneration of directors should never be more than is reasonable, and arrangements for payment to directors should always be transparent. As is generally recognised, the remuneration of directors can be used as a way to avoid the non-distribution constraint; in Thailand this could be a major problem since the country still does not have an independent external regulator who may take action if a director's remuneration seems to be too high. This is nevertheless a problem for not only social enterprises but is generally recognised in the Thai business community.<sup>8</sup> There have thus been attempts to create a standard or "best practice" for director

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<sup>7</sup> The concept of profit distribution constraint in Thailand can be found in co-operatives. According to the Cooperative Act 1999, s 60, not less than 10 per cent of the annual net profit must be allocated to the reserve fund of the co-operative and not more than 5 per cent for subscription to the Co-operative League of Thailand. The remaining profit can be distributed in the following manner: (1) dividends on paid-up shares not exceeding a designated rate; (2) patronage refunds to the members in proportion to their volume of business done with it during the year; (3) bonuses to the members of its board of directors and other personnel not exceeding ten per cent of the net profit; and (4) contributions to accumulated funds for carrying out any activity of the co-operative.

<sup>8</sup> Before the financial crisis of 1997, remunerations for executives in large companies were generally known in some cases to be unreasonably high. This in a way reflected Thailand's economic bubble before it burst.

compensation that might be used as a criterion for determining the remuneration of SIC's directors.<sup>9</sup>

#### 8.2.2.4 Social benefit requirement

This defining feature of social enterprises is not an unfamiliar aspect of Thai law. It is an integral part of non-profit structures like the foundation (though, naturally, it is not relevant to for-profit entities). Under the Civil and Commercial Code 1992, a foundation, in particular, cannot engage in activities other than those falling under the areas specified by the Code – i.e. activities undertaken for public charity, religious, artistic, scientific, educational or other public purposes. Moreover, as a non-profit organisation, it not allowed to engage in activities in those areas in any business-oriented way, that is, in any way amounting to private profit-maximising.<sup>10</sup> However, these rules are too restrictive for social enterprises, which should be allowed to pursue any business activity in any possible area, as long as such an activity is not against the law or detrimental to social order or good morality of the people – and, in particular, if it can be proven to contribute to social and community benefits.

Most significantly, as already pointed in Chapter 7, the TSEO has adopted a scheme under which social enterprises can apply for certification as such. Social enterprises applying for such recognition must satisfy five main requirements, one of which is that they must set the social objective as their main goal.<sup>11</sup> Therefore, in designing the SIC, I propose that we adopt this social objective requirement of the TSEO as one of its mandatory rules. Like the asset lock, this rule will be included in the governing documents of the organisations operating as SICs. By legally requiring an inclusion of this rule in the constitution of the organisations opting to operate as SICs, it will acquire a mandatory rule status.

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<sup>9</sup> For example, Thai Institute of Directors Association, *Director Compensation Best Practice* (Issue 1/2006, 2006).

<sup>10</sup> The association, another type of non-profit organisation, is limited in much the same way.

<sup>11</sup> The other four requirements include: main revenue (more than 50 per cent of the total income) coming from trading in goods or services; fair employment and trade, and the production process being up to recognised standards and environment-friendly; most of the profit being reinvested in pursuit of the social objective of the organisation or contributed to social activity, with no more 30 per cent of the profit being distributed for private benefits; and good and transparent governance. Thai Social Enterprise Office, 'Application for Social Enterprise Certification' *TSEO News* (Bangkok, 26 August 2015) <[www.tseo.or.th/news/231672](http://www.tseo.or.th/news/231672)> accessed 20 December 2015

The law legislating the SIC could authorise the TSEO, or any other body to be set up as the SIC regulator, to “test” or verify the social or community orientation of organisations applying for registration as SICs. Most interestingly, the questionnaire the organisations applying for certification as social enterprises are required to fill is essentially the “test” of whether or not they satisfy the five requirements, including the social objective one. Hence, authorising the TSEO to assume responsibility for a statutory social benefit test for social enterprises simply amounts to further formalising what it is already doing.

#### 8.2.2.5 Stakeholder participation

Our legal blueprint requires this as a mandatory rule for social enterprises. In Thailand, this requirement is not unfamiliar. Certain social enterprises have benefited from various forms of stakeholder involvement. Moreover, as a business operation norm or principle, stakeholder involvement is now generally acknowledged. A handbook prepared by the Department of Business Development for partnerships and private and public limited companies contains a separate section on “Ethical Standards of Business Organisations”. One of these ethical standards is the “participation principle”.<sup>12</sup>

However, with regard to how this practice should be integrated into the SIC, I would suggest that it form part of the latter as a *default* rather than mandatory rule. Such a rule would provide Thai social enterprises with flexibility, because, as indicated in the case of the CIC in Chapter 5, it might not be possible for all social enterprises, most of which are small ventures, to accommodate the same extent and depth of stakeholder participation.

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<sup>12</sup> According to this principle, the administrators of business organisations must give the shareholders, partners, employees, and stakeholders an opportunity to participate in the management of the organisations through their participation in the making of the decisions that would have an impact on the business, interests, or livelihood of the stakeholders. Participation may be effected in the following ways: (1) provision of various channels for public hearings and expression of opinions and complaints, such websites, satisfaction surveys, or comment boxes, and (2) policy allowing or inviting [stakeholders or members of the interested public] to take part in the business organisations’ activities. Department of Business Development (DBD), *Handbook on What to Know and Do upon Becoming a Partnership, a Private Limited Company, or a Public Limited Company* (DBD 2015) 42.

That means that the organisations opting to operate as SICs have the choice of whether or not to incorporate this requirement into their governing documents. Even if they decide to include the requirement in their constitutions, they still retain the flexibility of determining how to involve the stakeholders. For example, to follow the CIC Regulator’s guidance, it might be formally provided in their constitution that the stakeholders be consulted before the directors or members of the organisations make certain decisions and/or that stakeholders be invited to attend an open forum associated with their annual general meetings.<sup>13</sup> Even though they do not want to incorporate the stakeholder involvement as a mandatory rule, a “strong” guidance on this matter may be adopted as a practical measure for more or less the same result. In particular, TSEO, or any other regulatory body to be set up, should “strongly” recommend to organisations opting to operate as SICs that they put in place some measures for stakeholder participation.

#### 8.2.2.6 Stakeholder board

We have made it clear that as stakeholder entities social enterprises should not only cater for stakeholder participation in their activities but also involve the stakeholders at the governance level. I have extensively elaborated both the theoretical and practical aspects of this issue in Chapters 4 and 5. For the SIC, I propose, as in the case of stakeholder participation, that this feature of the legal blueprint be adopted as a default rather than mandatory rule.

In Thailand, though the idea of creating a stakeholder board is not entirely foreign (a private school board is clearly of this type), it might not be generally practicable. It is quite normal to involve those who bring benefits to the organisations – especially in the form of knowledge and expertise, financial support, or even prestige coming with the participation of eminent persons in society. But bringing in people who may seem to be “outsiders”, and who cannot be expected to come with any clear benefit to the organisations (even though they are clearly identified as “stakeholders”), does not seem at present to be a practical measure. Perhaps only in certain circumstances would forming a stakeholder board seem practicable: in

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<sup>13</sup> Office of the Regulator of Community Interest Companies, *Information and Guidance Notes – Chapter 9: Corporate Governance* (2013) 5-6.

particular, it seems possible for a community enterprise to initiate a stakeholder board by bringing in the people of its own community who, directly or indirectly, have a “stake” in its activities.

Therefore, though I have already expressed my preference in the case of the CIC for a mandatory rule for stakeholder board, for practical purposes (i.e. to allow for flexibility required by SICs operating in different circumstances), I propose the adoption of this measure as a default rule. As in the case of stakeholder participation, the measure should be “strongly” recommended for SICs by the TSEO or any other regulatory agency to be set up. At least organisations like community enterprises can presumably be expected to see the benefit as well as the practicality of forming stakeholder boards. How this could be achieved – especially, who should be brought in to sit on the board – should be left to their discretion.

#### 8.2.2.7 Directors’ duties and competence

Issues specifically relevant to the duties and competence of the directors of social enterprises were fully covered in Chapter 4 (sub-section 4.3.2.5), and in Chapter 5 (sub-section 5.5.2.5). We have seen that it is the duties of the directors to seek not only to promote the success of the company by maximising shareholder value, but also, and more significantly, to balance it against stakeholder interests. The above discussion of the social benefit requirement has also made it clear that the duties and responsibilities of the directors must be mandatorily directed towards social and community benefits. All this involves the directors’ competence and how they should perform their duties especially in balancing the interests of the owners of the company against those of the stakeholders. As indicated in Chapter 5, we cannot expect the law to fully provide how the directors should perform their “balancing act”, but I shall here not go over the points I have already made in Chapters 4 and 5.

The directors’ duties and responsibilities *vis-à-vis* stakeholders must of course be statutorily provided for. How they perform their duties, as well as the issues of “the standard of care” and the level of competence expected of them, can be expected to be governed, more or less as in the case of the CIC, by relevant provisions of the



company law,<sup>14</sup> court decisions, non-corporate laws, and standards of “best practice”.<sup>15</sup> As will shortly be pointed out in relation to public disclosure, the Civil and Commercial Code 1992 imposes on the directors not only the “standard of care” but also the duties relating to financial disclosure to ensure transparency.

#### 8.2.2.8 External regulator and public disclosure

Thailand still does not have a social enterprise regulatory regime. TSEO cannot be expected to function as an external regulator. Its role consists mainly in providing support for, and facilitating the operation of, social enterprises. The initiation of the SIC would not be possible without transforming the TSEO into a regulatory body or establishing a new organisation for this purpose. On the other hand, social disclosure has to some extent been provided for by the Civil and Commercial Code 1992; these provisions would serve our purpose with additional requirements (i.e. in addition to financial disclosure).

As pointed out above, the TSEO is remarkably assuming some *de facto* regulatory functions. The requirements it has set out for organisations seeking the social enterprise certification amount to setting the terms according to which they must operate. Of course, it has neither legal authority nor administrative capabilities to oversee their activities and take action if any of them has drifted from their social mission, but the existence of a body like the TSEO actually provides a necessary modicum for the development a regulatory regime.

The law governing the SIC must give the TSEO a new mandate for its regulatory functions or establish a new body charged with the same functions. Our blueprint of the legal forms for social enterprises contains an ideal-type external regulator (sub-section 4.3.2.6) whose main features include the regulator’s independence,

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<sup>14</sup> Under Thai law it is only provided in the Civil and Commercial Code 1992, s 1168 that ‘The directors must in their conduct of the business apply the diligence of a careful business man; [i]n particular, they are jointly responsible for (1) for the payment of shares by the shareholders being actually made; (2) for the existence and regular keeping of the books and documents prescribed by law; (3) for the proper distribution of the dividend or interest as prescribed by law; [and] (4) for the proper enforcement of resolutions of the general meetings’.

<sup>15</sup> The “Ethical Standards of Business Organisations” referred to above, which are principally aimed to govern the behaviour of the directors or administrators of these organisations, include adherence to the rule of law, moral principles, transparency, participation, accountability and value for money. DBD (n 12) 38-43.

accountability, roles and responsibilities, together with other aspects of the regulator's duties and functions. My analysis of the CIC has found that the law governing the CIC Regulator practically incorporates all these features. The CIC Regulator can thus serve as a practical guideline for developing the SIC regulatory regime. Even the CIC Regulator's "light-touch" approach may also be adopted.

However, in view of corruption remaining one of Thailand's major problems, the scope of the authority and functions, as well as the regulatory approach, of the SIC regulatory regime must be carefully devised. In particular, a "light-touch" regulatory approach might be necessary, in the sense that the regime should not impose a tight bureaucratic oversight but should instead leave social entrepreneurs with flexibility and freedom to pursue their business and social objectives. But unlike the CIC Regulator's light-touch approach (sub-section 5.5.2.6), which '...does not envisage pro-active supervision of individual CICs by the CIC Regulator', the proposed SIC regulatory body needs to be significantly *more* pro-active in executing both its regulatory and supervisory functions.

A crucial function of an external regulator is both to promote and protect the social enterprise sector. As in the case of the CIC Regulator, the SIC regulatory body could have a critical role in protecting the sector by weeding out bogus social enterprises and eliminating fraudulent practices. This would have the important effect of protecting the image of, and maintaining confidence in, the SICs. The social enterprise sector as a whole would significantly benefit in this respect from the regulator's roles and functions. With regard to the latter's promotional role, the TSEO has already contributed much to the development of the social enterprise sector in Thailand, particularly by providing knowledge and information, and serving as a centre for coordination of the country's social enterprise networks.

At this juncture, a possible future issue should be mentioned. The Bill does not spell out how possible legal problems arising out of the creation and/or termination of social enterprises, or perhaps also their governance, would be dealt with. I presume that administrative regulations would be issued following the enactment of the law. Presumably, most regulatory problems would be solved in accordance with these regulations. We should nevertheless also anticipate legal conflicts. Civil cases

involving, say, breaches of contract, would be settled in the Civil Court. But how are conflicts between social enterprises and TSEO (or any regulatory agency to be set up) to be dealt with?

Let me give just one possible conflict of this type, namely, the case of an application for the registration of a social enterprise being rejected by the regulatory agency (as in the case of the CIC, a dual registration can actually be expected, that is, registration as a limited company with the Department of Business Development and registration as a social enterprise with the social enterprise regulatory body). If the applicants do not agree with the rejection, what can they do? Of course, an appeal procedure would presumably form part of the regulations to be set out. However, the conflict might not end there; then, how could it be further dealt with?

One possible way is for the applicants for the registration of the social enterprise to bring the case to Administrative Court – which in Thailand functions as a court of justice.<sup>16</sup> This court is empowered to consider cases of conflict between (1) government agencies, (2) government employees and their organisations, and (3) private citizens/organisations and a government agency.<sup>17</sup> Though presumably functioning autonomously, the social enterprise regulatory body to be set up will definitely be a government agency of one type or another. So, if a conflict arises between it and any social enterprise it will be governing, this might have to be finally settled in court.

Finally, let us turn to the issue of social disclosure. As pointed out above, this requirement for the limited company is mandatorily provided for by the Civil and Commercial Code 1992 to ensure the transparency of its operation, especially in regard to financial matters. As a normal standard of practice, this involves the preparation of the annual financial statement, which needs ‘to be examined by one or more auditors and submitted for adoption by a general meeting within four months of its date’.<sup>18</sup> It is the directors’ duty ‘to send to the Registrar a copy of

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<sup>16</sup> Office of the Administrative Court, *Modes of Administrative Court Verdicts Volume 4* (Bangkok: Administrative Court 2013).

<sup>17</sup> Establishment of Administrative Courts and Administrative Court Procedures Act BE 2542 (1999), s 9.

<sup>18</sup> Civil and Commercial Code 1992, ss 1196-1197.

every balance sheet not later than one month after it has been adopted by the general meeting'.<sup>19</sup> The directors must also ensure that accounts be kept of the company's revenue and expenses, as well as its assets and liabilities.<sup>20</sup> 'Every auditor shall at all reasonable time have access to the books and accounts' and, moreover, 'may examine the directors or any other agents or employees of the company'.<sup>21</sup> Finally, the law provides for "public inspection of documents"; that is, on payment of a fee, 'every person is entitled to inspect the documents kept by the Registrar, or to require a certificate of the registration of any partnership or company, or a certified copy or extract of any other document, from the Registrar'.<sup>22</sup>

However, I have made it clear in Chapters 4 and 5, social disclosure for social enterprises must also cover their reports on how, and how much, they have met their social benefit goals. For this purpose, the CIC's approach may be adopted; that is, the SIC is mandatorily required to prepare and deliver annually to the Registrar: (i) the balance sheet, (ii) an annual SIC report and (iii) annual return. Alternatively, apart from the financial report to the Registrar, the SIC is mandatorily required to deliver an annual social benefit report to the TSEO or an external regulator to be set up to ensure that it continue to pursue its social goals.

