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**SOCIAL ENTERPRISE IN ETHIOPIA:
ANALYSIS OF THE POLICY AND
REGULATORY ENVIRONMENT**

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School of Law,
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June, 2018

Title page

SOCIAL ENTERPRISE IN ETHIOPIA: ANALYSIS OF THE POLICY AND REGULATORY ENVIRONMENT

A Thesis Submitted in Partial Fulfillment of the Requirements for
the Degree of Master of Laws (LL.M.) in Business and Corporate
Law Program at the School Of Law, Bahir Dar University,
Ethiopia.

By

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June, 2018



Thesis Approval Page

The thesis titled “social enterprise in Ethiopia: analysis of the policy and regulatory environment” Mr. Tajebe Getaneh Eniyew is approved for the degree of master of laws (LL.M.) in Business and Corporate Law Program at the School Of Law, Bahir Dar University, Ethiopia

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Declaration

I, Tajebe Getaneh, declare that this thesis comprises my own work. In compliance with widely accepted practices, I have duly acknowledged and referenced all materials used in this work. I understand that non-adherence to the principles of academic honesty and integrity, misrepresentation/fabrication of any idea/data/fact/source will constitute sufficient ground for disciplinary action by the University and can also evoke criminal sanction from the State and civil action from the sources which have not been properly cited or acknowledged.

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List of Abbreviations and Acronyms

Art.	Article
BC	Benefit Corporation
CIC	Community Interest Company
CSR	Corporate Social Responsibility
CSA	Charities and Societies Agency
Ed.	Edition
Ecopia	Ecological Products of Ethiopia
ERCA	Ethiopian Revenues and Customs Authority
FMOT	Federal Ministry of Trade
FPCs	Flexible Purpose Corporations
ICSM	International Comparative Social Enterprises Models
Inc.,	Incorporated
NPOs	Nonprofit Organizations
No.	Number
OECD	Organization for Economic Co-operation and Development
PLC	Private Limited Company
Proc.	Proclamation
SEEC	Social, Environmental, Economic and Cultural
SEPA	Social Enterprise Promotion Act
SFS	Société à Finalité Sociale
SPCs	Social Purpose Corporations
UK	United Kingdom
UN	United Nation
USA	United State of America
USAID	United States of America International Development
Vol.	Volume

Abstract

Traditionally, private entities were dichotomized as for-profit and NPOs with the purpose of profit and social maximization respectively. Recently, however, both social and profit maximizations begin to be done in a single entity. Investors undertake a business with the primary goal of solving the social, environmental, economic and cultural (SEEC) problems of the community by receiving a limited amount of profit. Such type of investors are called social entrepreneurs and their business is named as social enterprise. Social enterprise blends the profit and social mission in a single entity. Though they principally drive their income from their business, they also receive donor-funded grants and government subsidies. This type of businesses are operating in Ethiopia currently. Investors are undertaking a commercial activity primarily to address SEEC problems of the community and, incidentally, to receive some profit. To this end, they collect their funds from equity investments, contributions, business profits and donations. Though the sector is flourishing, there is no a special policy and regulatory framework in Ethiopia designed for social enterprise. They are, rather, treated and regulated as an ordinary for-profit business through the existing business legal regimes of Ethiopia. The purpose of this study is, therefore, to examine whether Ethiopia needs to come up with a special policy and regulatory framework for social enterprise. In doing so, the researcher, first, identifies factors necessitate to frame special policy support for social enterprise in Ethiopia. The researcher argued that there is a need to give special policy support for social enterprises. Specifically, it is argued that the existence of sever SEEC problems in the country and potentiality of social enterprise to address them, and the practical challenges that social enterprises face due to the absence of special policy supports necessitate to frame special policy framework for social enterprise in Ethiopia. The researcher also identifies the unique regulatory concerns of social enterprises that a social enterprise regulation needs to address. Following that, a detail assessment is made whether the existing business laws of Ethiopia fit to address the unique concerns of social enterprise. The researcher argued that the existing legal regimes of for-profit business is not suitable to regulate the concern of social enterprise. Finally, the researcher recommends for the government to come up with a special policy and regulatory framework for social enterprise.

CHAPTER ONE: INTRODUCTION

1.1. Background of the Study

Traditionally, in most countries, private legal entities were dichotomized as for-profit and nonprofit, with the purpose of maximizing the interests of shareholders and societies respectively.¹ While for-profit legal entities try to maximize the interests of shareholders through making much profit, nonprofit organizations (NPOs) thrive to tackle social, environmental, economic, and cultural problems (herein after referred as SEEC) of societies by collecting income mainly from grants, “legacies”, and membership payments.² In the contemporary world, however, the attributes of for-profit and nonprofit legal entities begin to be mingled in a single legal entity. On the one hand, nonprofit legal entities participate actively in income-generating activities like for-profit corporations to fund their mission.³ And on the other hand, for-profit business entities enter a deep commitment to solving the SEEC problems of the community like that of nonprofit entities.⁴

The fuse of the features of nonprofit and for-profit entities in a single legal entity causes a creation of another category of a legal entity called social enterprise which engages in the commercial activity with the prime mission of solving SEEC problems of the society.⁵ Such types of legal entities have different nomenclatures including “shared

¹ Mark S. Blodgett et al, ‘Social Enterprise: Reaffirming Public Purpose Governance through Shared Value’, *Journal of Business and Securities Law*, 2016, Vol. 16, No. 2, pp. 305-328, at p. 306 (herein after, Mark S. Blodgett et al, Social Enterprise: Reaffirming Public Purpose Governance Through Shared Value)

² Bob Doherty et al, ‘Social Enterprises as Hybrid Organizations: A Review and Research Agenda’, *International Journal of Management Reviews*, 2014, Vol.16, No 4, pp. 1-20, at p. 3 (herein after, Bob Doherty et al, Social Enterprises as Hybrid Organizations: a Review and Research Agenda)

³ Matthew F. Doeringer, ‘Fostering Social Enterprise: A Historical And International Analysis’, *Duke Journal Of Comparative & International Law*, 2010, Vol. 20, No. 2, pp. 291-330, at P. 293-294 (herein after, Matthew F. Doeringer, Fostering Social Enterprise: A Historical And International Analysis)

⁴ Ofer Eldar, ‘The Role of Social Enterprise and Hybrid Organizations’, *Columbia Business Law Review*, 2017, Vol. 2017, No.1, pp. 92-198, at P 95ff (herein after, Ofer Eldar, The Role of Social Enterprise and Hybrid Organizations’)

⁵ Alissa Mickels, ‘Beyond Corporate Social Responsibility: Reconciling the Ideals of a For-Benefit Corporation with Director Fiduciary Duties in the U.S. and Europe’, *Hastings International and Company Law Review*, 2009, Vol. 32, No. 1, pp. 271-304, at, P. 279 (herein after, Alissa Mickels, Beyond Corporate Social Responsibility)

value”, “social enterprise” “mission-driven business”, “social business”, “social entrepreneurship” or “triple bottom line”.⁶ But under this study, they are referred as ‘social enterprise’ throughout the paper. Such type of businesses blend both the mission of profit-making and solving SEEC problems in a single entity.⁷

Within in the past few decades, the concept of social enterprise is remarkably expanded to many countries including to Europe, United States of America, Latin America and Asian countries.⁸ As such type of such business is a strategic tool to solve SEEC problems of the community, it easily gets acceptance in many countries of the world within few years.⁹ Particularly, countries began to develop separate policy and regulatory framework for social enterprises with the view of facilitating them in the country.¹⁰ To mention few, United Kingdom (UK),¹¹ United States of America (USA),¹² Canada (British Columbia and Nova Scotia),¹³ Belgium,¹⁴ and Italy¹⁵ are countries that develop special legal forms, policies and regulatory frameworks for social enterprises. Even business persons, business schools, and NGOs start to call for the development of social enterprise business type in the world.¹⁶ More importantly, research institutions,

⁶ Alicia E. Plerhoples, ‘Can an Old Dog Learn New Tricks? Applying Traditional Corporate Law Principles to New Social Enterprise Legislation’, *Transactions: The Tennessee journal of Business Law*, 2012, Vol. 13, No.2, pp. 221-265, at pp. 228-229 (herein after, Alicia E. Plerhoples, Can an Old Dog Learn New Tricks?)

⁷ Id. p. 223

⁸ Jacques Defourny and Marthe Nyssens, ‘Conceptions of Social Enterprise in Europe: A Comparative Perspective with the United States’, 2012, p. 4 (herein after, Jacques Defourny and Marthe Nyssens, Conceptions of Social Enterprise in Europe)

⁹ Id. p. 1ff

¹⁰ Matthew F. Doeringer, *Fostering Social Enterprise: A Historical And International Analysis*, p. 306ff

¹¹ Id. p. 309

¹² Id. p. 210ff

¹³ Pauline O’Connor, ‘The New Regulatory Regime for Social Enterprises in Canada: Potential Impacts on Nonprofit Growth and Sustainability’, *Centre for Voluntary Sector Studies*, Ryerson University, 2014, Working Paper Series, vol. 1, P. 7ff (herein after, Pauline O’Connor, ‘The New Regulatory Regime for Social Enterprises in Canada’) available at < http://www.ryerson.ca/cvss/working_papers > accessed on 13/4/2018

¹⁴ Matthew F. Doeringer, *Fostering Social Enterprise: A Historical And International Analysis*, p. 308

¹⁵ Alissa Pelatan and Roberto Randazzo, ‘The First European Benefit Corporation: Blurring The Lines Between ‘Social’ And ‘Business’’, ____, p.1 (herein after, Alissa Pelatan and Roberto Randazzo, The First European Benefit Corporation: Blurring The Lines Between ‘Social’ And ‘Business’)

¹⁶ Robert T. Esposito, ‘The Social Enterprise Revolution in Corporate Law: A Primer On Emerging Corporate Entities in Europe and The United States and The Case for The Benefit Corporation’, *William & Mary Business Law Review*, 2013, Vol. 4:639, No 2, pp. 619-714, at p. 642ff (herein after, Robert T.

foundations, and workshop centers in business schools have been established in different countries to give training and supports to social enterprises with the view of encouraging them.¹⁷

Though it is not as such developed as other countries, the concept of social enterprise begins also to be practiced in Ethiopia in recent periods.¹⁸ In Ethiopia, investors in the for-profit sector commence undertaking businesses with the primary aim of solving SEEC problems of the society by considering themselves as a social entrepreneur.¹⁹ They start to be socially, culturally and environmentally conscious and endeavor to fill the gaps left unmet by other sectors through adopting business strategies. To mention few, Ecopia Organic Food PLC,²⁰ Eternum Energy Ventures (EnVent),²¹ World Entrepreneurs Do Good (W.E. Do Good) company,²² Oliberté Limited company,²³ Eminence Social Entrepreneurs Company,²⁴ Bahir Zaf Restaurant²⁵, Whiz Kids Workshop PLC,²⁶and Tebita Ambulance Company²⁷ are some of the businesses that

Eposito, *The Social Enterprise Revolution in Corporate Law*) and Matthew F. Doeringer, *Fostering Social Enterprise: A Historical And International Analysis*, p. 292

¹⁷ Jacques Defourny and Marthe Nyssens, *Conceptions of Social Enterprise in Europe*, p. 1 and Joseph W. Yockey, 'Does Social Enterprise Law Matter?' *Alabama Law Review*, 2014, Vol. 66:4:767, pp. 766-824, P.778 (herein after, Joseph W. Yockey, *Does Social Enterprise Law Matter?*)

¹⁸ British council, *The State of Social Enterprises in Ethiopian*, 2016, P. 7 (herein after, British council, *The State of Social Enterprises in Ethiopian*)

¹⁹ Id. p. 4ff

²⁰ "Ecopia// Welcome//Company", available at <<http://www.ecopia.de/>> accessed on February 23, 2018

²¹ "Africa's Need is Not Another Great Lamp Design– EnVent Energy Energizes Solar Lamp Distribution in Ethiopia (EcoStories)", available at <<http://www.bailiffafrica.org/africas-need-is-not-another-great-lamp-design-envent-energy-energizes-solar-lamp-distribution-in-ethiopia-ecostories/>> accessed on February 23, 2018

²² "SDUS Business Alum Builds School in Ethiopia" available at <<https://business.sdsu.edu/articles/2016/02/Ethiopia>> accessed on February 23, 2018

²³ "Oliberté's factory in Addis Ababa, Ethiopia: The world's first Fair Trade Certified™ footwear manufacturing factory" at <https://www.oliberte.com/pages/fair-trade-certified/>

²⁴ "Eminence Social Entrepreneurs" available at < <https://www.2merkato.com/directory/19911-eminence-social-entrepreneurs>> accessed on February 23, 2018

²⁵ British council, *The State of Social Enterprises in Ethiopian*, 2016, p. 27

²⁶ "Mission and Milestones", available at <<http://www.whizkidsworkshop.com/about/mission-milestones/>> accessed on February 23, 2018

²⁷ "Team-Tebita Ambulance", available at <<http://tebitaambulance.com/team/>> accessed on February 23, 2018. Tebita Ambulance is a social enterprise company established at Addis Ababa, Ethiopia with the primary of providing "emergency ambulance service, create awareness on first aid and health safety through formal trainings and mass media and advocate the development of well-organized emergency medical services and management." (taken from the profile of Tebita ambulance)

claim the status of social enterprise declaring that their primary aim is solving SEEC problems of the community.

Though the social enterprises business type is expanded in many jurisdictions in the world including Ethiopia, there is not yet a single agreeable definition given for it.²⁸ In some countries, especially in most European countries, the concept of ‘social enterprise’ is understood as “not-for-profit” legal entities that engage in commercial activities without profit distribution.²⁹ For example, in the Italy, social enterprises are understood as a private legal entity,³⁰ in for-profit or nonprofit legal form, that ‘perform *continuously and mainly economic activity* of production or exchange of goods and services of social utility, aimed at achieving *general interest goals*³¹ and “either *reinvest* those profits in *public benefit or use them to increase assets*³² (*emphasis added*). In some other countries, however, it is used to describe for-profit ventures that carry out a business to solve SEEC problems with possible distribution of limited profit to owners.³³ For example, in Belgium, it is understood as a company with ‘a purpose of serving members of the community rather than seeking profit, an independent management, a democratic decision-making process, and the primacy of people and labor over the capital in the distribution of income.’³⁴

Moreover, in the UK, it is defined as ‘a business with primarily social objectives whose surpluses are *principally reinvested* for that purpose in the business or in the community,

²⁸ Mark S. Blodgett et al, *Social Enterprise: Reaffirming Public Purpose Governance Through Shared Value*, p. 313

²⁹ Mystica M. Alexander, ‘A Comparative Look at International Approaches to Social Enterprise: Public Policy, Investment Structure, and Tax Incentives’, *William & Mary Business Law Review*, 2016, Vol.7, No 2, Pp. 1-34, at p. 9 (herein after, Mystica M. Alexander, *A Comparative Look at International Approaches to Social Enterprise*)

³⁰ *Ibid.*

³¹ Weisen Tang, *The Research on Social Enterprise Legal Systems —To Establish the Social Enterprise Legal System in China*, PhD Thesis, Doctoral School in Comparative And European Legal Studies, 2014-2015, (available at http://eprintsphd.biblio.unitn.it/.../The_research_on_social_enterprise_legal_systems_to_establish_the_social_enterprise_system_in_china.pdf >P. 16ff (herein after, Weisen Tang, *The Research on Social Enterprise Legal Systems —To Establish the Social Enterprise Legal System in China*)

³² Mystica m. Alexander, *A Comparative Look at International Approaches to Social Enterprise*, p. 9

³³ *Id.* p. 2

³⁴ Matthew F. Doeringer, *Fostering Social Enterprise: A Historical And International Analysis*, p. 308

rather than being driven by the need to maximise[sic] profit for shareholders and owners' (*Emphasis added*).³⁵ Furthermore, in South Korea, article 2 of the Social Enterprise Promotion Act enacted in 2006 (SEPA) defined social enterprise as;

“[T]hose companies that have been certified (...) that engage in business activities such as the production and sale of goods and services with the objective of achieving social goals, including providing vulnerable groups with social services or jobs, thus improving the local residents' quality of life.” Additionally, for an enterprise to be legally recognized as a social enterprise, the SEPA requires that it “adopt a decision-making structure where stakeholders (including service recipients, workers, etc.) are represented” and that “at least two-thirds of any profits generated (...) be used for the realization of social goals”, thus making the elements of participatory decision-making and social contribution mandatory requirements. (*Quotations in original*)³⁶

When we see the definition of social enterprise from the context of Ethiopia, we may not be able to get any literature or legal instrument that gives a clear definition of social enterprise. As the business is a newly developed business type, there is no any literature that attempts to define the concept of social enterprise from the Ethiopian context. In fact, an attempt is made in one literature to give some operational criteria of social enterprise. To mention it, a research conducted by British Council³⁷ tries to give some operational criteria of determining the social enterprise status of a business. According to this study, social enterprise is understood as a legal entity that fulfills the following criteria: (1) gives primacy for achievement of social goals or equal weight with the profit-making objective (2) drives its majority fund from its business operation, but can receive donation and (3) can distribute few profits but not as a primary mission.³⁸ Except for this criteria, there is no any attempt made thus far to define what mean by a social enterprise in Ethiopia.