To conclude this sub-section, let me emphasise that the proposed legal form for Thai social enterprises, the SIC, has been designed in accordance with both the requirements of the ideal-type legal vehicle for social enterprises and the practical approach of the CIC. This proposed legal structure is presumed to be well suited to the practical conditions of the Thai social enterprise sector and Thai society in general. A number of the model components, most notably the social benefit requirement, the asset lock, the external regulator and social disclosure, must be statutorily provided for. With most of the components of the ideal-type legal vehicle for social enterprises being already more or less familiar features in some legal forms in Thailand, it is hoped that legislating this proposed legal vehicle for social enterprises in this country is a practical possibility. However, as I have stressed at the outset, the initiation of a legislative measure involves political decision. I wish

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<sup>19</sup> Civil and Commercial Code 1992, s 1199.

<sup>20</sup> Civil and Commercial Code 1992, s 1206.

<sup>21</sup> Civil and Commercial Code 1992, s 1213.

<sup>22</sup> Civil and Commercial Code 1992, s 1020.

therefore to suggest an alternative to the initiation of a new legal form: this involves the use of an existing legal form to achieve more or less the same purpose.

### **8.3 Alternative legal arrangement to the SIC**

I have earlier emphasised several times that contractual legal arrangements can be internally made among those forming a business venture. The law provides packages of rules mainly to facilitate its operation especially by reducing its transaction costs. Hence, as the initiation of the SIC depends on a future political decision, what social enterprises in Thailand can do now is to make internal arrangements for their proper operation as this particular type of business, for example, by imposing on themselves the social benefit objective, asset lock, dividend cap, and stakeholder participation, so that the Thai people can clearly distinguish them from for-profit and non-profit organisations. This sub-section aims to propose such an alternative legal arrangement for Thai social enterprises in the absence of a specifically designed legal form (social enterprises can actually opt for marketing or public relations approach rather than a legal arrangement of this type).

My assessment of the existing legal forms under the Civil and Commercial Code 1992 in Chapter 6 resulted in my proposal that the limited company form is most suitable for social enterprises. In view of this suitability, the limited company form has been adopted as the basis for the creation of the SIC in the previous sub-section. For the same reason this main corporate form will also be used as the “core” of an alternative legal arrangement to be proposed in this sub-section.

A straightforward and simple legal arrangement is for a social enterprise operating within the limited company structure to include in its governing documents the main components of the blueprint of legal forms for social enterprises – especially the social benefit objective, the asset lock, dividend cap, and social disclosure.<sup>23</sup> The governing documents of the limited company include the memorandum of association and the articles of association.

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<sup>23</sup> Company law is part of Book III of the Civil and Commercial Code 1992, which covers contracts. This means that the provisions on this matter are default rules, which could differently have been agreed upon by the parties to the contract. Amendments to the company regulations can thus be made by the shareholders' consent.

The memorandum is required for the registration of a limited company, which contains the name, the address, the objects of the company, as well as the statement of the limited liability of shareholders of the company, the number of shares and the details and signatures of the promoters.<sup>24</sup> The company's articles must be the first thing decided in the general meeting on the company's establishment. It contains regulations or operating procedures involving the persons in the company, such as the powers of the directors, the meeting of shareholders, the appointment of auditors, the payment of dividends, the appropriation of reserve fund, among other matters. The memorandum is different from the articles in that while the former deals with the company's activities involving external persons, the latter governs the company's internal relationships.<sup>25</sup>

The first thing that social enterprises can/should do in order to differentiate themselves from for-profit companies is to insert the social benefit requirement in the objectives, which are part of the memorandum. The law does not define the objects of the company in any specific way, and this endows the limited company form with flexibility. It is clearly the objectives that actually define the nature and purpose of the business. Hence, whether or not a limited company can be characterised as a social enterprise depends mainly on what it sets out at registration as its objectives.

I studied a number of limited companies<sup>26</sup> claiming to be operating, or being recognised, as social enterprises and found that all of them set forth a wide range of objects – that is, ranging from 23 to 41, which are mainly the model objectives. Rakluke Group is the only one among the companies I studied that has set out the most relevant objectives to its social mission. The company has added some social objectives such as operating as a consultant for participatory learning involving children, the family, society, and the community.<sup>27</sup> Others have chosen to adopt the

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<sup>24</sup> Civil and Commercial Code 1992, s 1098.

<sup>25</sup> Nonthawat Nawatrakulpisut, *Law on Partnership, Limited Company and Public Limited Company* (3<sup>rd</sup> edn, Winyuchon 2015).

<sup>26</sup> These include Sungkhom Sukhaphab, Pen Tai Publishing, Open Dream, Rakluke Group, Suan Ngoen Mee Ma, and Rung Arun School.

<sup>27</sup> From access to the company registration information source of the Registrar on 14 October 2015, Rakluke Group Co., Ltd was established on 17 November 1982, Registration no. 0105525042435.

model objectives (though some of the objectives are not relevant to their not-for-profit activities at all)<sup>28</sup> and added only one or two social activities. We hardly know from their profiles in the public record that they are social enterprises. In practice, most Thai social enterprises choose to inform society of their public- or community-oriented activities through public relations outlets such as their websites or participation in public- or community-oriented events.

Only pursuing the social benefit goal is certainly not sufficient for social enterprises. Other important features of the legal blueprint, notably the asset lock, stakeholder participation, and the stakeholder board, should also be incorporated into the limited company structure, so that it could serve as an adequate legal vehicle for social enterprises. A possible legal arrangement for this purpose is to include these features in the company's articles.

Though the law permits amendments to the articles (partly or wholly), it is recommended that social enterprises set forth those rules from the beginning since the amendment process is rather complicated and subject to fees.<sup>29</sup> For example, the model articles, chapter 6, section 18, only provide that prior to the distribution of dividends an allocation to the reserve fund must be made under section 1202 of the Civil and Commercial Code 1992 but offer no detail on this matter. This means that social enterprises can determine their dividend cap rate, say, not more than 35 per cent. However, any additional rules must not conflict with the Code, under which the limited company operates, and must not contradict the memorandum.

Unfortunately, none of the social enterprises I studied<sup>30</sup> chose to insert any stakeholder elements into their companies' articles. However, this does not mean

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<sup>28</sup> For example, one of the objects of the company, Sungkhom Sukhaphab, meaning "healthy society", is to operate a massage parlour, which is obviously not a respectable business. From access to the company registration information source of the Registrar on 14 October 2015, Sungkhom Sukhaphab Co., Ltd was established on 6 June 2003, Registration no. 0105546064969.

<sup>29</sup> To amend the company's articles, the following procedure must be followed: (1) issuing to shareholders a call for the meeting, which must be published in newspapers or sent to them by post; (2) holding the meeting whose decision requires a three-quarter majority vote of those attending the meeting and are entitled to vote; and (3) registering the amendment for which relevant documents and fees are required. Department of Business Development, 'How to register the amendments to the limited company's articles of association'

<[www.dbd.go.th/download/downloads/03\\_boj/intro\\_step\\_bj\\_change\\_010.pdf](http://www.dbd.go.th/download/downloads/03_boj/intro_step_bj_change_010.pdf)> accessed 12 January 2015

<sup>30</sup> (n 26).

that they are not trying to do anything about this. Instead, some of them probably favour an internal agreement over incorporation of the arrangement into the constitutional documents. For example, Suan Ngen Mee Ma publishes on its website that 10 per cent of the profits from its business activities will be deducted as a donation to Satiragoses-Nagapradeep Foundation, which took part in the setting up of the company and which has provided it with support; 30 per cent of the profits will be deducted as the company's reserve fund for its activities; and the rest 60 per cent of the profits will be distributed as dividends to two types of shareholders, i.e. 1) those who do not expect such a benefit and 2) those who do so, in proportion to the number of shares they own. In addition, more than half of shareholders must be of the first type, and more than half of the directors are selected from among the shareholders who do not expect dividends.<sup>31</sup> This arrangement clearly represents a good practice.

To conclude this sub-section, we should note that there is at present a possibility that this alternative arrangement will be adopted as a not-for-profit mode of operation of Thai social enterprises under the new law to be enacted (Social Enterprise Promotion Bill, which will be discussed in section 8.3). Though it is seemingly not possible at present to create a new legal form for social enterprises, this alternative to a new legal vehicle can be expected to serve some useful purposes.

However, whether social enterprises choose this alternative legal arrangement or make their own private agreements, there is always the possibility of *converting* the social enterprises to traditional profit-maximising ones (mission drift). Incorporating the social enterprise features into the constitutional documents only makes the convertibility more difficult but does not prevent it. This convertibility would undermine the credibility of the limited company with a social mission, thus representing a crucial drawback of operating the limited company as a social enterprise. But since it is still not possible to initiate a specific legal vehicle for social enterprises, the limited company with a social mission represents a possible alternative. In the end, a legal form for social enterprises is still needed.

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<sup>31</sup> Suan Ngen Mee Ma, 'About Us' <[www.suan-spirit.com/about.php](http://www.suan-spirit.com/about.php)> accessed 18 February 2016



## 8.4 Branding and the development of social enterprise in Thailand

As I have pointed out in Chapter 1, a legal form specifically designed for social enterprise is expected to meet a *dual* purpose of enabling social enterprises to function as genuine stakeholder entity and contributing to the fostering of the social enterprise sector. One crucial problem which has, in my view, inhibited the growth of social enterprise in Thailand is that of “branding”. We now consider how such a legal form can *solve* this problem and thereby contribute to the development of social enterprise in Thailand.

In talking about the problem of “branding”, we must recognise that, in a number of cases, the legal forms Thai social enterprises have adopted seem to suit their respective social and/or business goals. A community museum operating more or less like a charity (i.e. earning only a small income from the sale of souvenirs and drinks and depending almost totally upon volunteers) has found that the association is a legal form best suited to its purpose.<sup>32</sup> If it had opted to operate as a foundation, it would have been more heavily regulated, while a corporate form, particularly the limited company, is clearly unnecessary for its very limited commercial activities. Likewise, a home stay as a small venture based entirely on voluntary cooperation of community households<sup>33</sup> simply does not want to be burdened with any formal regulatory control.<sup>34</sup>

Nonetheless, despite the existence of such cases of compatibility between the objectives and activities of social enterprises and the legal structures within which they operate (if they opt to operate in any legal structure at all), the social enterprise sector in Thailand still faces the “branding” problem which has important implications for its development. The problem lies essentially in the continued reliance on the existing traditional legal forms, which makes the social enterprise

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<sup>32</sup> Interview with Wanna Nawikamool, co-founder of House of Museum (Bangkok, Thailand, 10 February 2013).

<sup>33</sup> Interview with members of Ban Dong Home Stay’s executive committee (Prachinburi, Thailand, 21 February 2013).

<sup>34</sup> The home stay is not entirely “unregulated”. That is, although it is not regulated by any specific law, such as the company law under the Civil and Commercial Code 1992, its services are subject to the Home-stay Standard Certification by the Ministry of Tourism and Sports.

sector *formally unrecognisable*. Having a clearly defined social enterprise sector, it is argued, is crucial for its development.

It might be asked whether this problem would be settled by the latest development in the government policy support for social enterprises – the initiation of Social Enterprise Promotion Bill. I shall shortly try to show that this new development does not invalidate my argument. Let me first deal with the problem how the continued reliance of Thai social enterprises on the existing legal forms impedes further development of the social enterprise sector.

It is worth re-emphasising that social enterprises are not identified by the specific legal forms they have adopted but rather by their orientations, i.e. the objectives and activities they are pursuing (especially those characterised by the triple bottom line goals) and the manner in which they manage their profits – to what extent are the profits subject to non-distribution constraint? Practically, this does not seem to pose any serious problem. A social enterprise operating within any of the main legal forms can always continue to do so until it decides to cease its existence or to opt for other objectives.

However, the problem of this continued reliance on the traditional legal forms seems obvious. That is, social enterprises operate *formally* either as for-profit or non-profit organisations. Despite their use of a legal form that can be regarded as “not-for-profit” in character, such as the co-operative, legally, they are *not* distinguishable from the traditional legal entities of all these types. The implication this has for the development of the social enterprise sector seems also clear. That is, if our goal is to develop the sector, particularly by bringing more people into it, it should be formally recognisable. Obviously, however, operating as traditional legal entities, they will continue to be undistinguishable from these entities in the eyes of the public, thereby failing to draw on them for the recruitment of future social entrepreneurs.

There always are people who want to engage in not-for-profit or voluntary activities. We are indeed witnessing an emerging enthusiasm about social

entrepreneurship, especially among young people.<sup>35</sup> But since this type of business is still new in Thailand, making it formally recognisable is very important. Most Thai people are still unfamiliar with the idea of business with a social mission.<sup>36</sup> For-profit enterprises are expected, or indeed destined, to perform as what they formally are – that is, profit-making ventures, whereas non-profits are expected, or even required, to depend on donations and grants rather than engage in business activities.

With the Thai people generally remaining unfamiliar with the nature of social enterprise, and with the latter remaining formally unrecognisable, this type of business would be attractive to only a limited number of people. In other words, this continued state of affairs will fail to provide an *incentive* to social entrepreneurship, which is, in my view, a crucial condition for the growth and development of the social enterprise sector. According to a recent survey, this lack of incentive is a major obstacle to the development of social enterprise in Thailand.<sup>37</sup> Without such an incentive, how could we promote this new sector in this country?

In addition to its implications identified above, the problem of branding also poses serious practical difficulty for Thai social entrepreneurs. The difficulty is, again, related to the social enterprise sector still remaining formally and practically unrecognisable in Thai society. To highlight only one aspect of this difficulty, even

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<sup>35</sup> As Evans and Amnuaiporn have pointed out, '[i]n many Southeast Asian countries, the younger generation is paying increasing attention to social entrepreneurship. This new trend lends new hope that the solution to many problems faced by Southeast Asia's disadvantaged will be tackled by those young social entrepreneurs...In Thailand...many competitions for young social entrepreneurs over the past two years have helped encourage young people to participate and develop their social business plans along the principles of social enterprises e.g. the Social Enterprise Business Plan Competition, arranged in collaboration with Chulalongkorn Business School, CYPN, British Council, Change Fusion and others'. Pred Evans and Sumalee Amnuaiporn, 'Social Entrepreneurship in Southeast Asia' 9 *Trendnovation Southeast Asia* 3.

<sup>36</sup> The Thai people are of course becoming familiar with corporate social responsibility (CSR) and are actually demanding further expansion of contributions, especially by large corporations, to the advancement of the common good of society. However, most people still know very little about social enterprise, and even the more knowledgeable of them still cannot see the crucial differences between CSR and social enterprise.

<sup>37</sup> Change Fusion, *Final Report on the Social Enterprise Promotion Research Project with the Moral Promotion Centre's Fiscal 2009 Funding Support* (2010) (the project was submitted to the Moral Promotion Centre).

social enterprises functioning as for-profit organisations tend to face greater difficulty than traditional businesses in securing funding.