Generally, there is no internationally accepted definition of social enterprise. Its definition varies from jurisdiction to jurisdiction. The main justification of the absence of a single internationally agreeable definition of social enterprise is that each definition

³⁵ Robert T. Esposito, *The Social Enterprise Revolution in Corporate Law*, p. 646

³⁶ Hwang Deok Soon et al, 'Social Enterprise in South Korea: International Comparative Social Enterprises Models (ICSEM)', ICSEM Working Papers No. 35, 2016, p. 4 (herein after, Hwang Deok Soon et al, *Social Enterprise in South Korea*)

³⁷ British council, *The State of Social Enterprises in Ethiopian*, P. 7

³⁸ *Ibid.*

of social enterprise is given based on the political, economic, social and cultural context of countries.³⁹ As each definition are given considering the context of the concerned country, the researcher refrain either from commenting on each definition or adopting a single definition for this research. Rather, the researcher opts to use a self-developed operational definition that will be used only for this research which is given below.

❖ **Operational Definition**

Social enterprise is a privately owned business that undertakes a business freely with the primary aim of solving SEEC problems of the community in tandem with limited profit distribution and that collects funds from multiple sources including donation. Such entities, from the outset registered as a for-profit legal entity, not as a non-profit entity or as a subsidiary of a nonprofit entity. Though their primary source of such entities is income generated from their business, they also receive funds from donations, debts and other sources of fund.

1.2. The problem of the study

As mentioned before, social enterprises are flourishing in Ethiopia in recent periods.⁴⁰ Investors undertake a business with a primary mission of solving SEEC problems with limited profit distribution to their private benefit.⁴¹ Though the initiation of operating a social enterprise comes from the investors' part, the government doesn't yet enact a special legal framework for such types of businesses. Currently, they are treated and regulated in the policy and regulatory regime of ordinary business.⁴² They are "licensed" and "registered" in scattered existing business legal forms including in partnerships, private limited companies (PLCs), and "sole traders" without being given a special business status.⁴³ They acquired the status of 'social enterprise' through self-declaration after they are licensed and registered as an ordinary business.⁴⁴

³⁹ Mystica m. Alexander, A Comparative Look at International Approaches to Social Enterprise, p. 2

⁴⁰ *Supra*, p. 3, Chapter One, Section, 1.1. Para. 3

⁴¹ British council, The State of Social Enterprises in Ethiopian, 2016, P. 7

⁴² *Id.* P. 37

⁴³ *Ibid.*

⁴⁴ *Id.*, p. 23

But, it has been heard when owners of social enterprises routinely describe their frustration about the absence of distinctive policy supports and regulatory regimes for their business_ social enterprise. Except for such frustration on the part of the social investors, there is no scientifically proved evidence, however, that whether Ethiopia needs to frame special policy and regulatory framework for social enterprise. There is no clarity whether there are factors that necessitate to give special support for social enterprises in Ethiopia. There is also some confusion that whether the existing business laws of Ethiopia fit to regulate social enterprises in the country. Specifically, it is not clear whether the existing business laws of Ethiopia fit to protect stakeholders of social enterprises such as customers, donors, and investors from the problem of “green/social washing”,⁴⁵ “legacy problem”,⁴⁶ “mission drift”,⁴⁷ and other related problems. Hence, the researcher conducted this study to explore critically all the aforementioned research concerns.

1.3. Literature Reviews

The area of the social enterprise doesn't yet attract the attention of legal researchers in Ethiopia. To the best knowledge of this researcher, there are only two pieces of literatures directly written on social enterprises in Ethiopia, both of which are written by non-legal professionals. The first is the survey study on ‘the state of social enterprises in Ethiopia’ conducted by British council in 2016.⁴⁸ The aim of this study was to better understand the profiles of social enterprises in Ethiopia, including providing an estimate size and scale of the social enterprise sector. The study deals with the ecosystem of all types of social enterprises in Ethiopia in general including cooperatives, NPOs with income-generating activities and for-profit social enterprises. This study found that,

⁴⁵ By definition, “green washing” refers to a situation where a business entity (social enterprises in this case) try to brand its organization as a green business or social driven to attract customers though it actually spends a nominal money for social and environmental investment (Alicia E. Plerhoples, *can an Old Dog Learn New Tricks?* p. 223)

⁴⁶ “Legacy problem” means the change of social enterprise status to other ordinary for-profit business by the transferee when there is transfer of ownership through sale, succession or else (Joseph W. Yockey, *Does Social Enterprise Law Matter?* P. 773)

⁴⁷ The term “mission drift” refers a situation where the preference of shareholders or managers shift away from its social mission to pursuit of profit as time goes by (Joseph W. Yockey, *Does Social Enterprise Law Matter?* P. 772-773)

⁴⁸ British council, *The State of Social Enterprises in Ethiopian*, 2016

inter alia, there is no special legal framework for social enterprises in Ethiopia, though the sector is growing. It found that social enterprises in Ethiopia are working within the existing policy and regulatory regime of business.

This study, however, failed to address whether there is an actual need to give special policy supports for social enterprises in the country. It also failed to show that whether the existing business law of Ethiopia fits to regulate social enterprises. It simply indicates the absence of a special legal framework for social enterprises in general and recommends for the enactment of a special legal framework of social enterprises without showing the possible problems of regulating them under the existing business laws. It also failed to identify the unique legal and regulatory concerns that a social enterprise regulation needs to address.

The second is an article on “Social Entrepreneurship: Literature Review and Current Practice in Ethiopia” written by Abdulnasir Abdulmelike.⁴⁹ As it can be inferred from the title itself, the main objective of this article was to review the literature of social enterprises and to assess the practices in Ethiopia. The writer tries to review foreign literature written on the definition, legitimation, and thoughts of social enterprises. Regarding the regulatory aspect, however, the writer adds little, except that he reiterates what has been found in the study conducted by British Council, mentioned above. The writer found that there is no special legal form for social enterprises in Ethiopia, inter alia.

This research differs from the above-elaborated literature by focusing only on the policy and regulatory environment of social enterprises in Ethiopia. In doing so, this study, first, assesses the existence of needs to give special policy support for social enterprises in the country. It also identifies the unique regulatory concerns of social enterprises that a social enterprise regulation needs to address and the possible problems that may arise

⁴⁹ Abdulnasir Abdulmelike, ‘Social Entrepreneurship: Literature Review and Current Practice in Ethiopia’, *European Journal of Business and Management*, 2017, Vol.9, No.31, PP. 86-93

if they don't well regulated. Second, it assesses that whether the existing business laws of Ethiopia fits to regulate such concerns of social enterprises. This research also attempts to show some practices of regulating social enterprises presently. Finally, it gives some recommendation with respect to each issue.

1.4. The objective of the Study

1.4.1. General Objective

The overall objective of this study was to assess whether Ethiopia needs to develop special policy and regulatory framework for social enterprises.

1.4.2. Specific Objectives

Having the above general objective, the study was endeavor to realize the following specific objectives;

1. To explore the existence of factors necessitate to frame a special policy for social enterprise in Ethiopia
2. To identify the regulatory concerns of social enterprises that a social enterprise regulation needs to address
3. To examine the suitability of the existing business laws of Ethiopia to regulate the concerns of social enterprise

1.5. Research Question

1.5.1. General Question

- Should Ethiopia develop a special policy and regulatory framework for social enterprise?

1.5.2. Specific Research Questions

1. Are there factors necessitate to frame special policy framework for social enterprise in Ethiopia?
2. What are the regulatory concerns of social enterprise?
3. Are the existing business laws of Ethiopia fit to regulate the unique concerns of social enterprise?

1.6. Delimitation of the Scope of the Study

Normally, the theme of social enterprises is very vast. It includes NGOs which drive their income primarily through operating business on a restricted area of business, cooperatives that operate a business to solve members' SEEC problems primarily, commercial businesses which discharge their CSR properly and privately owned businesses that undertake commercial activities freely to tackle SEEC problems of non-members primarily with limited distribution of profit to owners.⁵⁰ Just to make the scope more specific, the scope of this study is limited to the last type of legal entity i.e. voluntarily established private businesses that undertake an economic activity with the primary mission of addressing SEEC and distribution of limited amount of profit. Specifically, the scope of this study is limited to analyze the policy and regulatory environment of such type of social enterprise in Ethiopia. It is not the scope of this study to evaluate the actual status of the existing self-declared social enterprises in Ethiopia.

1.7. Significant of the Study

This study may be very helpful for any stakeholder in the area of social enterprises including researchers, government, and students. Chiefly, it may help to call the attention of the government to come up with a special policy and regulatory regime for social enterprise in Ethiopia. Particularly, it may be very helpful for drafters of social enterprise regulation and policy as it can be used as a reference. It can also serve as a steppingstone for further research on social enterprises by law scholars, writers and researchers. Lastly, it is very helpful for students, teachers and other readers to have some knowledge on the subject matter of social enterprise.

1.8. Research Methods and Methodology

1.8.1. Research Approach

As stated before, the study emphasizes on critical analysis that whether Ethiopia needs to develop special policy and regulatory framework for social enterprises. In doing so, the researcher specifically assess whether there are factors that necessitates to frame special policy supports for social enterprise in the country and whether the existing

⁵⁰ Mystica M. Alexander, A comparative Look at International Approaches to Social Enterprise, p. 2

business laws of Ethiopia fit to regulate the concern of social enterprise. It is not the purpose of this study to generalize the characteristics of samples to the whole population or quantifying the findings of the study, rather to describe the nature of the subject matter. To this end, it is the qualitative research approach that fits to conduct the study. The researcher, therefore, adopts qualitative research approach.

Under the qualitative research approach, a researcher principally adopts the doctrinal research type. Doctrinal research type is used to analyze national legislations including proclamations, regulations, and directives, and secondary sources including journal articles, books, theses, reports and newspapers. But, incidentally, the researcher employs empirical research type. It is used in some cases to substantiate the legal argument by the practice through interviewing social entrepreneurs, directors or managers of social enterprises, and concerned government officials from the Ministry of Trade (MOT) and Yeka Sub-city Administration Trade Licensing and Registration Bureau.

1.8.2. Data Sources and Collection Tools

While conducting the study, the researcher, basically employed both primary and secondary sources of data. Particularly, the researcher used primary data sources including national legislation of NPOs, cooperative societies, for-profit business organizations, and others. Since the focus of the study was to give the analysis of national documents and logic, the researcher adopted document analysis collection tool. Besides, the researcher used primary data collected through interview. Particularly, semi-structured interviewing was employed since it allowed the researcher to be somehow flexible and open to adapt depending on the circumstance and somehow predetermined to avoid informality. Interviews in face to face and through telephone calls were made with directors or managers of social enterprises, and with concerned government officials from the MOT and equivalent Trade Bureaus. The number of interviewees was determined based on data saturation as it was a qualitative research. The researcher used purposive sampling technique since this technique allows to select interviewees who have exposure on the area of study. Secondary data including journal articles, books, theses, reports, newspaper and comments were also used.

1.8.3. Data Analysis Technique

Since the researcher adopted a qualitative research approach, qualitative research data analysis technique was used. Firstly, the data was prepared through transcribing audio recordings of interviews to written forms, translated from the Amharic to English language, and made available commentaries on legislation. Secondly, the researcher familiarized himself with data to identify very significant data and adjusted them to each topic accordingly. Thirdly, the data was interpreted using coding, categorization, and themes. Finally, the data was verified against theoretical and legal arguments.

1.9. Limitation of the Study

While conducting the study, a researcher has faced inaccessibility of literature written both at the domestic and international level. On the one hand, the domestic literature on the subject matter is almost none. On the other hand, foreign literature related to the topic of this study requires fees to access them, which was very challenging for the researcher. However, the researcher tried to access such documents from friends who have access to such literature, especially from overseas Ethiopian students. Moreover, the researcher has faced challenges to identify business entities that considered themselves as a social enterprise in Ethiopia for the purpose of interviewing since there is no special status entitled to them by law. If there were a means to identify social enterprises existed currently in Ethiopia, it would have been easy to make an interview as to their attitude towards regulation of social enterprises in Ethiopia.

1.10. Organization of the Study

To make the study very precise, but comprehensive, the study is organized into four chapters. The first chapter addresses the introductory part of the study. Specifically, it includes the background of the study, the statement of the problem, literature reviews, and the objective of the study, research questions, the scope and limitation of the study, organization of the study, the research methodology and operational definition of social enterprises. On the second chapter, a brief elaboration is made on the general conceptual framework of the social enterprise including, origin and development, commonly shared

characteristics, justification to emerge, difference and similarity of social enterprises with other corporate models, and benefits and challenges.

Next, a brief analysis is made on the third chapter of the study about the social enterprise in Ethiopia and its policy and regulatory environment. Under this chapter, first, some general overview of social enterprises in Ethiopia is made. Second, an assessment is made whether there are factors necessitate to frame special policy regime for social enterprise in Ethiopia. Third, the suitability of existing business laws of Ethiopia to regulate social enterprises is assessed in light of the unique regulatory concerns of social enterprises. On the same part, assessments also made as to the current practice of regulating social enterprises in Ethiopia. Lastly, conclusions and recommendations are given in the fourth chapter of the study.

CHAPTER TWO: CONCEPTUAL UNDERPINNING OF SOCIAL ENTERPRISE

2.1. Introduction

In the first chapter of this paper, the researcher tries to give some introductory insights of social enterprise.⁵¹ Among others, the researcher attempts to discuss the definition of social enterprise. After analyzing different definitions given for social enterprise in different countries, the researcher gives an operational definition which is going to be employed only for the purpose of this study.⁵² Using that operational definition as a benchmark, in this chapter, the researcher makes an effort to give some other detail discussions on the concepts of social enterprises. In exploring the concepts of social enterprises, the researcher starts by elaborating the origin of social enterprise and its development in the international arena. After assessing the historical development of social enterprise, the researcher explores some other major conceptual issues of social enterprise, basically, by reviewing different pieces of literature written on each subject matter. The researcher, specifically, endeavors to explore the major features of social enterprise, the justifications for the emergence of such businesses, differences, and similarities of social enterprises from other legal entities, and finally about the major advantages and challenges of social enterprises.

2.2. Origin and Development of Social Enterprise

In its modern sense, social enterprise emerged first in Europe specifically in Italy in the 1980s and later on, expanded to other European and beyond European countries.⁵³ Social enterprise first originated from the nonprofit sector when “volunteers” undertake businesses to render “social services” and create job opportunity to the disadvantaged people.⁵⁴ It was in 1991 that social enterprise got an official recognition when the Italian

⁵¹ *Supra*, p. 1ff, Chapter One, Section 1.1

⁵² *Supra*, p. 6, Chapter One, Section 1.1.

⁵³ Carlo Borzaga, ‘The Concept and Practice of Social Enterprise. Lessons from the Italian Experience’, *International Review of Social Research*, 2012, Vol. 2, No. 2, pp. 85-102, p. 89 and Jacques Defourny & Marthe Nyssens, *Social Enterprise in Europe: Recent Trends and Developments*, EMES Research Network, 2001, P. 4 (herein after, Jacques Defourny & Marthe Nyssens, *Social Enterprise in Europe: Recent Trends and Developments*)

⁵⁴ Mystica M. Alexander, *A Comparative Look at International Approaches to Social Enterprise*, p. 9

government recognized it in a distinctive legislation_ social cooperative act (law 381/1991) and legal form_ social cooperative.⁵⁵ Unlike traditional co-operatives whose primary aim is to *serve its members*, the Italian social co-operatives aim at *serving non-member communities* by undertaking business with total inhibition of profit distribution to members (*emphasis added*).⁵⁶ Inspired by the development of social cooperative social enterprises in Italy, most European countries also introduced Italian like co-operative social enterprise at different times.⁵⁷ To mention few, Portugal introduced social solidarity co-operative in 1997, Spain introduced social initiative co-operative in 1999, Greece introduced limited liability social co-operative in 1999 and France introduced collective interest co-operative society in 2002.⁵⁸

Moreover, Italy also enacted another law on social enterprises in 2005 that allows any legal forms of entity, be it non-profit or for-profit, to operate as a social enterprise which is referred as “*social enterprise et lege*” (*emphasis added*).⁵⁹ This law also prohibits distribution of profit, and assets to owners even during dissolution period.⁶⁰ Through different times, most European countries introduced the not-for-profit social enterprise type which includes cooperatives, associations, foundations and mutual societies⁶¹. In general, the social enterprise in most European countries developed in the nonprofit sector through undertaking a business to resolve SEEC problems of non-member societies with total a prohibition of profit distribution and asset lock in the dissolution period. Such type of social enterprises categorized as a “not-for-profit” social enterprise.⁶²

⁵⁵ Mystica M. Alexander, A Comparative Look at International Approaches to Social Enterprise, p. 9

⁵⁶ Id. p. 5

⁵⁷ Jacques Defourny and Marthe Nyssens, Conceptions of Social Enterprise in Europe, p. 4

⁵⁸ Jacques Defourny & Marthe Nyssens, Social Enterprise in Europe: Recent Trends and Developments, p. 7

⁵⁹ Mystica M. Alexander, A Comparative Look at International Approaches to Social Enterprise p. 9