The reason for such difficulty seems clear. Not profit-maximising in their operation, social enterprises are mostly involved in “unprofitable” ventures, such as providing services to the disabled and other disadvantaged groups in society. Private financial sources like commercial banks are therefore justifiably reluctant to provide them with funding. On their part, social investors and philanthropists, who might otherwise be important alternative sources, are also justifiably reluctant to offer financial support to them – but for precisely opposite reasons. For social investors and philanthropists, the crucial problem is that there are no guarantees that social enterprises operating as the traditional for-profit entities will not later change their orientation and become profit-maximising. Hence, we may conclude, *reliance on such legal forms does not permit social enterprises to be readily formally recognisable as such.*

One of the social enterprise operators I had an opportunity to talk with revealed real *practical* problems of this type being faced by Thai social entrepreneurs who have adopted the limited company form. The problem faced by the operators of Open Dream, a company engaging in IT business, is a case in point.<sup>38</sup> The difficulty it has experienced in gaining access to funding is not directly related to the limited company form it has adopted but has rather been mainly caused by the “branding” problem. It is not clear for most people how an IT company could provide benefit to society.<sup>39</sup> As the company is not generally seen as creating social impact, it is difficult for it to attract investment capital. Whereas private investors tend to view it as an NGO, philanthropic organisations often regard it as a for-profit company aiming to maximise profit rather than social benefits. This clearly shows that social enterprises in Thailand have a problem of clarifying their status and role in society

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<sup>38</sup> Interview with Patipat Susampao, managing director of Open Dream (Bangkok, Thailand, 26 February 2013)

<sup>39</sup> The company’s main job is to assist those who directly work to create such benefits – such as in constructing the website for Mo Chao Ban [Doctors for the General Populace]. The website [www.doctor.or.th](http://www.doctor.or.th) now contains information derived from the magazine of this name which has been regularly published for more than 30 years.

– a state of affairs that definitely justifies the need to develop a legal form specially designed for social enterprises in this country.<sup>40</sup>

I have so far focused on branding as being associated with the need for social enterprise to be readily recognisable (in particular, the need for it not to be mistaken for either an NGO or a traditional company, as the case may be), but the idea is not simply meant to be restricted to the need for social enterprise to be recognised as such. Branding is also conceived as a means of inspiring *public trust* and *confidence* arising from the social enterprise operating within a familiar legal vehicle, especially one which is well recognised for transparency and accountability.

Whereas, as indicated above, the need for social enterprise to be readily recognisable was derived from my fieldwork in Thailand, there has so far been no study testifying to a legal form being capable of inspiring public trust and confidence. At this stage we can only expect that my proposed SIC, once it has been adopted as a legal form for social enterprise, would be recognised for its efficiency (in much the same way as the limited company has been widely so recognised in the business community in Thailand), as well as for its transparency and accountability, given its governance features and the regulatory regime in which it must operate. The experience of the UK's CIC and charities might also be instructive.

The CIC has experienced growing popularity, with the number of organisations registered as CICs already passing the 10,000 mark in November 2014, and their ‘...increased recognition has...had an impact on the NHS, with the majority of health spin-outs choosing the CIC brand as their way forward’.<sup>41</sup> On the other hand, a recent study on public trust and confidence in charities in the UK has identified, among other factors, the public concern whether charities are “well managed”. This particularly involves their transparency and accountability: ‘Concerns about how

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<sup>40</sup> According to the managing director of Open Dream, 80-90 per cent of Thai social enterprises operate as non-profit organisations and only about 10 per cent of them are for-profit businesses with social purposes. Such a situation reinforces the belief or understanding that if one wants to help other people, one should not make profit but, like a charitable organisation, rather seek grants and donations. Such a view does not augur well for the development of the social enterprise sector.

<sup>41</sup> Office of the Regulator of Community Interest Companies, *Annual Report 2014/2015* (10<sup>th</sup> Anniversary edition, BIS 2015) 16-17.

charities spend their money are felt widely'.<sup>42</sup> In Scotland a similar research has produced a similar research finding, i.e. the public concern that money go 'to good causes, rather than staff salaries'.<sup>43</sup> From such findings we may infer that a legal vehicle specifically designed to suit both the commercial and stakeholding needs of social enterprise can be expected to inspire public trust and confidence.

It is not difficult to see how practical difficulty faced by social enterprise operators would impede the growth of the social enterprise sector. The difficulty in accessing funding sources would of course have a crucial implication in this respect. But the fact that the sector is still formally unrecognisable would also seriously affect the efforts of social entrepreneurs and their supporters to create popular awareness of, and enthusiasm for, this type of business. Needless to say, popular understanding and support is a really crucial ingredient in the development of the social enterprise sector.

Funding is a fundamental problem being faced by small businesses in general, including social enterprises. However, in so far as the problem of "branding" is concerned, a legal form like the proposed SIC can be expected to relieve Thai social enterprises of at least some difficulty. Social investors and consumers or users of its services and products will know that a company operating a SIC is truly social benefit-oriented, while prospective loan providers will not mistaken it as an NGO. At this point, we might ask if the current legislative project, the Social Enterprise Promotion Bill, would invalidate the argument I have made thus far. In particular, it is very important to make clear if certain regulatory arrangements being planned under this project would result in changing the situation I have described.

One such arrangement is the social enterprise certification system. Indeed, under the Social Enterprise Promotion Bill (still to be enacted), only the social enterprises registered under this law are permitted to use the "social enterprise" tag in their business names. Moreover, there is also an arrangement for social enterprises to incorporate as limited companies under the Civil and Commercial Code 1992 and

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<sup>42</sup> Charity Commission, *Public trust and confidence in charities: Research conducted by Populous* (Populous, 2016) 4.

<sup>43</sup> OSCR: Scottish Charity Regulator, *Scottish Charity Surveys 2016 – General Public Research Findings*, June 2016 10.

hence to operate as not-for-profits (that is, as what has been referred to as “Social Enterprise Type A”). Together, such arrangements would have the important effect of *formalising* the social enterprise sector (i.e. making it more formally recognisable among members of the general public) and incorporating Thai social enterprises with a crucial stakeholder feature – the non-distribution constraint (the no-dividend/asset-lock mechanisms).

We cannot certainly deny that once the Social Enterprise Promotion Bill becomes law the Thai social enterprise movement would experience a very significant progress, not only in terms of public policy support for social enterprises, but also in so far as the sector’s legal status is concerned. However, the legislative project has important limitations: in my view, it does not adequately address the need to formalise the social enterprise sector – which, as I have been trying to demonstrate, would have significant implications for its growth.

We should not forget that the certification system (which has already been implemented) serves principally as an administrative mechanism for providing financial support for social enterprises. Even though once the system is further formalised under the Social Enterprise Promotion Act (when it is enacted) social enterprises will be formally registered, there is no guarantee that the social enterprise sector will become more formally recognisable. Let me further elaborate on this point.

As we have seen in Chapter 7, the law (as it is being conceived) allows social enterprises to be registered as either Social Enterprise Type A (no dividend/asset lock) or Social Enterprise Type B (social purpose/re-investment). I nevertheless do not agree with the idea of reserving the label “social enterprise” for only those enterprises registered under this law. In so far as in the UK, for example, “social enterprises” are not limited to those incorporated as CICs, so “social enterprises” in Thailand should not be restricted to the so-called Type A and Type B entities. Any enterprise, even a small unincorporated organisation, should be able to call itself “social enterprise” as long as it pursues its goals and activities in a manner warranting it being referred as such. Such a *restrictive* legal provision would have an important effect of restricting, rather than expanding, the social enterprise sector.

Of course, there is a tricky issue here. Without such a restriction, the social enterprise sector would suffer from greater confusion. The variety of social enterprises would be expanded, with two additional types of social enterprises, the Social Enterprises Type A and Type B, coming into being. However, my point here is that even a restrictive legal provision as it is being conceived is not likely to result in the social enterprise sector becoming more formally recognisable than it is now. As we have seen, the Social Enterprise Promotion Bill expects social enterprises registered under it to operate within some legal form or another (if they want to rely on any legal vehicle at all), and the Social Enterprises Type A, in particular, are expected to register as limited companies under the Civil and Commercial Code 1992. However, I do not see that these social enterprises, even with the legally required name tag “social enterprise”, are likely to be more formally recognisable as such. This is essentially because they are *at the same time* the legal entities under other laws – the Civil and Commercial Code or any other law. For example, Social Enterprises Type A incorporated as limited companies are likely to be perceived as such by members of the public (who are still unfamiliar with social enterprise), despite the “social enterprise” label they are carrying. So now we are back to where we started: without a legal vehicle specially designed for social enterprises, the sector is likely to remain formally unrecognisable.

To conclude this section, let me briefly explain how such a legal vehicle would solve this “branding” problem. In my view, at least two factors are of decisive importance. The first factor involves the need for a specific “brand”: the CIC, for example, is definitely a social enterprise, in the sense that it is *not* at the same time any other legal entity. The other factor involves the brand that is associated with a specific “legal form”: to what extent is it designed to incorporate the essential features of social enterprise, such as those identified in Chapters 2-4? A legal form that has been designed to sufficiently represent the nature, and facilitate the operation, of social enterprises would have an important effect of inspiring the *confidence* of social entrepreneurs (and those interested in or contemplating entering the social enterprise sector) in using it as well as the public *trust* that the organisations operating within it are authentic social enterprises. It is the confidence



and trust in *both* the “brand” and the “legal form” associated with it that provides a crucial condition for the growth of the sector.

The CIC is again a case in point. Though not all social enterprises in the UK operate as CICs, the growing confidence and trust it has inspired must have importantly led to the spectacular rise in the number of CICs during the past decade. We can even foresee that, while the social enterprise sector in this country will remain diverse with social enterprises assuming various legal structures, the sector will be increasingly associated with the “CIC brand”.

## **8.5 Conclusion**

My primary purpose in this chapter is to propose a new legal form for social enterprise that is modeled upon the legal blueprint developed in Chapters 3 and 4. While this new legal form is required because it is one which embodies the essential features of social enterprises and which meets the needs of social entrepreneurs, I have also reaffirmed this requirement in view of its implications for the problem of “branding” and the development of the Thai social enterprise sector. That is, I have argued that if our goal is further develop the sector, we need a legal form specifically designed for social enterprises. I have tried to explain how such a legal form is associated with the problem of social enterprise branding and the development of the social enterprise sector. I have also pointed out that the initiation of the new legislative project on social enterprise does not satisfy my argument for the need for such a legal form.

I have thus presented both the case for such a legal vehicle, which I provisionally propose to call a “social interest company”, or SIC, and its design. In proposing this legal vehicle, I have considered whether or not its main components are already familiar to the Thai business community and Thai society in general. This is to make sure that the SIC in its proposed form is hopefully workable and acceptable as a legal vehicle for social enterprises in Thailand.

I recognise that the introduction of legislation on a new legal vehicle for social enterprises requires a political decision. Hence, one alternative arrangement for the

use of the limited company form has also been proposed, which basically transforms it into a limited company with social mission. The advantages of this corporate legal form have been confirmed by the new legislative project, which proposes a similar arrangement – that is, an arrangement for social enterprises to incorporate as limited companies and operate as not-for-profits. Other arrangements for a creative use of the existing legal forms are possible, but this arrangement under the new legislative project, which will hopefully become law in the near future, seems to have settled our choice.

# Chapter 9

## Conclusion

### 9.1 Introduction

Taking the legal forms for social enterprise as its central theme, this thesis has emphasised the importance of a legal form specifically designed for this type of business. Indeed, the availability of such a legal vehicle is considered very important to the operation of social enterprises and the development of the social enterprise sector itself. The initiation of the community interest company (CIC) in the United Kingdom in the mid-2000s unmistakably testifies to this importance.

I have stressed that the social enterprise sector requires a diversity of legal structures to meet its vast and varied nature. However, a legal vehicle specially tailored to the needs of social enterprises not only satisfies their hybrid nature evident in their pursuit of both business and social goals but also provides the sector with “branding”. Thailand still does not have such a legal vehicle, and this shortcoming has provided a rationale for my proposal in this thesis for its development.

The CIC can actually serve as a “model” or “blueprint” for the development of a Thai version of this legal vehicle for social enterprise. But I have deemed it more appropriate to design an *ideal-type legal form* for this type of business rather than adopt a legal-transplant approach. The ideal-type is of course based on my understanding of social enterprise in the *real* world – i.e. understanding of its origin and development, as well as its characteristics and orientation. This is admittedly the Euro-Atlantic world, where social enterprise as a concept has most clearly developed. Social enterprise thus developed has now been generally accepted in other parts of the world, and the ideal-type derived thereof can presumably be expected to have, *mutatis mutandis*, universal applicability.

Designing this ideal-type, or blueprint, of legal forms for social enterprises represents the central part of my thesis. The blueprint incorporates the characteristics essential for the operation of social enterprise as understood in this thesis. It thus provides a conceptual framework for both analysis and organisation

of the thesis's subject-matter. In particular, the analysis of the CIC and the main legal forms adopted by Thai social enterprises and the designing of a legal vehicle for social enterprises in Thailand have been undertaken within this framework. The thesis is divided into four parts; sub-sections 9.2.1-9.2.4 below provide a synopsis of what has been achieved in each respective part.

## **9.2 What Has Been Achieved?**

### **9.2.1 Social enterprise as understood in this thesis**

In **Part 1** of the thesis, which has provided a conceptual perspective (including a framework for analysis), I have addressed a crucial issue of *how we can understand social enterprise*. Instead of trying to come up with a rigorous definition, I have opted to understand social enterprise in terms of its origin, development, as well as characteristics and orientation. I first dealt with the confusion surrounding social enterprise and other related terms – notably “social entrepreneurship”, “third sector”, “social economy”, and “non-profit sector”.

I have used the term “social enterprise” as a *type of business*; hence, it is clearly not part of the non-profit sector. It rather needs to be “enterprising” or “entrepreneurial” (i.e. innovative and creative) like any business. But unlike a traditional, profit-maximising business, it is *not-for-profit* in its orientation. That is, while it generates revenue through commercial activities and needs to be financially viable, the revenue thus generated is not meant for private profit-sharing. Part of the profit must be re-invested in further development of its business or used for community benefit. Social enterprise is thus hybrid in nature, lying somewhere between the traditional for-profit business on the one hand, and the non-profit sector on the other.

The term “not-for-profit” more or less characterises this hybrid nature of social enterprise. Confusion nevertheless remains with terms such as the social economy and the third sector. The latter term is clearly associated with the idea of the “three sector economy” comprising the private sector, the public sector and the third sector. But whereas the social economy is similarly understood as occupying the

intermediate space between the private and public sectors, it is also sometimes characterised as part of the third sector – i.e. functioning as its “trading side”. Confusion has arisen – whether the third sector and the social economy are more or less the same; or, if not, how they are different.

The purpose of my thesis is not to theorise about the relationship between the third sector, the social economy and social enterprise. However, to minimise the confusion associated with these terms and to provide a theoretical grounding for my understanding of social enterprise, I accept the idea of it being associated with the “new entrepreneurship” that developed within the third sector. Lying on the intermediate space between the public and private sectors, the third sector is generally understood as providing goods and services that are not delivered by the market and the state. It fills the gaps left by these two main sectors in society.

But a crucial nuance has been introduced here. In particular, the difference between the third sector and the private sector is not simply one between the for-profit and non-profit sectors. Essentially in the European context, the difference is rather one between the “profit-oriented” and “social” economy. The difference is particularly influenced by the predominantly European social economy tradition, which is evident in the “democratic” aspect of the third sector in the UK and elsewhere in Europe. I have further developed this “third-sector” dimension into a crucial aspect of social enterprise – i.e. its “stakeholding” nature – in Chapter 4.

A problem faced by the third sector is that it needs to be financially viable, and as grants and donations have been drying up, it needs to be more entrepreneurial in its orientation. That is why “new entrepreneurship” developed from within this sector. Of course, other factors have also been relevant, such as the influence of the “new public management”, but all this has resulted in the increased reliance on the revenue generated through trading. Social enterprise has, from this theoretical point of view, developed as such a new entrepreneurship.

It needs nevertheless to be emphasised that one central aspect of this “new entrepreneurship” is the requirement (absolute or partial) for the production of surplus to be “socialised”, i.e. re-invested in further development of the enterprise

or used for the benefit of the community. It is this “social” or “stakeholding” aspect of the new entrepreneurship that characterises social enterprise, especially in so far as this involves its “democratic” governance in addition to its “triple bottom line” (social, commercial and environmental) objectives.

An understanding of social enterprise in this way points to its characteristics and orientation. I have identified three general orientations, namely, the “social purpose” perspective inherent in it being a business with a social mission, the “socialisation” perspective rooted in what I call its stakeholding aspect, and its economic or “entrepreneurial” orientation. On the basis of these orientations of social enterprise I have characterised it as having three central features that mark it off from other socially beneficial activities: (1) entrepreneurial orientation, (2) social purpose, and (3) social control over its assets and activities. The environmental goal which normally forms part of its triple bottom line is here subsumed under its social purpose characteristic.

Finally, I have considered the development of social enterprise in the UK with a view to understanding social enterprise in a *specific national context*. I have pointed out that the emergence of social enterprise in the UK, as in most other OECD countries, is the result of the *institutionalisation* of this movement, I have then traced its development at various stages from about the end of the 1990s. The landmark of this development is the establishment of the meaning and orientation of social enterprise in the early 2000s, culminating in the initiation of the CIC in 2005.

### **9.2.2 Designing a legal form for social enterprise**

My understanding of social enterprise described above has led me to develop an ideal-type, or a blueprint, of legal forms for social enterprise in **Part 2** of the thesis, which includes Chapters 3 and 4. The purpose is to use it as an ideal-type legal vehicle against which existing legal forms such as the CIC and a number of legal structures currently used by Thai social enterprises can be evaluated, and as a *blueprint* for the development of a legal form for social enterprises in Thailand.

On the basis of my understanding of social enterprise I have identified the most important features such a blueprint of legal forms for social enterprise should possess. Chapters 3 and 4 have been devoted to the development of this blueprint, which involves a conceptual analysis of the essential components, in the form of normative legal requirements, which should be incorporated into a legal vehicle for social enterprise. The blueprint serves as an analytical and organisational framework for all subsequent chapters, except Chapter 7, which presents the Thai social enterprise landscape.

Essentially, I have explored two aspects of a legal form for social enterprise – the *facilitative* and *regulative* rules. Like all other organisations, large or small, a social enterprise requires both types of rules: the facilitative rules primarily reduce the transaction costs incurred by its internal as well as external contractual relations, and the regulatory rules provide appropriate protection for those involved in its operation.

I have explored certain conceptual issues relating to legal forms for organisations (together with a synoptic view of existing legal forms) and the needs of social entrepreneurs from their legal form (mainly an organisation with its own legal personality, protection against risk, the raising of finance, and longevity). But given the stakeholding nature of social enterprise, a crucial part of its legal aspects consists of the rules to assure accountability to stakeholders. I have proposed these as *mandatory* requirements for a legal vehicle for social enterprise.

The blueprint is based on the limited liability company form, which already provides it with the fundamental needs of social entrepreneurs indicated above. Its mandatory rules, on the other hand, include the agency cost reduction, the asset lock, the social benefit objective, stakeholder participation and the stakeholder board, the directors' duties and competence, the external regulator and social disclosure.

These requirements may be characterised as *normative* in nature – i.e. features that should be incorporated into the legal form as its essential part. In certain national contexts it might not be possible for all these features to be incorporated as statutory

rules. Some of them might still need to remain optional or default rules. As an ideal-type, the blueprint includes all of them as mandatory requirements.

I have concluded this crucial part of my thesis with a reference to the stewardship model on governance, because a question is raised whether it might be more appropriate to view social enterprise from a more positive perspective on human nature offered by this model. Managers are here presumed to be good stewards diligently working to maximise the company's profit. They are thus viewed as trustworthy and should be fully empowered. They are also presumed to have a wide range of motives beyond self-interest, such as the desire for achievement and recognition, the intrinsic satisfaction of good performance and success, and so forth.

However, I have raised a problem with this governance model. In particular, the assessment of trust, which is an abstract idea, is not easy. Whether in reality managers would always act in accordance with the model is thus questionable. Even in social enterprises, where we might be tempted to expect managers to act altruistically, we cannot take this for granted. Hence, since we cannot expect agents in social enterprises to be more altruistic and trustworthy, the social enterprises, like all other organisations, require effective governance that is not simply based on trust. Indeed, in so far as the stakeholder requirements are concerned, mandatory rules to ensure compliance are necessary.

### **9.2.3 Existing legal forms for social enterprise evaluated**

Comprising Chapters 5 and 6, **Part 3** of the thesis has evaluated existing legal forms for social enterprises in the UK and Thailand. From among the UK legal forms only the CIC has been selected for this purpose, whereas the assessment of Thai legal forms has covered both the for-profit and non-profit structures, i.e. the partnership, the limited company, and the foundation.

The CIC is a legal form specifically designed to suit the characteristics and orientation of social enterprise. I thus deem it useful to see *how much the CIC matches the ideal-type legal blueprint*. This exercise is useful not just as a test of the blueprint's applicability to the real world of social enterprises. Equally



important, as the CIC has already been in use for about a decade, if it more or less marches the blueprint, then this could be of much practical value to the development of a legal vehicle for social enterprises in Thailand. This means that we shall be able to benefit from both a “theoretical model” in the form of the blueprint and a “practical guideline” provided by the CIC.

I have considered the CIC in Chapter 5, starting with its initiation and legislation in the early 2000s. I have pointed out that the initiation of the CIC was closely associated with the belief that creating an entrepreneurial culture could help deliver social justice to society, locally and nationally. With this belief, the New Labour Government committed itself to building a more enterprising society, creating opportunities for all and tackling barriers to a successful enterprise. This eventually led to the legislation of a custom-made legal form for community and social enterprises called “Community Interest Company”. The rationale for the creation of such a legal form involved the difficulties faced by social enterprises in explaining their business model to stakeholders, especially funders, who might suspect that the funding they provided might end up in private hands. The CIC was thus expected to bring about crucial improvements in access to finance, the asset-lock approach and branding.

CICs would be formed as companies under the Companies Act 2006 rather than a product of a “stand-alone” legislation. I have explored the advantages of a corporate legal vehicle being legislated in this way in Chapter 3 (the same strategy has been proposed for the legislation of a Thai legal form for social enterprise in Chapter 8).

Following this brief presentation of the initiation and legislation of the CIC, I have explored in depth how this legal vehicle meets the needs of social entrepreneurs and to what extent it satisfies the mandatory rules especially those assuring its accountability to stakeholders. With regard to social entrepreneurs’ needs I have pointed out that as limited companies, CICs are provided with a separate legal personality and limited liability protection, that they follow the same incorporation and reporting procedures as other companies, and that they have the same provisions on directors’ duties and members’ rights and duties. I have also elaborated the CIC start-up process and rules facilitating its operation, especially

those embedded in the model memorandum and articles. In addition, in order to see how, and to what extent, CICs operate their business for the benefit of the community and the wider public, I have fully explored provisions ensuring their operation in this direction.

I have found that the CIC as a legal form for social enterprises more or less meets most of the mandatory stakeholding requirements, particularly those involving the agency cost reduction, the asset lock, the social benefit objective, directors' duties and competence, and the external regulator and social disclosure. Nonetheless, the CIC is not subject to statutory provisions on stakeholder participation and the stakeholder board. I have expressed my view, in this regard, that whereas the CIC Regulator provides useful voluntary rules on the CIC's relations with stakeholders, it is unfortunate that a mandatory rule for a stakeholder board has not been included in the CIC structure, which would otherwise have made it most distinct from other legal forms adopted by social entrepreneurs.

Without a CIC equivalent, Thai social enterprises still rely on a number of legal forms, none of which is particularly suitable for this type of business. I have found that six legal structures serve as vehicles for Thai social enterprises, and that many social enterprises do not operate as any legal entity at all. Moreover, incorporated or unincorporated organisations can register as community enterprises under the Community Enterprise Promotion Act 2005. My analysis of the legal forms for Thai social enterprises has been limited to only the two for-profit legal forms, the partnership and the limited company, and one non-profit structure, the foundation.

The limited company form more or less meets social entrepreneurs' needs for an organisation with a separate legal personality, limited liability protection, the raising of finance, longevity, agency cost reduction, some extent of directors' duties and competence and social disclosure. The ordinary partnership form, either registered or unregistered, hardly meets these needs, whereas the limited partnership, which bears a close resemblance to the limited company, only partially satisfies the requirement for limited liability protection.

Neither the partnership of any type, nor the limited company, however, meets the model legal vehicle's mandatory requirements to assure accountability to stakeholders, namely, the asset lock, the social benefit objective, stakeholder participation and the stakeholder board, and the external regulator. The regulatory deficiency in this respect can be expected: the rationale for the partnership and company law is to facilitate the running of purely for-profit enterprises. Its orientation is obviously incompatible with the nature of social enterprise.

On the other hand, as a non-profit, the foundation more or less meets most of the blueprint's mandatory requirements, particularly the social benefit objective, the non-distribution constraint, directors' duties and competence, stakeholder participation, the external regulator and social disclosure. Like a limited company, the foundation is an organisation with a separate legal personality; the individual members of its committee are provided with limited liability protection. However, as a non-profit, it is severely handicapped in raising finance and generating revenue.

Clearly, the two traditional types of legal structures, the for-profit and non-profit legal forms, are not particularly suitable for the business with social mission nature of social enterprises. However, I have argued that the limited company form offers the best option among the existing legal forms. For this reason I have proposed, in Chapter 8, an arrangement for the use of this corporate form as an alternative to a specially designed legal vehicle for social enterprises (which I deem imperative to both the operation of social enterprises and the development of the social enterprise sector), in case the initiation of this specific legal vehicle is still not possible. The Social Enterprises Type A as being conceived under the legislative project to be touched upon in Chapters 7 and 8 is more or less the same as this alternative arrangement.

#### **9.2.4 Surveying the Thai social enterprise landscape and creating a legal form for social enterprises in Thailand**

The **last part** of the thesis has examined, in Chapter 7, the Thai social enterprise landscape. The question I have addressed in this chapter is how Thai social

enterprises emerged, and how the public-policy infrastructure for this type of business has developed during the past few years.

The Thai social enterprise sector is different from its British counterpart, in that it does not have an equivalent of the CIC. My analysis of the existing state of the Thai social enterprise sector has reaffirmed the need for a legal structure tailor-made to suit the needs of Thai social enterprise.

My exploration of the Thai social enterprise landscape in Chapter 7 has found that though social enterprises, in some form or another, have been around since about the 1970s, the concept “social enterprise” has only recently been introduced into Thailand. In particular, the triple bottom line objectives of social enterprise have been generally accepted, even though “social enterprise” as a concept remains unfamiliar in Thai society, where most people, at best, are likely to confuse it with corporate social responsibility (CSR).

However, there has developed a social-support infrastructure in the form of social enterprise networks providing various types of support, including funding for start-up enterprises. Moreover, a public-policy infrastructure for social enterprises has emerged in the form of Cabinet regulations, a *Master Plan for Social Enterprise Development* and the establishment of the Thai Social Enterprise Office (TSEO). Most recently, a legislative project, the Social Enterprise Promotion Bill, has been initiated. Under this new law (still to be enacted) social enterprises may be registered as Social Enterprises Type A (no dividend/asset lock) or Social Enterprises Type B (social purpose/re-investment). Type-A social enterprises, which must also have social purpose and reinvestment as their fundamental features, are expected to incorporate as limited companies and operate as not-for-profits. All these developments represent crucial progress in fostering the Thai social enterprise sector, but I have pointed out that they are still not sufficient to further develop the sector.

Together with my analysis of the main legal forms for Thai social enterprises in Chapter 6, the finding of this shortcoming has given me a rationale for the development of a specially designed legal vehicle for Thai social enterprises in

Chapter 8. This rationale has been reaffirmed by my exploration in this chapter of the importance of “branding” to the growth of the social enterprise sector.

The problem Thai social enterprises are currently facing are significantly related to the sector not being more clearly defined. More specifically, *reliance on the existing legal forms does not permit social enterprises to be recognisable as such in Thai society*. I have pointed out that, though the new law being prepared on social enterprises represents crucial progress in the development of government policy support for this type of business, the registration of social enterprises as Type A and Type B under the new law (following its promulgation) does not solve the social enterprise “branding” problem. The social enterprise sector is not likely to be more formally recognisable, and this, I have argued, has significant implications for the growth of the sector.

Both the unsuitability of the existing legal structures for social enterprises and the “branding” problem provide, in my view, an enhanced rationale for my proposal for a specially designed legal vehicle for social enterprise – or, alternatively, certain legal arrangements for this purpose. I have provisionally termed such a legal vehicle “Social Interest Company (SIC)”.

The “blueprint” for the creation of this proposed legal vehicle is naturally the ideal-type legal form I have developed in Chapters 3 and 4. The ideal-type is based on a corporate legal form, and in Thailand such a form already exists; hence, the legal vehicle for Thai social enterprises is proposed to be created as a variant of the main corporate legal form – the limited company.

As a business organisation, the proposed legal vehicle will operate in much the same way as the existing limited company, benefiting from the latter’s flexibility and familiarity in the Thai business community. In matters relating to governance, relevant provisions of the Civil and Commercial Code will apply, such as those on the powers and duties of the board of directors and the shareholder meeting; and, like the limited company, it will be subject to the insolvency and tax laws. Only in matters relating to its social and stakeholding missions will the legal vehicle be

governed by another set of rules – i.e. the mandatory requirements of the ideal-type legal form.

It is not really difficult to see how this proposed legal vehicle would look like; so I shall not further elaborate on its main features, which are essentially modelled upon the blueprint. What should be noted is that these features are mostly not foreign to Thai society; they are actually present in some legal structure or another. They can thus be expected to be workable and acceptable.

I have nevertheless admitted that initiating a new corporate legal form cannot be expected to be easily accomplished. I have thus proposed a “creative use of the existing legal forms for social enterprises”. Only one possible arrangement for this purpose has been suggested.

As I have pointed out above, this is an arrangement for social enterprises operating as limited companies to include in their governing documents the main components of the ideal-type legal form for social enterprises – particularly the social benefit goal, the asset lock and social disclosure (i.e. the delivery of an annual social benefit report in addition to the balance sheet). Given the flexibility of the limited company structure, especially in terms of its capacity to accommodate the normative requirements of the ideal-type legal form for social enterprises, it should most suitably serve as a legal vehicle for Thai social enterprises. As I have also indicated, the Social Enterprise Type A as being conceived under the new law is actually similar to this proposed alternative arrangement. Therefore, I have not proposed any other possible arrangement, because this Type A concept seems to have settled our choice.