⁶⁰ Ibid

⁶¹ Jacques Defourny & Marthe Nyssens, ‘Social enterprise in Europe: At the crossroads of market, public policies and third sector’, *Policy and Society*, 2010, vol. 29, No. 3, pp. 231-24, pp. P. 232 (herein after, Jacques Defourny & Marthe Nyssens, Social enterprise in Europe: At the crossroads of market, public policies and third sector)

⁶² Jacques Defourny and Marthe Nyssens, Conceptions of Social Enterprise in Europe, P. 4

The concept of social enterprise, however, began also to develop in the for-profit sector.⁶³ For-profit entities began to engage in commercial activities with the prime motive of solving SEEC problems i.e. beyond the practice of corporate social responsibility, but with limited profit distribution to investors.⁶⁴ Such type of social enterprises called as a for-profit or hybrid social enterprise. This type of social enterprise “serves two masters, they have a profit motive, but their SEEC mission is at the core of their businesses.”⁶⁵ For-profit social enterprises officially recognized for the first time Belgium in 1995.⁶⁶ In 1995, the Belgium parliament passed a law that creates a legal form called “Société à Finalité Sociale (SFS)” for social enterprises.⁶⁷ SFS is a legal form designed for social enterprises that engage in the commercial activities primarily to solve SEEC problems with a total or partial (not more than 6% on the investor’s principal) restriction of profit distribution to owners.⁶⁸ Next to Belgium, for-profit social enterprise officially recognized in the UK in 2004.⁶⁹ Under the UK company act of 2004, the UK government recognized social enterprises in a distinct legal form called ‘community interest company (CIC).⁷⁰ UK’s CIC is a hybrid social enterprise model that integrates “the mission of creating social betterment with generating a profit for investors.”⁷¹ The parliament of UK opted to adopt for-profit social enterprise than not-for-profit social enterprise model by justifying that the former is better to raise capital through attracting investors by rewarding return for owners.⁷²

Similarly, in the United States, many states introduced for-profit social enterprise in their jurisdiction at different periods. Vermont is the first state of United States to introduce for-profit social enterprise in its jurisdiction.⁷³ It was in 2008 that Vermont

⁶³ Robert A. Katz' & Antony Page, ‘The Role of Social Enterprise’, *Vermont Law Review*, 2010, Vol. 35, pp. 59-103, p. 60-61 (herein after, Robert A. Katz' & Antony Page, The Role of Social Enterprise)

⁶⁴ Mystica M. Alexander, A Comparative Look at International Approaches to Social Enterprise p. 2

⁶⁵ Alicia E. Plerhoples, can an Old Dog Learn New Tricks? p. 223

⁶⁶ Matthew F. Doeringer, Fostering Social Enterprise: A Historical And International Analysis, p. 308

⁶⁷ Ibid.

⁶⁸ Id. p. 309

⁶⁹ Robert T. Esposito, The Social Enterprise Revolution in Corporate Law, P. 675ff

⁷⁰ Ibid.

⁷¹ Mystica m. Alexander, A Comparative Look at International Approaches to Social Enterprise, p. 12

⁷² Id. 13

⁷³ Robert T. Esposito, The Social Enterprise Revolution in Corporate Law, P. 682

introduced its own for-profit social enterprise legal form, named as low profit limited liability Company, along with its regulatory framework.⁷⁴ Afterward, many states of United States also introduced their own for-profit social enterprise legal and regulatory frameworks in their jurisdiction. For example, California introduced Flexible Purpose Corporations (FPCs) in 2011, Washington introduced Social Purpose Corporations (SPCs) in 2012, and Maryland introduced benefit Corporation (BC) in 2010.⁷⁵ In addition, California, Hawaii, Illinois, Louisiana, Massachusetts, New Jersey, New York, Pennsylvania, South Carolina, Vermont, Virginia, and the District of Columbia are states in the United States that introduced Benefit Corporation at different periods.⁷⁶ Contemporarily, the area of social enterprise attracts the attention of business schools and academicians.⁷⁷

Moreover, British Columbia and Nova Scotia in Canada have also introduced their own hybrid social enterprises legal forms namely Community Contribution Companies (C3s) in 2012, and Community Interest Companies (CICs) in 2012, respectively⁷⁸. These two hybrid social enterprise forms resemble the UK's Community Interest Company (CIC).⁷⁹ Like UK's CIC social enterprise model, these two forms of social enterprise designed to enable investors to do business to bring positive social and environmental externalities and at the same time to drive limited profit for owners.⁸⁰

In general, while in most European countries social enterprises were developed from the third sector, nonprofit sector, and treated as parts of the third sector, in the United States, they are treated as a fourth sector, in addition to public, private and nonprofit sectors.⁸¹ Moreover, unlike not-for-profit social enterprises of most European countries, for-profit social enterprises permitted to distribute profit for shareholders if they want,

⁷⁴ Robert T. Esposito, *The Social Enterprise Revolution in Corporate Law*, P. 682

⁷⁵ *Id.* P. 688ff

⁷⁶ *Id.*, 697

⁷⁷ Matthew F. Doeringer, *Fostering Social Enterprise: A Historical And International Analysis*, p. 292

⁷⁸ Pauline O'Connor, *The New Regulatory Regime for Social Enterprises in Canada: Potential Impacts on Nonprofit Growth and Sustainability*, P. 7

⁷⁹ *Ibid.*

⁸⁰ *Id.* p. 28ff

⁸¹ *Id.* P. 682

in addition to the duty of creating positive social and environmental externalities.⁸² Development of social enterprise both in the nonprofit and for-profit sector results in two categories of social enterprise namely for-profit social enterprise and not-for-profit social enterprise. While it is possible to share some amount of profit owners in case of for-profit social enterprises, it is totally prohibited to share profit to owners in non-profit social enterprises.

2.3. Major Features of Social Enterprises

As it can be inferred from the name itself, social enterprise has two dimensions namely the enterprise and social dimension. These two dimensions are the major characteristics of social enterprise. In appreciating the major features of social enterprises, one may say that social enterprises are the direct replicate of public enterprise. As different literature mentioned, similar to social enterprise, the public enterprise has two basic aspects i.e. public and private/enterprise dimension.⁸³ But this doesn't mean that all features of public and social enterprises are the same. For example, unlike public enterprises, social enterprises may not be necessarily fully owned by the public or society. Especially, in the case of for-profit social enterprise, there is no public ownership at all. The details of each dimension are elaborated herein under.

2.3.1. The Enterprise/Economic Feature

Basically, social enterprises undertake economic activities with the motive of generating profit.⁸⁴ As a type of enterprise, they continuously engage in the production and sale of goods and services.⁸⁵ Participating in the production and sale of goods and services is the very secret of their survival.⁸⁶ In doing so, they employ business methods, principles/disciplines, and strategies like that of profit-oriented businesses.⁸⁷ They

⁸² Pauline O'Connor, *The New Regulatory Regime for Social Enterprise in Canada: Potential Impacts on Nonprofit Growth and Sustainability*, P. 682

⁸³ Tewedros Meheret, 'The Concept and Characteristics of Public Enterprises in Ethiopia', *Mizan Law Review*, 2014, Vol. 8, No.2, pp. 333-370, at P. 342

⁸⁴ Keren G. Raz, 'Toward an Improved Legal Form For Social Enterprise', *New York University School of Law*, 2012, Vol. 36, PP. 283-310, (herein after, Keren G. Raz, *Toward an Improved Legal Form For Social Enterprise*)

⁸⁵ Robert A. Katz & Antony Page, 'Sustainable Business', *Emory Law Journal*, 2012-2013, Vol. 62, Pp. 851- 884, at P. 851 (herein After, Robert A. Katz & Antony Page, 'Sustainable Business')

⁸⁶ Jacques Defourny and Marthe Nyssens, *Conceptions of Social Enterprise in Europe*, p. 6

⁸⁷ *Ibid.*

interact with the market, other competitors and business regulatory institutions.⁸⁸ They involve in the market by taking business or economic risks, the risk of loss.⁸⁹ The profit motive of social enterprises makes them be efficient and innovator.⁹⁰ As a business entity, social enterprises strive to maximize their investment return by winning the competition that may face in the market.⁹¹ Financially, social enterprises primarily rely on incomes generated from their commercial activities.⁹² Though there are some other sources of funds of social enterprises such as grants and subsidies, driving an economic gain through engaging in the continuous manufacturing and sale of goods and services takes the lion share for financial sustainability of social enterprises.

The other enterprise feature of social enterprise is the distribution of profit to investors. As mentioned in the first chapter, distribution of profit is permitted in social enterprises of some countries, though it is not as the primary objective of the entity.⁹³ Especially in the for-profit social enterprises, investors are allowed to receive some limited amount of return from their investment in the social enterprises.⁹⁴ For example, in the UK⁹⁵, Belgium⁹⁶ and Canada⁹⁷, social enterprise investors can receive a restricted amount of dividend from the net profit of their business. Moreover, in the USA, sharing of profit to shareholders or owners from the surplus of the enterprise is allowed.⁹⁸ In fact, in some

⁸⁸ Nardia Haigh and Andrew J. Hoffman, 'Hybrid organizations: The Next Chapter of Sustainable Business', *Universe ScienceDirect*, 2012, vol. 41, pp. 126-134, p. 129 (herein after, Nardia Haigh and Andrew J. Hoffman, Hybrid organizations: The Next Chapter of Sustainable Business)

⁸⁹ Jacques Defourny and Marthe Nyssens, *Conceptions of Social Enterprise in Europe*, p. 6

⁹⁰ J. Gregory Dees and Beth Battle Anderson, 'For-Profit Social Ventures', in Marilyn L. Kourilsky and William B. Walstad, *Social Entrepreneurship*, 2003, Senate Hall Academic Publishing. Duke University, p. 5 (herein after, J. Gregory Dees and Beth Battle Anderson, For-Profit Social Ventures)

⁹¹ Ibid.

⁹² Robert A. Katz & Antony Page, 'Sustainable Business', P. 853

⁹³ *Supra*, p.4ff, Chapter One, section 1.1.

⁹⁴ Robert A. Katz & Antony Page, *the Role of Social enterprise*, P. 62

⁹⁵ In the UK, social enterprise investors allowed to receive a return from their investment provided that it is not more than 50% of the annual net profit of the business (Pauline O'Connor, *The new regulatory regime for social enterprise in Canada: potential impacts on nonprofit growth and sustainability*, P. 46)

⁹⁶ Social enterprise investors in Belgium permitted to receive the annual return from their social enterprise businesses not more than 6% of the investor's principal shares (Matthew F. Doeringer, *Fostering Social Enterprise: A Historical And International Analysis*, p. 309)

⁹⁷ For example, in a district of British Columbia and Nova Scotia, social enterprises allowed to distribute surplus to investors which shall not be exceeded 40% of the total annual profit of the enterprise (Dr. Pauline O'Connor, *The new regulatory regime for social enterprise in Canada: potential impacts on nonprofit growth and sustainability*)

⁹⁸ Mystica M. Alexander, *A Comparative Look at International Approaches to Social Enterprise*, p.5

countries like in Italy, social enterprises are totally prohibited to distribute profit to owners or members.⁹⁹ The enterprise dimension of social enterprise includes also the requirement of startup capitals, registration and licensing as a trader, entrepreneurial managerial system, the requirement of establishment and other internal statutes including memorandum and article of association, the keeping of book of accounts, annual financial report, and financial auditing.

2.3.2. The Social/Environmental Feature

The social and/or environmental dimension is the other bold feature of social enterprise legal entities. The major indicator of the social dimension of social enterprise is the very purpose of their formation. Social enterprises are created primarily to solve SEEC problems of the society.¹⁰⁰ Their core objective is the creation of “social value”¹⁰¹ and they, “rather than hiding behind their business as traditional for-profit businesses do”, describe their social objectives expressly.¹⁰² They, rather than donating some amount of money to charities, worry how to address a certain social problems that happen in the society.¹⁰³ As a type of social conscious entity, they reinvest the majority portion of their profit to solve SEEC problems of the community.¹⁰⁴ This clearly indicates the existence of social dimension in social enterprises.

In addition, in some countries, the social dimension of social enterprises includes social management system_ stakeholders’ participatory corporate governance system. “Representation and participation of users or customers, influences of various stakeholders on decision-making and a participative management often constitute important characteristics of social enterprises.”¹⁰⁵ For example, in Italy, social

⁹⁹ Mystica M. Alexander, A Comparative Look at International Approaches to Social Enterprise, p.5

¹⁰⁰ Fiona Wilson and James E., ‘Business models for people, planet (& profits): exploring the phenomena of social business, a market-based approach to social value creation’, *Small Business Economics*, 2013, Vol. 40, No. 3, pp. 715-737, at p. 716 (herein after, Fiona Wilson and James E., Business models for people, planet (& profits): exploring the phenomena of social business, a market-based approach to social value creation)

¹⁰¹ Ibid.

¹⁰² Dana Brakman Reiser, ‘Theorizing Forms For Social Enterprise’, *Emory Law Journal*, 2013, Vol. 62, Pp. 681-740, at p. 684, (herein after, *Dana Brakman Reiser, Theorizing Forms For Social Enterprise*)

¹⁰³ Keren G. Raz, Toward an Improved Legal Form For Social Enterprise, p. 290

¹⁰⁴ Mystica M. Alexander, A Comparative Look at International Approaches to Social Enterprise, P. 34

¹⁰⁵ Jacques Defourny and Marthe Nyssens, Conceptions of Social Enterprise in Europe, p. 7

enterprises required to include the participation of non-member stakeholders in the decision-making process.¹⁰⁶ Furthermore, the social dimension of social enterprises includes the public control feature.¹⁰⁷ Social enterprises are controlled/supervised by public authorities representing individuals to ensure the fulfillment of requirements of law and the alignment of social enterprise deeds to their original motive.¹⁰⁸

2.4. The Justification for the Emergence of Social Enterprise

2.4.1. Market and Government Failure

In principle, in a country where a free market economic policy is adopted, resources are left to be allocated by the market force.¹⁰⁹ Especially, in economically advanced states, allocation of scarce resources is mainly left to be made by the market itself.¹¹⁰ However, the market may not always allocate resources as efficient as it is expected. Societies in the world have been faced with different SEEC ills due to the “market failure” to allocate resources efficiently.¹¹¹ They have faced inaccessibility of public goods such as “national defense, basic infrastructure, environmental protection, listener-sponsored radio, improved race relations, and community development.”¹¹² Moreover, as a result of market failure, societies in the world have faced and are now facing the problem of illiteracy, poverty, poor health condition, and scarcity of consumption goods, income inequality, market price inflation, unemployment, social exclusion, famine, and others.

Seeking to correct the problem of market failure, the government of many countries began to intervene in the market.¹¹³ Governments intervene in the market in different ways including through using policy and regulatory instruments, and/or through direct

¹⁰⁶ Weisen Tang, *The Research on Social Enterprise Legal Systems —To Establish the Social Enterprise Legal System in China*, p. 18

¹⁰⁷ Policy Department C: Citizens' Rights and Constitutional Affairs of European Parliament, *A European Statute for Social and Solidarity-Based Enterprise*, European Union, Brussels, 2017, p.7 (herein after, Policy Department C: Citizens' Rights and Constitutional Affairs of European Parliament, *A European Statute for Social and Solidarity-Based Enterprise*)

¹⁰⁸ *Ibid.*

¹⁰⁹ Robert A. Katz' & Antony Page, *the Role of Social Enterprise*, P. 65

¹¹⁰ *Ibid.*

¹¹¹ Joseph W. Yockey, *Does Social Enterprise Law Matter?* p. 771

¹¹² Robert A. Katz' & Antony Page, *the Role of Social enterprise*, p. 65

¹¹³ Joseph W. Yockey, *Does Social Enterprise Law Matter?* p. 771

engagement in the economic activities. Governments enact regulatory legislation, and policies to prevent or correct problem of market failure.¹¹⁴ For example, governments of many countries enacted environmental pollution control legislation to control environmental pollution.¹¹⁵ Similarly, governments intervene directly in the market and engage in the economic activities through public enterprises or else with the aim of correcting the market failure. Practically, however, countries faced the problem of “government failure” like that of market failure.¹¹⁶ The government failed to rectify the problem of market failure due to budget deficit, “an unwieldy bureaucracy” and due to steadiness to respond as a result of “political infighting or pressures from special interest groups.”¹¹⁷ Hence, failure of market and failure of government to rectify the SEEC problems of the community justifies the emergence of social enterprise that undertakes a business with the primary aim of solving SEEC problems of the communities. Social enterprises are more responsive than the government as they have a voluntarily established deep commitment towards solving SEEC problems of the community.¹¹⁸

2.4.2. Backdrops of the Nonprofit Sector (NPOs)

The problem of ‘market and government failure’ necessitates countries to look for another way of remedy for such SEEC problems of the community from the third sector_ the non-profit sector. To begin with its definition, NPO lacks a single agreeable definition. It is defined differently in different jurisdictions and by different scholars and institutions. The researcher may not go through all such different definitions of NPO. But to mention few, the UN defines it as ‘a not-for-profit group, principally independent from the government, which is organized on a local, national or international level to address issues in support of the public good. Task oriented and made up of a people with a common interest’.¹¹⁹ It is also defined as “is one which is

¹¹⁴ Joseph W. Yockey, Does Social Enterprise Law Matter? P. 772

¹¹⁵ Ibid.