### **9.3 Where shall we go from here?**

I have made it clear in Chapter 8 that in proposing that Thailand develop a legal vehicle to foster the social enterprise sector, it is not my intention to suggest how a legislative initiative could be taken for this purpose. I have admitted that the initiation of a legislative measure involves a political decision, and this depends, in turn, on whether or not the government sees the need and has a clear rationale for

such a measure. What I have hoped to achieve is rather to *explain the need for a legal form specifically designed for social enterprise and supply one such a legal form based on the blueprint I developed in this thesis.*

I have pointed out that, to my knowledge, there are presently very few substantive studies on social enterprises in Thailand – let alone those that analyse the *legal aspects* of this type of business, as I have done in this thesis. There is no question about the Thai government seeing the need to promote the role of the social enterprise sector (although the inconsistency of government policy remains a problem). Its perception of such a need is evident in the recent development of a public-policy infrastructure for social enterprise. However, what I have not yet seen is a substantial effort to address the issues relating to the need for a legal form specially designed for social enterprise (I have so far come across only one study on such issues) – particularly why a legal form specifically designed for social enterprise is essential to the development of the sector, and what such a legal vehicle would look like.

I am confident that by far my thesis offers the most substantive analysis of the legal forms for social enterprise. I also hope that the UK experiences in the initiation and legislation of the CIC serve as both valuable *practical rationale* and *guideline* for why and how a specific legal vehicle for social enterprise should be created. This is my rather modest aim in pursuing this comparative study of social enterprises in the UK and Thailand

## Appendix

### 1. Chao Phraya Abhaibhubes Hospital Foundation

#### 1.1 Origin and development

In the late 1990s, when Thailand was suffering from a severe financial crisis, greater self-reliance in healthcare represented a viable approach to sustainable restoration of its economy. Seeing this self-reliance potential, the government supported Chao Phraya Abhaibhubes Hospital in creating a demonstration project on a comprehensive promotion of herbal medicine products.<sup>1</sup>

A personal interest in herbal medicine led Dr. Supaporn Pitiporn,<sup>2</sup> the hospital's pharmacist, to engage in in-depth study of Thai traditional herbal medicine with local specialists in this field. She found a large number of herbal plants that could be used as medicine, food and cosmetics. In 1986, *Clinacanthus nutans* Zburm.FX Lindau, a little known herb then, was chosen and developed into a glycerine preparation. Today it is one of the approximately 30 herbal medicine products of Chao Phraya Abhaibhubes Hospital approved by Thailand's Food and Drug Administration (FDA).<sup>3</sup>

Since then other products have been developed, ranging from non-aerosol mosquito spray to cough syrup. Moreover, herbal extracts have also been prepared for the production of numerous personal care products ranging from facial creams, lotions to soaps. All its skin care products passed non-irritation tests by the Medical Science Department. Another important aspect of the project involves its relations with the local community and the environment. Adhering to the principle of community involvement and fair trade, the hospital buys herbal materials directly from the farmers. The volume, quality and prices of these materials are jointly determined for fairness. Moreover, given its concern for the environment, organic farming has been adopted to ensure that the cultivation of herbal plants is ecologically sound and environmentally friendly, as well as safe for farmers and consumers alike.<sup>4</sup>

#### 1.2 Organisation and management

For legal and administrative purposes, Chao Phraya Abhaibhubes Hospital Foundation (CAF) was set up in 2002 to operate the herbal medicine development project. As a non-profit organisation, the foundation can register its products with the FDA and legally place them on sale. CAF runs its activities under the supervision of the foundation committee.

To meet the need for the development and production of quality herbal medicine, in 2003 CAF set up a pharmaceutical factory well equipped with production

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<sup>1</sup> Abhaibhubes, 'History of the Organisation' <[www.abhaiherb.com/about/history](http://www.abhaiherb.com/about/history)> accessed 15 March 2013

<sup>2</sup> Interview with Dr Supaporn Pitiporn, Head Pharmacist, Abhaibhubes Hospital (Prachinburi, Thailand, 18 February 2013)

<sup>3</sup> Abhaibhubes, 'About Us' <[www.abhaiherb.com/en/about](http://www.abhaiherb.com/en/about)> accessed 15 March 2013

<sup>4</sup> *ibid.*



machinery, quality control inspection tools, and a microbiological laboratory. It has since developed its production and testing processes, and has continually passed GMP (Good Manufacturing Practice) inspections in the categories of herbal medicine, cosmetics, and health beverages.

CAF's income comes mainly from the sale of the herbal medicine products. 70 per cent of the profit goes to the hospital to help cover its medical expenses, and the remaining 30 per cent is reserved for reinvestment in the development herbal medicine products and in running the foundation's social activities. At present, according to Supaporn, CAF does not have any serious financial problem since it makes profit every year. It also does not rely on grants and donations. It is currently satisfied with its sustainable growth and performance, though it does not plan to expand the business now.

CAF has been attempting to educate people about benefits of traditional herbal medicine and also to encourage them to take herbal drugs as the first resort when attending to minor illnesses such as colds, aches and allergies. As has been indicated, it produces and sells its herbal medicine by itself. It directly buys herbs from local farmers (who grow organic herbal plants under its supervision) with prices that are slightly higher than the market ones. This helps create income and employment in the community. In Thailand "Abhaibhubes" has already become a very well-known brand for high-quality, low-price herbal medicine products.

### 1.3 CAF as a social enterprise

According to Supaporn, CAF views itself as self-evident social enterprise in healthcare services. It focuses on social benefits in terms of both community well-being and environmental conservation. It is at the same time entrepreneurial in its orientation. However, as part of the hospital, CAF's management, particularly in so far as decision-making is concerned, is still run more or less like a government agency rather than a business organisation. Supaporn understands well that being a non-profit relying only on grants and donations is not financially viable and difficult to grow. She also realises that if CAF is separated from the hospital, for example, by setting a company to manage the business, it can grow bigger and at the same time create more benefits to the community. However, she insists that she is happy with the way the foundation is doing now – small but stable and sustainable.

In her view, CAF has reached its main aim of helping people. There is still no reason or motivation to change anything including its legal form and management style. However, it does not mean that she does not want to help more people, but it needs more people like her who have the same passion and readiness to work for public benefits. She also notes that no matter how perfect the law or management is, if people in general are not aware of social problems and do not care to help one another, then it means nothing.

Supaporn admits that strict rules and regulations governing foundations impose limits on CAF's expansion in production and investment. Moreover, a foundation is not automatically entitled to tax exemption. CAF still has to pay taxes at a two per-cent rate of the revenue from its sales. In addition, since the foundation is part

of hospital, the management and decision-making processes suffer from the normal bureaucratic red tape.

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## **2. Anantarakkarnboriban School**

### 2.1 Origin and development

Anantarakkarnboriban Health Training School (Anantarak for short) was set up in 2006. The idea of its founder, Pornrawee Seeluangsawat,<sup>5</sup> was to provide young Thai people, mostly girls, with a decent career that is currently in great demand in Thailand – that of caregivers for children and the elderly. Pornrawee saw that a lot of people in these two categories have not been properly taken care of. An increasing number of the elderly have been left alone. In 2007 about 600,000 of these people were left to live on their own. Pornrawee had thus embarked on a study of professional care for children and the elderly before she set up the school.<sup>6</sup>

The school aims to produce personnel well trained as professional elderly and child caregivers. It now provides a six-month training programme covering healthcare and elderly and child care, as well as a programme in healthy hotel and accommodation management for youths, students and people of 18-35 age groups. The first half of the training is devoted to the study of theory and principles of care providing services, and, during the latter three months, the trainees engage in actual practice in giving such services. Each year only 4-5 training classes are offered, each consisting of 7-8 students. So the school annually produces about 30-40 professional caregivers, for whom it also makes arrangements for job placement. Those who have decided to join the training programme can thus be confident that they will find a job upon completion of the training.<sup>7</sup>

Apart from organising professional training, Anantarak offers paid services. It can provide assistant nurses to look after patients at various health institutions or anywhere as required by the patients' relatives. In Hua Hin, a very popular seaside resort city about 200 kilometres from Bangkok, where the school is located, professional care and transport services for elderly or disabled visitors are available to enable them to have a truly pleasant and healthy stay in the area.<sup>8</sup>

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<sup>5</sup> Interview with Pornrawee Seeluangsawat, Founder and Manager, Anantarakkarnboriban School (Prachuabkirikhan, Thailand, 7 March 2013)

<sup>6</sup> Sarinee Achavanuntakul (ed), *Thailand Social Enterprise 50* (Krungtheptharakij 2010) 64.

<sup>7</sup> *ibid* 64-65.

<sup>8</sup> The Family Trees, 'Anantarak...a great team to help seniors enjoy Hua Hin, <[www.familytree-huahin.com/1/post/2013/02/anantarak-a-great-team-to-help-seniors-enjoy-hua-hin.html](http://www.familytree-huahin.com/1/post/2013/02/anantarak-a-great-team-to-help-seniors-enjoy-hua-hin.html)> accessed 15 March 2013

## 2.2 Organisation and management

Anantarak is a private school formally established under the Private School Act B.E. 2550 (2007). As a juristic person with a formal school license, it has been allowed to run as a healthcare training school and issue certificates recognised by the Ministry of Education, and which qualify those who have completed the training course to work as caregivers in Thailand and abroad. The Ministry still maintains regular supervision and monitoring of its activities.

According to Pornrawee, Anantarak is formally run by an executive committee. However, it is her “passion” for it and the existing resources of her family that are crucial for its operation. She does not have to pay rents for the school premises, which belong to the family; and the latter’s businesses, including operation of a youth camp resort and daycare and tours for children and the elderly, provide a professional and business foundation for her own business. The training programme organised by the school is thus relatively cheap – that is, tuition fees of 30,000 baht (around £600)<sup>9</sup> for which the Government Savings Bank provides loans for those who need them.

The main revenue of the school comes from this source. Even though Anantarak was set up as a school to help underprivileged children to become professional caregivers, the school has to pay taxes like any other mainstream private schools, which are normally run as private businesses. But since 2010 it has begun to gain some marginal profits (it suffered a net loss of 250,757 baht (around £5,015)<sup>10</sup> in the previous year). Its main expenses are salaries of teachers and staff.

## 2.3 Anantarak as a social enterprise

Pornrawee emphasises that the purpose of the training programme is not simply to equip trainees with knowledge and skills but also to inculcate in them the right attitude and passion. In her view, one should not expect a huge profit from running a social enterprise, which is to help other people. It is thus the huge passion for the job that is specifically required. The school thus regularly offers free services for poor people, schools, hospitals, etc., in Hua Hin.

From Pornrawee’s point of view a social enterprise needs to be operated as if it were a “business-oriented foundation”: despite its social orientation, it must be able to financially sustain itself and compete with for-profit companies. In the case of Anantarak, it is fortunate that it neither has to pay rent nor ask for grants and donations. It is partly supported by the founder’s family-run resort business and other businesses.

Pornrawee nevertheless recognises that as Thailand is becoming an aging society, she is likely to face an increasing number of profit-oriented competitors. *The question is how to make a distinction between a social enterprise like Anantarak and the profit-maximising businesses.* It is for this reason that there should be a specific legal form for social enterprises. However, she is concerned that having a

<sup>9</sup> Bank of England, £1 can be exchanged for 50.43 Thai Baht (10 March 2016)

<sup>10</sup> *ibid.*

strict law could also be a hindrance to the development of the social enterprise sector. In particular, the law should not impose heavy restrictions on those who want to enter the sector since it might discourage *real* social entrepreneurs while encouraging those who simply want to be called social entrepreneurs without the real intention to be so. That is why she still enthusiastically maintains that one must really have a “passion” for what one does as a social entrepreneur.

Any law for social enterprise must, in her view, make it clear where the profit should go. Moreover, it should support rather than control this sector. No matter what legal forms we may set up for this purpose, the passion to help other people and transparency in running a social enterprise are most important. She thus sees the need for social entrepreneurs to “prove” themselves in this respect in some way or another for at least three years.

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### 3. Ban Dong Home Stay

#### 3.1 Origin and development

Ban Dong Home Stay is a community project originated at Ban Tai Dong village of Ban Dong Kratong Yam sub-district in Srimahaphot District of Pachinburi Province, which lies to some 136 kilometres to the east of Bangkok. The people of Ban Dong Kratong Yam are descendants of “Tai Puan”, an ethnic Tai group whose ancestral land is in today’s Xiangkhouang province of Lao PDR.<sup>11</sup>

Like the majority of Thai people in the rural areas, those of Ban Dong Kratong Yam engage in rice farming and cultivation of other crops, but Ban Tai Dong village specialises in the production of sieves used in boiling noodles before they are prepared as meals. In 2006 the village participated in a national contest of OTOP villages,<sup>12</sup> and was awarded an OTOP Village Champion certificate. As a result of this success, not only this village but also the sub-district itself became more widely known nationally. Moreover, since the area is endowed with cultural (especially *Tai Puan*) and natural resources for tourism, several groups of people including those from government agencies began to make study-visits to it.<sup>13</sup>

As a result of these experiences, the sub-district administration organisation (SAO)

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<sup>11</sup> A famous place in this province is the Plain of Jars, now listed as a UNESCO World Heritage site, which was not only heavily bombed by the United States but also witnessed fierce battles during the Vietnam War.

<sup>12</sup> OTOP is an acronym for “one *tambon* [sub-district] one product”, a project which was launched about a decade ago to promote community enterprises. The idea is for a community to offer at least one local product to the national or even global market.

<sup>13</sup> Ban Dong Kratong Yam Sub-district Administration Organisation (SAO), ‘Document submitted as part of the request for the assessment of Ban Dong Home Stay’ (2012) 2.

of Ban Dong Kratong Yam led by Mrs Ratchanee Senkhao,<sup>14</sup> took the initiative in setting up a home stay as a community enterprise managed by the people in the community. The primary purpose was to encourage the local people to acquire supplementary income through this activity and thereby to upgrade their well-being.

Ban Dong Kratong Yam SAO has encouraged the villagers to develop their home-stay services in accordance with the standards established by the Ministry of Tourism and Sports.<sup>15</sup> Ban Dong Home Stay passed its first assessment in 2010 for the period 2010-2012: eleven households were certified as meeting the home-stay standards.<sup>16</sup> Now, according to Ratchanee and Mrs Duanpen Khanthong, chairperson of the Home Stay Executive Committee, more households are joining the home-stay group and being officially certified.

### 3.2 Organisation and management

Ban Dong Home Stay is a typical community enterprise. According to Ratchanee and Duanpen, it is functioning as a local collaborative activity without any particular legal structure. It is nevertheless operated by a committee chaired by Duanpen, a retired teacher of the local school. The committee is under an advisory body chaired by the SAO chief and comprising six other local officials, including the director of Ban Dong Kratong Yam School. The committee itself is composed of 17 members, plus 40 members of the households participating in the home stay enterprise.

Ban Dong Home Stay provides more than basic room rentals. Apart from necessary accommodation facilities, it offers various activities that enable the visitors to absorb the way of life of the local people and their cultural heritage, namely: visiting *Tai Puan* Museum at Wat [Buddhist temple] Mai Dong Kratong Yam; observing the production of sieves, the main product of Ban Tai Dong village; experiencing Thai traditional massage for health; observing the processing of Prachinburi jasmine rice; and cycling around the Ban Dong Kratong Yam area to experience its scenic landscape and the living cultural life of the local people.

### 3.3 Ban Dong Home Stay as a social enterprise

The main purpose of the home stay project is to enable the villagers to acquire supplementary incomes. However, as a collaborative enterprise, it has also benefited the community: not only has it encouraged the development of community spirit resulting in fair distribution of financial benefits but also essentially contributed to the conservation of local cultural resources and the environment.

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<sup>14</sup> Interview with Ratchanee Senkhao, Chief of Ban Dong Kratong Yam SAO, and Duanpen Khanthong, Chairperson of Ban Dong Home Stay Committee (Prachinburi, Thailand, 21 February 2013)

<sup>15</sup> These standards, together with forms for the request for home-stay assessment, are available at Department of Tourism, Ministry of Tourism and Sports, 'Home Stay Standards Thailand' <[http://maehongson.mots.go.th/images/intro\\_1219219438/Download1.PDF](http://maehongson.mots.go.th/images/intro_1219219438/Download1.PDF)> accessed 28 February 2013

<sup>16</sup> Ban Dong SAO (n 13) 4.

Moreover, even though the home stay project now provides only small supplementary incomes for the villagers, what these people have perhaps more significantly gained from participation in this community enterprise is in learning how to live sustainably and independently. In other words, they have been encouraged to learn to develop their local community on their own rather than depend only on government assistance.

The main problem of the home stay (and many other community projects) is that it lacks skilled personnel who can manage the project professionally. For example, the home stay is just a gathering of a number of village households ready and willing to develop to meet the home-stay standards. They collaborate in operating this community enterprise without any legal advice. The home stay has so far been known only to a few groups of customers/tourists because those who manage it do not know how to promote it. In addition, it is hard to survive on a long-term basis, that is, how to survive its founders, some of whom are already in their late sixties.

It does not matter if the operators of Ban Dong Home Stay – who are ordinary villagers (though some of them are former school teachers) – really know much about social enterprise – or whether they know anything about the British CIC. What they currently engage in is without doubt a social enterprise. The crucial problem is that a social enterprise like this, if it is to become viable on a long term basis as a community enterprise, needs to be run within a more formal structure.

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#### **4. Green Net Co-operative**

##### **4.1 Origin and development**

Green Net Cooperative is a non-governmental organisation (NGO) specialising in marketing farm products by directly linking producers in alternative agricultural networks and community business groups to consumers. It focuses on promoting organic farming and developing alternative markets for organic and natural products that are safe for consumers as well as the environment. Green Net operates as a distribution centre for various products including rice, cereals, fruits and vegetables, herbal tea, processed foods, and eco-friendly local textiles.<sup>17</sup>

The agricultural sector in Thailand has been suffering from a whole range of problems – drought, agricultural water scarcity, soil degradation, inefficient production and distribution, and decline of commodity prices, among others. Vitoon Panyakul<sup>18</sup> and his friends saw these problems and believed that organic farming represented a possible alternative in the effort to solve them. They thus decided to

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<sup>17</sup> Green Net Co-operative, 'About Us' <[www.greennet.or.th/about/greennet](http://www.greennet.or.th/about/greennet)> accessed 20 March 2013

<sup>18</sup> Interview with Vitoon Panyakul, President, Green Net Co-operative (Bangkok, Thailand, 19 March 2013)

start a business specialising in marketing organic products.<sup>19</sup>

Green Net started its business in 1993 by collecting farm products such as chemical-free vegetables from farmer groups in various provinces for sale through a sort of “mobile flea markets” held at government and business organisation offices, home and office delivery for members, and various green and health shops in Bangkok as well as provincial towns. In 1994 it opened its own “Green Net Shop” in Bangkok and Natural Food Co-operative Shop Limited was set up to accommodate the growth of its business. The following year Natural Food Co-operative Shop Limited registered with the Ministry of Commerce as a rice exporter, and, with the expansion of the scope of its business activities, it changed its name to Green Net Co-operative in 2001.

In 2000, Sayai Phandin Foundation (or Earth Net in English) was established to help support the work of Green Net. Now the foundation focuses on educating farmers, providing them with advice, creating farmer networks and links between farmers and consumers, as well as publishing books and articles, particularly those on organic farming and fair trading. In addition, according to Viton, a new limited liability company has recently been set up to manage a new product, namely coffee beans.

#### 4.2 Organisation and management

Green Net was incorporated on 10 May 2001 as a co-operative under the Co-operative Act 1999 (now Co-operative Act 2010). It now operates in co-operation with Earth Net Foundation. Earth Net Foundation is responsible for agricultural promotion and development whereas Green Net focuses on product distribution, namely, marketing, wholesaling, operating Green Net shop, exporting, engaging in fair trade deals, and serving as a rice packaging centre.

Now almost all Green Net products have been accredited and certified under the IFOAM Accredited Organic Programme. More than 1,200 households of agricultural producers all over Thailand are Green Net Cooperative members. It has also been assisted by fair trade groups in distributing products to over 10 countries in Europe, including France, Germany, Italy, Switzerland, and the UK. Apart from business activities, Green Net organises venues for exchange of knowledge and experience in organic farming and seeks co-operation with foreign resource persons.<sup>20</sup>

Green Net as a corporate entity is actually comprised of three organisations, namely, Green Net Co-operative, Earth Net Foundation and the newly set-up company. Operating within different legal structures, these three organisations are run independently of one another. However, some persons, including Viton, are involved in all three organisations, as directors or shareholders.

According to Viton, the main reason for setting up this company is related to the inflexibility of the Co-operative Act and co-operative auditing rules and regulations.

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<sup>19</sup> Achavanuntakul (n 7) 80.

<sup>20</sup> *ibid* 80-81.

Since Earth Net is a non-profit foundation, it is not allowed to trade and make profits. Its main funding source is Green Net's revenue, together with grants and donations. The money Green Net Co-operative transfers to Earth Net Foundation cannot be treated as donations, which otherwise would entitle the co-operative to tax reduction or exemption. This is because the foundation has not been included in the list of the Revenue Department for this purpose. The amounts transferred to Earth Net are generally declared as Green Net's expenses instead.

#### 4.3 Green Net Co-operative as a social enterprise

It is clear that a social enterprise in Thailand faces difficulties if operates as a co-operative. Again according to Vitoon, a co-operative form may be able to survive in the market. However, if they want to grow, they must overcome a lot of obstacles. The law is, in his view, outdated and not compatible with practices, especially if a co-operative wants to engage in business activities, which have become increasingly complicated. The Co-operative Auditing Department (CAD)'s strict supervision and requirements, such as a double-entry bookkeeping system and shareholding, pose one such obstacle.

Vitoon points out that the definition of social enterprise is loose and unclear, and this provides those who are not genuine social entrepreneurs with an opportunity to take advantage of the term. However, he disagrees with the term being defined by law as it could impose constraints on social entrepreneurs. Instead, he prefers social enterprise being certified or accredited by an independent and reliable organisation in a way similar to certification and accreditation by the World Fair Trade Organization (WFTO).

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## 5. House of Museums

### 5.1 Origin and development

Located in the southwest of Bangkok, a little way off the main road leading to southern Thailand, House of Museums was founded by a famous collector and author, Anek Nawikamool, and his wife Wanna,<sup>21</sup> who is a lecturer at the Faculty of Humanities, Kasetsart University. House of Museums was officially opened on 14 July 2001 and has since then become one of the most well-known and still thriving community museums in the country.

By its very name, House of Museums is intended to be a house where the everyday Thai life going back to the late 1950s is portrayed through collections of articles such as household utensils, books, cameras, toys, advertising boards, gramophones,

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<sup>21</sup> Interview with Wanna Nawikamool, Director, House of Museums (Bangkok, Thailand, 10 February 2013)



films, tables, cabinets and many others, as well as through model shops and displays of certain everyday activities such as market life. Most of the articles have been donated, and some of them have been purchased. The idea is that these articles, which would have normally been thrown away, should be preserved as a record of the memory of the past that would otherwise have been forever lost. Its slogan is: “Keep it today and it will be an antique tomorrow!”

House of Museums began as a private collection club and was later transformed into an association called Kijwatanatham. Though privately initiated, this community museum came into being largely through a “public” or collective effort. Together with most of the collections it houses, the land on which it is located was donated; the plans and designs of its two buildings, as well as the display designs for the collections, were all the results of collective voluntary efforts.

## 5.2 Organisation and management

Since there is no law for the setting up and operation of museums in Thailand, according to Wanna Nawikamool, House of Museums was registered as an association. The main reason for the decision to opt for this particular legal form, rather than that of a foundation, was to avoid the strict rules and regulations governing such organisations.

According to Wanna, running this community museum as an association has certain advantages. In particular, though it is mainly dependent on grants and donations, it can gain supplementary income from admission fees, sale of souvenirs and books, and operating a coffee shop. If the museum was set up as a foundation, it would not be allowed to earn extra income besides grants and donations. The only main advantage of being registered as a foundation is its being entitled to a full income tax exemption.

However, even though in running a community enterprise like House of Museums, the legal form of association is more flexible than that of the foundation, there are some restrictions, which clearly show *the disadvantages of the unavailability of a proper legal form for social enterprise*.

First and foremost, since the museum is being operated as a private organisation, it is difficult to ask for governmental support, though it has clearly been set up for community and social benefits. Financial support from the government is possible only in certain cases, such as for the purpose of hiring museum guides, but in such cases the benefits go to those guides rather than directly to the community enterprise. Of course, it could be argued that this form of governmental support also benefits the community if the museum guides are recruited from among the community people: this would have the effect of promoting employment in the local area. Nevertheless, such an impact would be minimal, and this is not the main purpose of House of Museums, which is to serve the Thai populace in general rather than only its local community.

Moreover, unlike foundation, House of Museums is not entitled to issue any receipt to those who donate money to it. This means that those who have made such

donations cannot apply for tax refund. This makes it even more difficult for the museum to receive grants and donations – which are definitely crucial for its future expansion. It currently relies exclusively on volunteers who are not in any way remunerated, except those who benefit from donations to support their education.

### 5.3 House of Museums as a social enterprise

Wanna enthusiastically affirms that House of Museums is a social enterprise. She knows very well that such an enterprise must be self-sustaining, while at the same time being able to contribute to the community. She is nonetheless aware of the important issue of social enterprise branding and how this is related to the future development of House of Museums.

In the first place, she recognises that the branding of social enterprise involves its credibility: both those who are prospective donors and/or backers and those who would benefit from its activities want to know its pedigree – especially whether it could be trusted as a socially- or community-oriented enterprise.

Moreover, House of Museums has a plan for future development – that is, for an expansion that would transform it from a “house” into a “Little Market” occupying a much larger land area. The most important challenge is whether the legal form of association under which House of Museums is now operating is appropriate for its expansion.

For this purpose House of Museums must definitely be more entrepreneurial in its orientation, but among major obstacles is the lack of funding and skilled management. Wanna and her husband are admittedly not prepared to go it alone for such an enterprise and an association would not be able to overcome those obstacles through mobilisation of fund and acquiring a professional management team. Among other conditions a more appropriate legal form is required for future development of this community museum.

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## 6. Khaokwan Foundation

### 6.1 Origin and development

Khaokwan Foundation began its activities as a non-governmental organisation (NGO) specialising in the development of technology, rice seeds and other local crops appropriate for specific localities. It also engaged in research on the impacts of agricultural chemicals and the search for possible alternatives for farmers who did not want to use chemicals in their agricultural production. In 1984, operating as part of Appropriate Technology Association (ATA), it launched a rice-fish farming project, together with other integrated farming activities, in northeast Thailand. In

1989, it separated itself from ATA and formed its own organisation – Technology for Rural and Ecological Enrichment Centre (TREE) – before eventually registering as a Khaokwan Foundation in 1998 with an office in Suphanburi Province, which lies about 100 kilometres to the west of Bangkok.

The person instrumental in establishing and developing Khaokwan Foundation is Decha Siripat. His purpose was to relieve the problems most Thai rice farmers have been facing almost all through their lives – problems that have resulted in the steady decline in their livelihood. The most serious problem the accumulation of debts rather than profits. Most of their children thus do not want to inherit rice-farming occupation from their parents.

Rice farming has been part of Thai culture and society for a very long time. The problem, in the opinion of Ananya Hongsa,<sup>22</sup> is that they have neither proper knowledge nor a “heart” for rice farming. The foundation thus aims at educating farmers (mainly in Suphanburi Province) by providing a rice farming study programme covering everything about rice including how to use organic fertilisers, how to develop rice seeds, and etc. It is free of charge for the participants who are farmers since it is financially supported by the Ministry of Agriculture and Co-operatives.

So far more than 300 farmers have graduated from the foundation’s intensive training programmes, whereas more than 3,000 have attended short-term training courses. Several of those who attended its training programmes have been selected by the Ministry of Agriculture and Co-operatives for awards as “Distinguished Farmers”. It also offers similar training to farmers from foreign countries, including Bangladesh, India, Lao PDR, Myanmar, and Sri Lanka. Moreover, the foundation has succeeded in developing a rice-farming system relying on insect-resistant rice strains requiring no use of agricultural chemicals. The system results in high yields at low labour and other costs with no serious environmental impacts.<sup>23</sup>

## 6.2 Organisation and management

Khaokwan has registered as a foundation with Decha Siripat serving as its director. Now apart from offering several training programmes in rice farming and other related activities, it also sells many organic farm products including jasmine brown rice, jasmine white unpolished rice, quality paddy rice seeds, and vegetable seeds. Moreover, the foundation has been involved in the restoration and conservation of ancient festivals related to farming.

According to Ananya, the foundation is not responsible for the marketing of the farm products. Its main purpose is to educate the farmers, so that they can educate more farmers. The foundation has also filed petitions against the use of chemicals in agriculture and for the cancellation of tariff exemption and reduction for chemical products. Luxury taxes should be imposed on chemicals and their prices should be controlled. This will help farmers in the long run. The government's current rice

<sup>22</sup> Interview with Ananya Hongsa, Manager, Khaokwan Foundation (Suphanburi, Thailand, 6 March 2013)

<sup>23</sup> Achavanuntakul (n 7) 84-85.

project (rice pledging scheme) does not solve the problem at its root. Those who have benefited most from the scheme are still the middlemen.

Therefore, what the foundation is trying to do is to change the attitude of the farmers towards rice farming. The foundation has set up a forum where farmers in Suphanburi can share their opinions and problems of growing rice. The forum has also helped create a network of farmers which widens the same understanding and provides mutual support among fellow farmers. The foundation hopes that farmers will be proud of what they are doing and will be released from their debt burden and from being “slaves” in the sense that they are always told what to do. For example, they are told by the government or merchants to use chemicals and certain rice seeds to maximise products. Those who sell chemicals never farm, but farmers tend to believe them.

### 6.3 Khaokwan Foundation as a social enterprise

Since Khao Kwan was set up as a foundation, it is a non-profit organisation. The main revenue has come almost entirely from grants and donations. For example, its office building was donated by the Japanese government in 2002. Even though the Ministry of Agriculture and Co-operatives provides fund for its courses every year, the fund is limited to only 200 participants. Also every baht spent has to be declared.

According to Ananya, the foundation still faces loss and lacks access to capital. As a foundation, it is not allowed to take loans from banks, nor can it make profits from selling rice. Khaokwan has tried hard to solve its financial problems by taking private loans, that is, those made in the name of the founder, Decha, not the foundation since it cannot rely on grants and donations all the time. Those who work for Khaokwan are treated like members of the same family. They all have a heart to work for social benefits. Some of them are rice experts who can earn much more if they work for a private company. Therefore, in order for the foundation to survive, its people need a decent living too.