¹¹⁶ Weisen Tang, The Research on Social Enterprise Legal Systems —To Establish the Social Enterprise Legal System in China, p. 1ff

¹¹⁷ Joseph W. Yockey, Does Social Enterprise Law Matter? P. 772. Here, the term distribution is understood as a ‘payment of a dividend or any part of the income or profit of a corporation to its members, directors or officers. (Dana Brakman Reiser, Theorizing Forms For Social Enterprise, p. 686)

¹¹⁸ Ibid.

¹¹⁹ Sisay Habte Gemed, Doing Business via nonprofits: Lessons from the USA for Ethiopia, LL.M. Thesis, Central European University, 2015, (available at <www.etd.ceu.hu/2015/habte_sisay.pdf>), P. 7 (herein after, Sisay Habte Gemed, Doing Business via nonprofits)

not driven by profit but by dedication to a given cause that is the target of all income beyond what it takes to run the organization”.¹²⁰ Saving aside the variations in defining NPO, for the purpose of this study, it is understood as “a firm that can’t distribute net profit to the people who control or invest in it.”¹²¹

Nonprofit organizations asked to “revitalize cities; transform education, health, and social systems; strengthen civic and cultural institutions; and, in general, uplift [societies] collective spirits”.¹²² Accordingly, they have played a decisive role to uplift the society from some stressful SEEC ills.¹²³ They have worked in areas on education, health, environment, and other related areas to bring sustainable development in different countries.¹²⁴ Moreover, they have played a decisive role in helping persons who are impoverished and helpless.¹²⁵ However, though nonprofit entities have played some key roles to solve some stressful SEEC issues in the society, still, their contribution is restrained by the problem of capital constraint.¹²⁶ In different jurisdictions, nonprofit entities have faced inaccessibility of capital which is caused by restrictions imposed by law.¹²⁷

Firstly, nonprofit organizations inhibited from making distribution surplus to owners, founders, managers, members, or directors.¹²⁸ In the contemporary world, in most jurisdictions, NPOs are allowed to drive profit as that of traditional for-profit entities, but they are totally prohibited to distribute such profits to owners.¹²⁹ They must, rather,

¹²⁰ “Non-profit organization (NPO)”, available at <<https://whatis.techtarget.com/definition/non-profit-organization-NPO>> accessed on May 27, 2018

¹²¹ Brian D. Galle, ‘Social Enterprise: Who Needs It?’ *Boston College Law Review*, 2013, Vol. 54, PP. 2025-2045, at P. 2027 (herein After, Brian D. Galle, Social Enterprise: Who Needs It?)

¹²² Howard J. Berman, ‘Doing "Good" vs. Doing "Well": The Role of Nonprofits in Society’, *The Mc Nerney Forum*, 2002, Vol. 39, No. 1, pp. 5-11, at p. 8 (herein after, Howard J. Berman, Doing "Good" vs. Doing "Well": The Role of Nonprofits in Society)

¹²³ Id. p. 8

¹²⁴ Ibid.

¹²⁵ Ibid.

¹²⁶ Ibid.

¹²⁷ Michael D. Gottesman, ‘From Cobblestones to Pavement: The Legal Road Forward For The Creation Of Hybrid Social, Organizations’, *Yale Law & Policy Review*, 2007, Vol. 26, No. 1, Pp. 345-358, P. 345-349 (herein after, Michael D. Gottesman, From Cobblestones to Pavement)

¹²⁸ Joseph W. Yockey, Does Social Enterprise Law Matter?, P. 772

¹²⁹ Robert A. Katz' & Antony Page, The Role Of Social Enterprise, P. 68

employ the profit for the furtherance of their non-financial missions. Nonprofit entities allowed only to pay to controllers including managers, trustees, and directors a “reasonable or fair compensation” which is assessed against the amount of salary in other for-profit entities of the same condition.¹³⁰ Of course, “[t]he flip-side of the non-distribution constraint is an injunction to actively pursue the organization's social mission.” (Emphasis added)¹³¹ The non-distribution constraint may be an important tool to prevent controllers from using the resource of the entity for their private purpose. But, at the same time, this restriction compromises the ability of the nonprofit legal entities to attract equity investors.¹³² As a natural consequent, equity investors need to receive a return on their investment. But, in the case of nonprofit entities, owners or investors may not permitted to receive any private benefit directly or indirectly. Hence, it is hardly possible to access capital from equity investors in nonprofit organizations.¹³³

In fact, there are also jurisdictions which totally prohibit NPOs from undertaking income-generating activities at all. For example, in the Czech Republic, “foundations and funds” are totally inhibited from income-generating activities.¹³⁴ This total restriction exacerbates the capital constraint problems of NPOs.

Secondly, a legal restriction is imposed, in most jurisdictions, on the areas of economic activities to be pursued to generate income to support the mission of the entity.¹³⁵ Though nonprofit entities are allowed to engage in the economic activities to generate income for the furtherance of their mission,¹³⁶ in most jurisdictions, they are required by law to engage only in business areas that are related to the “*scope of [their] stated*

¹³⁰ Robert A. Katz' & Antony Page, *The Role Of Social Enterprise*, P. 67

¹³¹ *Ibid.*

¹³² Michael D. Gottesman, *From Cobblestones to Pavement*, p. 348

¹³³ *Ibid.*

¹³⁴ Douglas Rutzen et al, ‘The Legal Framework for Not-for-Profit Organizations in Central and Eastern Europe’, *International Journal of Not-for-Profit Law*, 2009, vol. 11, no. 2, P. 28

¹³⁵ Ross Kelley, ‘The Emerging Need for Hybrid Entities: Why California Should Become the Delaware of “Social Enterprise Law”’, *Loyola of Los Angeles Law Review*, 2014, Vol. 47, pp. 619-656, P. 627 (herein after, Ross Kelley, *The Emerging Need for Hybrid Entities*)

¹³⁶ Robert A. Katz' & Antony Page, *the Role of Social Enterprise*, p. 67-68

charitable or public purposes” (*emphasis added*).¹³⁷ Income-generating activities of NPOs required to be incidental to their charitable mission.¹³⁸ This restriction limits the ability of NPOs to be flexible in generating income for their mission by investing in the areas of businesses that are more profitable to them. Consequently, it causes them to have inadequate financial capacity and thereby weak social performance.

Thirdly, because of the above-mentioned restrictions of law, the source of fund for NPOs primarily rely on donations and grants.¹³⁹ However, the dependence of nonprofit entities on donor granted capitals has its own pitfalls. On the one hand, NPOs, especially those operating in developing countries, face a challenge to raise capital from donation since there are very *limited “pool of donors”* in such countries (*emphasis added*).¹⁴⁰ The existence of a very limited number of donors worsens the problem of capital constraint in NPOs.¹⁴¹ Moreover, the tax rules on deductibility of donations made to NPOs have a risk of discouraging donation or reduce the amounts of donations made by donors. In most jurisdictions, the amount of tax deductibility of donations made to NPOs is limited only to the extent of a certain percentage.¹⁴² Obviously, if the donor doesn’t receive the benefit of tax deductibility above a certain amount of percentage, it will limit its donation only to the extent of the percentage that the tax deductibility is allowed. This causes an insufficient amount of donation to NPOs by donors.

On the other hand, even when there is sufficient amount of donations granted by donors, the donors may impose a restriction on the NPOs how to and for what purpose should

¹³⁷ Ross Kelley, *The Emerging Need for Hybrid Entities*, p. 628

¹³⁸ Mark S. Blodgett et al, *Social Enterprise: Reaffirming Public Purpose Governance Through Shared Value*, P. 11

¹³⁹ Heather Sertia , ‘Hybrid Entities: Distributing Profits With A Purpose’, *Fordham Journal, Of Corporate & Financial Law*, 2012, Vol.17, Pp. 261-297, at P. 266 (herein after, Heather Sertia, ‘Hybrid Entities: Distributing Profits With A Purpose’)

¹⁴⁰ Ross Kelley, *The Emerging Need for Hybrid Entities*, p. 628

¹⁴¹ Heather Sertia, ‘Hybrid Entities: Distributing Profits With A Purpose’, P. 266

¹⁴² For example, in the United States of America, donations made by corporations are tax deductible provided that they are not above ten percent of the profit of the corporation and donations made above ten percent of the profit of the donor’s corporation is taxable at the normal tax rate given on the income tax law of the country (Matthew F. Doeringer, *Fostering Social Enterprise: A Historical And International Analysis*, p. 304)

the capital be used.¹⁴³ This restriction affects the decision of controllers of the entity such as directors, managers and founders not to be flexible.¹⁴⁴ This may also be an obstacle for NPOs to achieve their mission. All the above-mentioned limitations of NPOs led to the emergence of social enterprises that rectify the problem of capital constraint in the NPOs through engaging freely in the production and sale of goods. Social enterprises are better financially and thereby to solve SEEC problems than NPOs as they have multiple sources of funds including equities, profits, donations and other, and can engage in any business area without restriction.¹⁴⁵