This clearly shows the limitation of being set up as a foundation. What the foundation is planning to do in a year or so is to build a factory for the improvement and production of rice seeds and organic fertilisers. The factory will be set up as a limited liability company which allows it to make profits. However, all of the profits will be reinvested into the factory and sent to the foundation. Khaokwan is not concerned about being viewed as a for-profit organisation since it believes in its transparency and honesty. The income and profits will be declared and explained professionally and honestly. Anunya strongly believes that a legal form like the British CIC will be a suitable structure for social enterprise. She said ‘[CIC] is exactly what we want now!’

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## 7. Lemon Farm

### 7.1 Origin and development

Lemon Farm Patana Co-operative Limited was set up in 1999 by Monkolchaipatana Co., Ltd. and Bang Chak Petroleum Plc. as a mechanism connecting farm producers in the rural areas with consumers in the urban areas, and promoting their mutual help in strengthening community health and social well-being, and preserving local culture. The main concern of Lemon Farm's founders was that Thai people had only limited access to chemical-free foods: agricultural produce, in particular, was contaminated with chemicals, especially insecticides, that were harmful to the health of both producers and consumers.

The first Lemon Farm shop was opened on an experimental basis at the Bang Chak Petrol Station in Bangkok. The shop was meant to serve as an outlet for organic farm and other chemical-free products, including agricultural processed goods, from local communities, as well as to promote popular livelihood on the basis of "sufficiency economy" advocated by His Majesty King Bhumibol Adulyadej.<sup>24</sup> Now in addition to its head office, Lemon Farm has opened nine branches almost all over Bangkok. It is the first organic farming co-operative that has achieved success at the national level.<sup>25</sup>

### 7.2 Organisation and development

Lemon Farm has been set up as a co-operative. Its core workforce consists of former employees at Bang Chak Petroleum, who followed Sophon Suphamong, their CEO, when he quit the company to assume a full-time work in community development. These people only wanted to pursue a career in this area and provide Thai society with a development alternative that did not rely on the market and the business competition on which it is based.<sup>26</sup>

At present Lemon Farm has authorised Sungkhom Sukhaphap Co. Ltd. to assume responsibility for the management of its business activities. According to Suwanna Langnamsung,<sup>27</sup> managing director of Sungkhom Sukhaphap, the popularity of organic farm products is currently rising; Lemon Farm is thus planning to open new branches in Bangkok to meet the rising demand. It must nevertheless be stressed that the success of Lemon Farm as a co-operative has relied very much on Sungkhom Sukhaphap, a subsidiary in a limited company form, which is responsible for its business management, especially in retail marketing.

### 7.3 Lemon Farm as a social enterprise

Lemon Farm is a good case of social enterprise providing social benefits in terms

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<sup>24</sup> Achavanuntakul (n 7) 32.

<sup>25</sup> *ibid* 32-33.

<sup>26</sup> Suporn Sae Tan, 'Lemon Farm: Comprehensive, Sustainable' (May 2012) *Manager Magazine* <<http://info.gotomanager.com/news/printnews.aspx?id=94613>> accessed 30 March 2013

<sup>27</sup> Interview with Suwanna Langnamsung, Managing Director, Lemon Farm (Bangkok, Thailand, 20 March 2013)

of good health and well-being of the people, as well as environmental protection, while being viable as a business venture. However, while as a co-operative it has provided benefits to a large number of households that are its members, it needs to operate as a business organisation, through Sungkhom Sukhaphap, in order to be financially sustainable.

According to Suwanna, the problem is that farmers (particularly those who produce organic farm products) lack market outlets for their products, especially outlets with direct access to consumers. There are middlemen who make profit from purchasing the products from farmers at relatively low prices and selling them to consumers at much higher prices. This is clearly unfair to both farmers and consumers. In order to earn more, farmers have to produce more in a shorter time. That is how chemicals come into play. As a result, it is consumers who have to pay for food and products that are harmful to their health and the environment. Those who get the most benefit are the middlemen.

Thai co-operatives law does not support co-operatives in competing in this kind of business, whose nature has been changing. For example, it is not easy to declare and explain the losses caused by fresh foods being rotten or stolen. Doing so will cost even more than the losses. Limited company form is more suitable because it is more flexible in running the business and helps reduce the risks of losses for its members/shareholders. Given its flexibility, this legal form is far better suited to the changing nature of business, which involves increasingly complicated transactions in the present business environment, whereas the Co-operative Act still maintains strict control over business activities of co-operatives.

Suwanna believes that social enterprise is a good concept but its meaning and operational modes are still unclear. Lemon Farm stopped selling Coke in its shops even if it made good profit, because it views a social enterprise as not involving only making profit to survive, but also concern for the well-being of people and society. In her view, a legal form like the CIC might encourage more people in Thailand to become social entrepreneurs. However, such a law should support (rather than control) social enterprise with such measures as tax incentives, marketing channels and business know-how.

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## **8. Opendream**

### **8.1 Origin and development**

Founded in 2008, Opendream was initially aimed to be a company offering services in designing and constructing websites for social firms and business organisations that at the same time engaged in socially and community-oriented activities. Its

founders, Patipat Susampao<sup>28</sup> and Patcharaporn Pansuwan, saw that despite their contributions to society and the community, these organisations were not generally known. “Information is power”;<sup>29</sup> therefore, organisations with no means of disseminating information on their missions and activities would be deprived of a major power capability.

Dissemination of information on the Internet is now cheaper than through other even less effective channels. Moreover, internet and other types of IT technology could be extensively exploited by social sector organisations for their powerful impacts on society and the community. Patipat and Patcharaporn decided to leave their promising careers in large companies to pursue this business line for commercial and social purposes. However, when they came into contact with Change Fusion, they decided to transform their business into a social enterprise specialising in delivering IT services mainly to organisations in the social sector. Though the company also offers services on a purely commercial basis, 80-90 per cent of its works have been delivered to those organisations.

Since its founding Opendream has accomplished more than 90 IT projects for organisations of this type and CSR agencies of many large companies, together with more than 50 website design and construction works. All these accomplishments have significantly contributed to the empowerment of such organisations.

A very good example is the construction of “Mo Chao Ban” (or Doctor for the General Populace in English) website. The website now contains information derived from the magazine of the same name that has been regularly published for more than 30 years. Opendream has digitalised the contents of the numerous issues of this magazine, transforming them into digitalised and soft-file databases, which are easy to download. Given this easy access, the number of people who visit the website has increased from about 1,000 per month to about 1,000,000 per month. Helping to popularise this IT instrument has indeed resulted in dissemination of knowledge on healthcare and medical problems in everyday life to a very large number of people.

## 8.2 Organisation and management

Opendream has been incorporated as a limited company. Patipat has been the company’s managing director since its establishment. What is particularly notable about this company is that it is very clear about its mission and activities: ‘We are a *social enterprise* with expertise in Internet solution development and information design...’ and its aim, the company boldly states, is to ‘deliver the information, change the world’.<sup>30</sup> Working through its networks of friends in NGOs, the new media, high-tech firms, research institutes, and software developers, it has provided not only the efficient solution but also the gateway to wider new opportunities of collaboration, extending and enhancing the reach of our client-friends.

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<sup>28</sup> Interview with Patipat Susampao, Founder, Opendream (Bangkok, Thailand, 26 February 2013)

<sup>29</sup> Opendream, ‘About Opendream’ <[opendream.co.th/about](http://opendream.co.th/about)> accessed 15 March 2013

<sup>30</sup> (n28).

Founded with a start-up funding of 350,000 Baht (around £7,000)<sup>31</sup> under the Youth Social Enterprise Initiative (YSEI), it earned 222, 681 Baht (around £4,450)<sup>32</sup> within one year, and its earning tripled in the year after that. It now develops its own products with a view to taking good care of itself and its team, so that they become financially viable. According to Patipat, one of the main problems involves the lack of capital and access to finance. The company does not have investment to run a bigger venture or compete with bigger for-profit companies. Its profits have been divided in the following proportion: 30 per-cent reinvestment, 30 per-cent cash flow, 30 per-cent social benefits, and 10 per-cent dividends (not guaranteed every year).

### 8.3 Opendream as a social enterprise

The lack of capital has been mainly caused by the “branding” problem. It is still not clear, Patipat admits, how an IT company could provide benefits to society. The company's main job is to assist those who directly work for social benefits. Mo Chao Ban website is a good example. Since Opendream is not generally seen as creating clear social impacts, it is difficult for the company to gain investment capital. *While private investors tend to view the company as an NGO, philanthropic organisations often regard it as a for-profit company aiming to maximise profit rather than social benefits.*

This clearly shows that social enterprises in Thailand have a problem of clarifying their position in society. According to Patipat, 80-90 per cent of Thai social enterprises operate as non-profit organisations and only 10 per cent of them are for-profit businesses with social purposes. Such a situation reinforces the belief or understanding that if one wants to help other people, one should not make profit but, like a charitable organisation, rather seek grants and donations. Such a view clearly does not augur well for the development of the social enterprise sector.

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## 9. Rakluke Group

### 9.1 Origin and development

The “Rakluke” brand came into being in 1982, when Plan Publishing Co., Ltd. was set up, with a clear purpose which the group has retained since then: the company would engage in media business that contributes to the betterment of society and not in maximising profits. Those joining in the development of this venture were young men and women who were intent upon creating a better society<sup>33</sup> with a belief that still guides the group’s business line: ‘the leaning process is a tool driving

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<sup>31</sup> Bank of England (n 9).

<sup>32</sup> *ibid.*

<sup>33</sup> Rakluke Group <[www.rlg.co.th/](http://www.rlg.co.th/)> accessed 6 March 2013



the family, society, community and the country in the direction of sustainable development'.<sup>34</sup> Or in the words of Subhawadee Harnmethee,<sup>35</sup> CEO of Rakluke Group, who reaffirmed this belief in a recent interview with KPMG Thailand: 'Our belief is "Learning Makes Change"'.<sup>36</sup>

Plan Publishing started with producing various types of "good media" including print media (especially magazines and handbooks), radio and TV programmes. But what could be regarded as its "flagship product" was the magazine Rakluke (or "love for one's children" in English). The purpose of all these products was to create and encourage learning activities between parents and their children. With the advent of new technology, especially the ICT, the company shifted its attention to "social learning". The name of the group was changed from Plan Publishing to Rakluke Group, so that it more clearly reflected the group's vision to become 'a leader in creating all aspects of learning for Thai families through the media and various creative activities'.<sup>37</sup>

## 9.2 Organisation and management

Rakluke Group has been incorporated as a limited company. Since the early 2000s it has diversified into various subsidiaries which cover different aspects of social learning in our age of technology. However, its main product, the magazine *Rakluke*, has remained most popular among publications of its kind in Thailand during the past 30 years. The subsidiaries include Rakluke Discovery Learning, Rakluke Edutex, and Rakluke Human and Social Innovation (all set up in limited company form).

## 9.3 Rakluke Group as a social enterprise

Rakluke Group as a social enterprise had come into existence long before this term was known in Thailand. Operating as a well-organised and full-fledged business enterprise, the group has become financially viable, and with a clear goal of being oriented to creating social and community benefits rather than becoming a profit-maximising venture, it has been widely recognised for what it does and the contributions it has made – though initially not as a social enterprise. Now that social enterprise as a term as well as concept has gained wider circulation, it is now more or less generally known as such.

According to Subhawadee, Rakluke clearly sees itself as social enterprise since its business is mainly for educating and helping parents and children (any family-related issues). It is social enterprise not because it makes a lot of donations; rather it does not earn enough to do that. It is social enterprise because the company

<sup>34</sup> Jirawat Khongkeo, 'Rakluke Group as a social innovator' *Krungtheptharakij* (Bangkok, 25 October 2012) <[www.bangkokbiznews.com/home/detail/business/csr/20121025/4743611](http://www.bangkokbiznews.com/home/detail/business/csr/20121025/4743611) รัศมฤกษ์ผู้สร้างสรรค์นวัตกรรมเพื่อสังคม.html> accessed 17 March 2013

<sup>35</sup> Interview with Subhawadee Harnmethee, CEO, Rakluke Group (Bangkok, Thailand, 27 February 2013)

<sup>36</sup> KPMG Thailand, 'Skilled in Both Worlds: Rakluke Group: A Social Enterprise in Thailand' (2012) 05 REACH 15.

<sup>37</sup> Achavanuntakul (n 7) 30.

believes that what it is doing is for public benefit.

Most of its profit has been reinvested in the company, particularly for social development projects which hardly make profit at all. However, many people including clients or business partners still see Rakluke not different from a for-profit company. Therefore, it is difficult for Rakluke to clarify its position since Thai people still do not understand the definition and concept of social enterprise, resulting in the company missing an opportunity to manage certain government projects.

Such a problem of misunderstanding is sometimes so serious that profit-making companies like Rakluke are not permitted to take part in certain government projects. Only so-called non-profit enterprises are allowed to do so. But in reality, sometimes such enterprises are not capable enough to handle the social development projects. To avoid such trouble, the company can only become the sub-contractor and the primary contractor would take some commission fees (being a middle man). In the end, the budget to manage the projects is not enough to make any profit.

In order to avoid such problem, Rakluke has been registered with the Finance Ministry as an expert/adviser in a particular field (children/parents/family). This will help make it easier for the company to explain its position to the public. Rakluke uses business methods in managing its projects. If it deals with educational institutions, they would focus mainly on training, research etc. If it is business, they would find an effective management system to run the projects nationwide with the same standard. Rakluke does not make a huge profit, though enough to survive. Some projects tend to provide hopeful profit, while social development projects almost gain none. Therefore, for the company, helping people and society does not mean how much they donate. Rakluke looks at itself as social service provider for society.

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## **10. Rung Arun School**

### **10.1 Origin and development**

A problem of schooling in Thailand is that it focuses more on providing children with substantive knowledge and strengthening their competitive capability (especially for their eventual success in the university entrance examination) than developing them physically, emotionally and morally. Moreover, the school system has not been properly adjusted to suit the social conditions that have been changing rapidly and have become increasingly complicated.

Many educational specialists, academics, parents, and other concerned individuals were fully aware of this problem. Seeing that no effective move had been taken to

solve it, Prapapat Niyom,<sup>38</sup> a former associate professor at the Faculty of Education, Chulalongkorn University, took the initiative in establishing a school that would meet the nature of human learning needs and serve as a concrete example of the move towards the development of Thai education in a new direction. As a result of these concerns and the search for an alternative to mainstream schooling in Thai society, Rung Arun School came into being in 1997.<sup>39</sup>

Rung Arun School was therefore set up to provide a new alternative schooling – one which follows a Buddhist way of life and which aims to fill the gaps left by the mainstream school system. Unlike the mainstream approach with its focus on competitive examinations and separation of academic knowledge from real life, this new alternative schooling provides a teaching and learning method that enables students to learn, think, and do by themselves, especially by integrating what they have learned into the pursuit of their daily life.<sup>40</sup>

The name of the school was given by Professor Dr. Praves Wasi, a highly respected educator and medical specialist, whose intention was for the school to represent “the Dawn of Wisdom” and to serve as a pilot move towards a best possible way of developing and providing education in Thailand. As he at that time put it, ‘...Rung Arun School will not only provide best teaching and learning for a number of students but will also create specialists in this new way of providing education, who will help train teachers of both state and private schools, so that this way of teaching and learning would eventually be adopted all over the country. Rung Arun is not just a school but rather a national intellectual strategy’.<sup>41</sup>

## 10.2 Organisation and management

Even though the school did not originate from a profit-making incentive, Prapapat needed loans from banks for the construction of the buildings and the coverage of initial administrative costs. Moreover, an innovative method of financial mobilisation was also introduced: it created understanding and trust among the parents of its students, and this led to advance payment of the school fees, which were then used as part of the funding for its expansion. This method has had the important effect of avoiding the risk of heavy reliance on bank loans and ensuring the school’s future revenue.<sup>42</sup>

The founding of Rung Arun School thus represented a collaborative venture of various sectors in society, particularly between the not-for-profit organisations and private businesses and financial institutions. Set up under the Private School Act,<sup>43</sup>

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<sup>38</sup> Interview with Prapapat Niyom, Founder, Rung Arun School (Bangkok, Thailand, 20 March 2013)

<sup>39</sup> Social Enterprise Thailand, ‘Rung Arun School: A Company of Unlimited Knowledge’ <<http://socialenterprise.in.th/?p=739>> accessed 25 March 2013

<sup>40</sup> *ibid.*

<sup>41</sup> Rung Arun School, ‘The Origin of Rung Arun’ <[www.roong-aroon.ac.th/index.php?option=com\\_content&view=article&id=141&Itemid=195](http://www.roong-aroon.ac.th/index.php?option=com_content&view=article&id=141&Itemid=195)> accessed 25 March 2013

<sup>42</sup> Social Enterprise Thailand (n 39).

<sup>43</sup> The latest version of this legislation is the Private School Act B.E. 2550 (2007) as amended by the Private School Act (No. 2) B.E. 2554 (2011).

the school has been accredited by, and operating under the supervision of, the Basic Education Commission of the Ministry of Education. As a private school, it needs also to be run as a business, and for this purpose Rung Arun School Co., Ltd. was established. However, since the school was purposely set up as a not-for-profit organisation, a foundation was also created in 2003 to promote its educational and other related activities including provision of social services such as training of personnel and volunteers in government agencies and not-for-profit organisations.<sup>44</sup>

At present Rung Arun School has more than 1,000 students and consists of three sections, namely, the kindergarten (pre-school grades 1-3), the primary level (grades 1-6), and the secondary level (grades 1-6). In founding and running Rung Arun, Prapapat was also inspired by Waldorf education, particularly the Waldorf School of Southwest London, but she has modified the English version of this “alternative education” to suit Thai society.

### 10.3 Rung Arun School as a social enterprise

As clearly stated in its website, Rung Arun School is ‘a not-for-profit organisation, which means an organisation that engages in revenue- and profit-generating activities, but that does not transform these profits into private assets of the shareholding individuals or legal persons. Rather, the profits are used in developing the missions of the organisation, which include developing its human and other resources, as well as its work system and other aspects of the organisation. The purpose is to further develop the latter on a sustainable basis’.<sup>45</sup> There is thus no question about the school being run as a social enterprise. According to Prapapat, the problem is to find a legal structure within which to run the school as a not-for-profit. Since she was not able to find such a legal form, it has now to operate under various laws and legal forms.

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## 11. Suan Ngoen Mee Ma

### 11.1 Origin and development

Established in 2001, Suan Ngoen Mee Ma Co., Ltd. was, according to its manager, Wallapa van Willenswaard, originally conceived of in the late 1990s as a way out of, or an alternative to, consumerism.<sup>46</sup> During that time the term “social enterprise” or “social entrepreneurship” was still unknown in Thailand, but the booming economic activities (before the onset of the financial crisis in July 1997) did not

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<sup>44</sup> Rung Arun School (n 41).

<sup>45</sup> *ibid.*

<sup>46</sup> Saran Masomboon, ‘Suan Ngoen Mee Ma: A New Paradigm for an Ideal Society – Wallapa van Willenswaard’, in *Creative Businesses as Social Allies: 15 Model CSR Organisations* (Social Venture Network (Thailand), 2013) 90-98.

deter certain groups of people from their determination to search for such an alternative.

Still uncertain about what an “alternative business” would be like, Wallapa sought advice from Mr. Sulak Sivaraksa, a well-known social critic and writer in Thailand. Through this consultation it was decided that a limited company would be set up. What it would engage in that would not come to be solely profit-oriented needed to be thought out. Eventually three main types of activity were chosen to represent the company’s business and social activity lines, namely: publishing, serving as an outlet for community products, and providing a venue for conferences and seminars, where knowledge and experiences would be exchanged. Since then a number of related enterprises and activities have developed.

A major outlet for the company’s publications is Suan Ngoen Mee Ma Bookstore, which sells books mainly of alternative types. Through social marketing in the form of group discussions and talks on new publications and other related matters it is now relatively well known that if one wants books of new paradigms or alternative types, she must visit Suan Ngoen Mee Ma Bookstore.

Initially providing an outlet for community products from organic cotton, Green Suan Ngoen Mee Ma Store now sells many organic products from community sources and small producers, serving at the same time as a learning source on organic farming and for Community-Supported Agriculture (CSA), which has been conceived of as a mechanism to promote organic farmers through advance payment by consumers to the farmers to support the latter’s organic farming.

## 11.2 Organisation and management

Suan Ngoen Mee Ma has been incorporated as a limited company, and its founder, Wallapa van Willenswaard,<sup>47</sup> now serves as manager. Its initial funding came partly from non-governmental organisations such as Sathirakoses-Nagapradeepa Foundation, and partly from the Social Venture Network group. Given the absence of the term “social entrepreneurship” at the time of its founding, Wallapa’s idea for the organisation she was about to set up was that of merging NGOs’ financial support with the business sector’s funding.

This idea actually reflected her understanding of “social enterprise” when the concept had not yet gained circulation in Thailand: that is ‘the idea of bringing together funding by charitable and non-governmental organisations and capital from the business sector, in the form of an alliance among the various sectors in society that want to see the latter develop in a sustainable direction’.<sup>48</sup>

Suan Ngoen Mee Ma has gained a distinct image of an enterprise that offers new alternatives. In addition, given the trust it has created among consumers, it now enjoys the latter’s confidence in it as a “social entrepreneur”.<sup>49</sup> Its revenue leaped

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<sup>47</sup> Interview with Wallapa van Willenswaard, Director, Suan Ngoen Mee Ma (Bangkok, Thailand, 15 February 2013)

<sup>48</sup> Masomboon (n 46) 93.

<sup>49</sup> *ibid* 96.

from 4.7 million baht (around £94,000)<sup>50</sup> in 2006 to 20.9 million Baht (around £418,000)<sup>51</sup> in 2007 – a 336 per cent increase in one year.<sup>52</sup> Though the company was severely hit by political instability in the country begun in 2008, it still has been running at a profit.

### 11.3 Suan Ngoen Mee Ma as a social enterprise

In certain important respects, Suan Ngoen Mee Ma is typical of Thai social enterprises: it operates within a network of allied organisations that have worked together to support some of the activities it is engaging in. The “Green Market” under the Community-Supported Agriculture scheme typically operates in this way. The market started as a group of organic farmers with the support of a network of foundations and allied organisations, and the consumers are mostly urban dwellers who take good care of their health. A market committee sees to it that the quality and prices of the products are in accordance with the required standards. Pathumthani Hospital, for example, is a permanent marketplace where organic farm products are on sale. Farmers come to sell their products as a group now consisting of about 90 producers, whose revenues are fairly shared.

Apart from the products, the group also sells its “Green Market” brand (now being diversified into sub-groups such as “Green Hut Village”). The idea is that the products come directly from farmers, who are mostly small producers, and the profits should go directly to them. However, the lack of capital remains the principal problem, and with this shortcoming the Green Market farmers cannot compete in the capitalist free-market system, in which an increasing number of commercial firms claim to be organic farm producers. Wallapa admitted that she was not aware of a legal form for social enterprise like the CIC. However, she believes that a legal framework that enables producers to develop themselves in the same way would contribute to the solution of at least some of the problems.

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## 12. Udomchai Farm

### 12.1 Origin and development

Udomchai Farm started its business in 1960. Its founder, Udomchai, was an overseas Chinese and represented the first generation of the Sangvatanakul family who owns the farm. According to the farm manager, Dr. Papis Sangvatanakul,<sup>53</sup> D.V.M. and MVPH, a veterinary and third generation member, the family started with pig farming with funding from loans. Then, about 30 years ago, it wound up

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<sup>50</sup> Bank of England (n 9).

<sup>51</sup> *ibid.*

<sup>52</sup> Achavanuntakul (n 7) 45.

<sup>53</sup> Interview with Dr. Papis Sangvatanakul, Manager, Udomchai Farm (Saraburi, Thailand, 9 March 2013)

this business and embarked on a new one – that of poultry and egg farming. It learned to raise chickens mainly by experiences. When it turned to focus only on egg farming, it raised up to 500,000 egg-laying hens.

In 2003 Udomchai Farm faced a major crisis – the outbreak of avian influenza. At roughly the same time, a family crisis also took place. It was at this time that the family decided to turn back to look after itself. It was good health, and the happiness it gave rather than wealth, that was now sought after. The family business was thus downsized, with the number of egg-laying chickens reduced from 500,000 to 50,000, so that it could focus more on the quality of farming. Hence, with the expanding encroachments of large egg industries, Udomchai Farm decided to shift to organic farming. It gradually upgraded itself in terms of quality without being dominated by big companies.

The farm did this by reducing the use of antibiotics, before eventually replacing them with bio-extracts and local medicinal herbs. This resulted in the chickens acquiring a strong immunity to diseases. Moreover, organic chicken feed was used, along with an organic farm environment – that of a free-range egg farm.

In 2008 Udomchai Farm entered the egg market with its own brand and slogan: “Ploikai Udomchai Farm” (Udomchai Free-Range Farm) offering “organic eggs from good-tempered hens”. With this brand and image, the farm has persistently maintained its free-range egg farming with humane treatment of the chickens – raising them with quality organic chicken feed in a clean, chemical-free farmyard located on a large land area of more than 40 acres. Certified by the Bureau of Livestock Standards and Certification, it has been promoted as an outstanding health farm by the FAO networks.

## 12.2 Organisation and management

Udomchai Farm has been registered as a limited partnership (LLP). For Papis this legal form is suitable for the business, since it is a family-run business whose partners are all relatives. Decisions are normally made in a non-business like family manner, relying on informal discussion among family members. With a dramatic reduction of the number of chickens, the farm has had to make sure that its income is enough to continue the business and take care of all the workers, some of whom have worked for it for more than 30 years. In addition, finding markets for the organic free range eggs is not that easy. Most consumers will normally find the eggs smaller and more expensive than regular eggs, which are mostly supplied by big companies. Fortunately, Udomchai Farm has been in the business for a long time; it is thus able to find buyers and business partners like Lemon Farm, who care more about health than prices. However, it will be quite difficult for those who want to start an organic farm: not only is the business highly competitive but it is also monopolised by only a few big farms.

One of the problems of becoming organic is that you cannot do everything alone. Udomchai Farm has been trying to grow organic corns themselves but the products are not enough to feed all the chickens. Local farmers are not interested in growing organic corns or other organic crops because this involves a slow and complicated

production process with poor harvests. They prefer using chemical fertilisers in growing crops for abundant yields.

### 12.3 Udomchai Farm as a social enterprise

Though in Papis's view a social enterprise cannot go it alone, she believes that it must be able at least to some extent to sustain itself financially. Udomchai Farm's main business ally is Lemon Farm, who well understands the situations of organic farmers. For example, if the eggs produced by these farmers are relatively small, they could compensate for this by adding the number of eggs in a pack, say, increasing it from 10 to 15, so that by weight a pack of 15 eggs is equivalent to a pack of 10 eggs. However, even a good business alliance is not enough for this kind of enterprise.

The biggest problem is that Thailand's livestock industry is currently dominated by only a few large companies. To gain market access to main department stores is very difficult. Therefore, if one wants to embark upon organic farming, one must be clear about what to produce and where one could find market outlets for the organic products. This is still not to mention the subtly complicated production process.

To be financially viable, Papis suggests, the business needs to operate within some suitable formal structure – one which would enable it to operate efficiently, such as a company form. If one relies on only the “heart”, that is, good intention and personal devotion, any success, if at all, could last only as long as one still has the “heart” for it. Apart from operational efficiency, honesty and ethical integrity are also required for this kind of business. For Udomchai Farm, a family business being operated as a social enterprise, profits have been partly invested in the family welfare (education and healthcare) and partly reinvested in further developing the quality of its organic products – the free-range eggs. Its goal is to maintain good health of both the family members and customers. In this way, Papis believes, it has contributed to the “health” of both society and the environment.

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## **13. WAY Magazine**

### 13.1 Origin and development

A variety magazine published by Pen Thai Publishing Co., Ltd., WAY first came out in 2006. The magazine features documentaries, individuals, society, and lifestyle, combining pictures and substantive contents in a way that appeals to various groups of readers, especially those who want both in-depth stories and insightful analysis.



WAY came into being when a group of young men and women, who are magazine and print media specialists, formed a team led by Athikom Kunawut.<sup>54</sup> The magazine has also brought together Thailand's leading writers and columnists. In 2012, which marked the 6<sup>th</sup> anniversary of its birth, WAY launched its [www.waymagazine.org](http://www.waymagazine.org) as a window for online communication.<sup>55</sup>

According to Athikom, founder and managing editor of the magazine, he emphasised that because the world is information, WAY aims to encourage the Thai people to read more and consume information which is not misleading or influenced by profit-oriented magazine publishers. WAY is different from mainstream general knowledge/entertainment magazines in both its size and contents: being smaller, containing fewer advertisements, featuring no advertorials, and etc.

### 13.2 Organisation and management

Pen Thai Publishing, which is WAY's publisher, was set up as a limited company. Apart from WAY magazine, the company also produces other print media to fill the gap in this sector in Thailand – the shortage of media of this type that do not seek to maximise profits through advertisements or confuse readers with the blurring spaces between advertisements and contents. The start-up fund for WAY was donated by Prof. Dr. Praves Vasee, a highly respected medical doctor who has been widely involved in social and community-oriented projects and activities in Thailand.

The cost of publishing a magazine is very high, while profits that can be made from such a venture are generally low. Hence, Athikom has pointed out, in order to survive in the competitive business, many publishing companies have to heavily depend on the revenue from advertisements. Those who want to have their products or services advertised in a magazine would normally demand big spaces for their advertisements or “advertorials” – advertisements in a newspaper or magazine that are made to look like normal articles. WAY finds advertorials not honest to the readers. It wishes to be an independent magazine that is able to express honest opinions to the readers and free from the influence of money. However, since WAY does not want to depend on advertisements, it does not make much profit, and even faces losses sometimes. Owing to lack of capital and cash flow, the magazine publishing was halted for a while. In order to continue the business, the company has had to find other jobs, such as graphic design services, to help support the magazine.

### 13.3 WAY as a social enterprise

According to Athikom, WAY does not view itself as social enterprise since it does not create a huge and direct social impact and the definition of social enterprise in Thailand is still unclear. However, he does not disagree with the concept of social enterprise and believes that it is still better to have an idea/desire to help society and other people no matter what it is called than having nothing at all. And we may add here that no matter how we call WAY, it serves a useful social purpose in filling the “gap” mentioned above. Athikom is also concerned that in so far as social enterprise

<sup>54</sup> Interview with Athikom Kunawut, Founder, WAY Magazine (Bangkok, Thailand, 8 March 2013)

<sup>55</sup> WAY, ‘About Us’ <<http://waymagazine.org/about/เกี่ยวกับเรา>> accessed 26 March 2013

needs to trade like a business, some businesspeople may have ulterior motives and take advantage of the term – that is, running a normal business under the cover of “social enterprise”. In any case, he realises that to be a social enterprise, only a dream is not enough. Social enterprise in Thailand still has a long way to go.

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