2.4.3. The Limitations of Traditional For-profit Businesses

2.4.3.1. Shareholders Primacy Problem

Whether the objective of a corporation should thrive only to enhance the interests of shareholders or should it consider the interests of other stakeholders¹⁴⁶ that may be affected by the decision is a hotly debated issue that attracts the attention of many academicians.¹⁴⁷ This debate first began in the 1930s when a hot debate exchanged between Professors Adolf Berle and E. Merrick Dodd.¹⁴⁸ While professor Berle developed shareholder primacy approach, E. Merrick Dodd, on the other hand, adopted the ‘stakeholders’ approach to corporate governance.¹⁴⁹ Professor Berle argued that the *exclusive purpose of a corporation is to maximize the interest of its shareholders*, and managers or directors of the corporation should strive to realize this purpose (*emphasis added*).¹⁵⁰ While he expounds his argument, he asserts that ‘all powers granted to a

¹⁴³ Robert A. Katz' & Antony Page, the Role of Social Enterprise, p. 61 & 94

¹⁴⁴ Ibid.

¹⁴⁵ Dana Brakman Reiser, Theorizing Forms For Social Enterprise, p 772 and 773

¹⁴⁶ Here, the term stakeholder is used to refer “any group or individual who is affected by or can affect the achievement of an organization’s objectives”, thus including any person or entity that simply could assist in or benefit from a corporation’s success.’(Migle Matuleviciene and Jurgita Stravinskiene, ‘The Importance of Stakeholders for Corporate Reputation’, *Inzinerine Ekonomika-Engineering Economics*, 2015, vol.26, No.1, Pp. 75–83, at p. 71)

¹⁴⁷ Kevin V.Tu, ‘Socially Conscious Corporations and Shareholder Profit’, *The George Washington Law Review*, 2016, Vol. 84, No.1, pp. 121-181, at p. 122 (herein after, *Kevin V.Tu*, Socially Conscious Corporations and Shareholder Profit)

¹⁴⁸ Id. P. 123

¹⁴⁹ Tamara C. Belinfanti, ‘Contemplating The Gap-Filling Role Of Social Intrapreneurship’, *Oregon Law Review*, 2015-2016, Vol. 94, Pp.67-124, At P. 87 (herein after, Tamara C. Belinfanti, Contemplating The Gap-Filling Role Of Social Intrapreneurship)

¹⁵⁰ Id. p. 87-88

corporation or to the management of a corporation . . . are necessarily and at all times exercisable only for the ratable benefit of all the shareholders. . . .'¹⁵¹

Opposing to professor Berle's argument, Dodd argued that the purpose of a corporation shouldn't be limited to maximize the interest of shareholders' interest only, rather it shall also consider the interest of other stakeholders such as "providing secure jobs for employees, quality products for consumers, and contributions to the broader society".¹⁵² According to the stakeholders 'approach, "directors should consider the interests of *non-shareholder stakeholders* such as employees, customers, creditors, the environment, and the community, and balance those interests with profit goals" (*emphasis added*).¹⁵³ Following their hot debate, in 1954, Berle wrote that the debate was settled in favor of Dodd's argument.¹⁵⁴

The shareholder primacy debate, however, revived in 1970 when economists assert that the sole purpose of a corporation is to drive profit to owners or shareholders.¹⁵⁵ Specifically, the Nobel-prize Winner economist Milto Friedm "argued that given that shareholders "own" the Corporation, increasing profits should be the only responsibility of business."¹⁵⁶ In addition, in 2001, Henry Hansmann & Reinier Kraakman, on their article 'The End of History for Corporate Law' provide that "it is settled that the main purpose of corporate law is to maximize long-term Shareholder value, . . . and they claim that legal systems in other nations are converging towards this position, or will slowly but surely be drawn to it, in large part because of its inherent superiority (*internal quotations omitted*)."¹⁵⁷

¹⁵¹ Kevin V.Tu, Socially Conscious Corporations and Shareholder Profit, P. 128

¹⁵² Tamara C. Belinfanti, Contemplating The Gap-Filling Role Of Social Intrapreneurship, p. 88

¹⁵³ Kevin V.Tu, Socially Conscious Corporations and Shareholder Profit, p. 123

¹⁵⁴ Tamara C. Belinfanti, Contemplating The Gap-Filling Role Of Social Intrapreneurship, p. 88

¹⁵⁵ Ibid.

¹⁵⁶ Tamara C. Belinfanti, Contemplating The Gap-Filling Role Of Social Intrapreneurship, p. 88

¹⁵⁷ Henry Hansmann & Reinier Kraakman, 'The End of History for Corporate Law', *Georgia Law Journal*, 2001, Vol.89, at p. 439 as cited on Ian B.Lee, 'Corporate Law, Profit Maximization, and the "Responsible" Shareholder', *Stanford Journal of Law, Business & Finance*, 2005, Vol.10, No. 2, PP 31-72, at p.33 (herein after, Ian B.Lee, Corporate Law, Profit Maximization, and the "Responsible")

At the same time, some other scholars continue to pose their argument in favor of stakeholders' approach to corporate governance. For example, in 1995, Lawrence E. Mitchell, on his book entitled *Progressive Corporate Law: New Perspectives on Law, Culture, and Society*, argued that corporate laws should be structured in a way that considers the interests of the broader constituents.¹⁵⁸ He added that corporate laws should treat corporations, not as a private institution that strives to maximize profits to owners, but as a public institution that considers the interests of the broader society including even communities who have no any relationship with the entity.¹⁵⁹

Despite these persistent and still ongoing debates with respect to the responsibility of corporations, in recent times, scholars begin to converge to the argument that corporations, rather than focusing on maximizing the wealth of shareholders, should the responsibility to consider the interests of other stakeholders including employees, environment, communities, and others.¹⁶⁰ Importantly, in the contemporary world, for-profit businesses required to discharge their corporate social responsibility (CSR) towards other stakeholders in addition to driving profit to shareholders.¹⁶¹ In fact, the term corporate social responsibility lacks a single agreeable definition. Aside from the myriad number of definitions of CSR, for this research, it is understood as the “integration of social and environmental issues into the operations and goals of organizations.”¹⁶²

¹⁵⁸ Carol Liao, *For-Profit, Non-Profit, And Hybrid: The Global Emergence Of Legally ‘Good’ Corporations And The Canadian Experiment*, PhD Thesis, University Of British Columbia, The Faculty of Graduate And Postdoctoral Studies (Law), 2016, (available at www.allard.ubc.ca/sites/www.allard.ubc.ca/files/uploads/.../liaocvmarch2018a.pdf), P. 90-91 (Herein After, Carol Liao, *For-Profit, Non-Profit, And Hybrid: The Global Emergence Of Legally ‘Good’ Corporations And The Canadian Experiment*)

¹⁵⁹ *Id.* P. 91

¹⁶⁰ Kevin V.Tu, *Socially Conscious Corporations and Shareholder Profit*, P. 131

¹⁶¹ Animaw Demis Ejigu, *Corporate Social Responsibility in Ethiopia: Case Study of Bahirdar and Habesha Leather Factories*, Master's thesis, 2016, (available at Bahir Dar University School of Law Library), p. 3ff (herein after, Animaw Demis Ejigu, *Corporate Social Responsibility in Ethiopia: Case Study of Bahirdar and Habesha Leather Factories*).

¹⁶² Oluwakemi Kupolokun, *For-Profit Social Entrepreneurship: A Study Of Resources, Challenges, And Competencies In UK*, PhD dissertation, Goldsmiths College University of London, 2014 (available at http://research.gold.ac.uk/11394/1/ICCE_thesis_KupolokunO_2015.pdf) P.79

Nowadays, CSR attracts the attention of multinational corporations, corporate lawyers, countries and research institution. For example, in most jurisdictions of United States corporate controllers allowed to consider the interests of the other non-financial stakeholders including employees, environment, and society.¹⁶³ Similarly, the concept of CSR gets straightforward recognition in the European level.¹⁶⁴ To mention specific scenario, the UK government, for example, recognized a stakeholder's related approach_ an "enlightened shareholders value" under the 2006 companies act.¹⁶⁵ According to the "enlightened shareholders" approach, "corporations should pursue shareholder wealth with a long run orientation that seeks sustainable growth and profits based on responsible attention to the full range of relevant stakeholder interests."¹⁶⁶ According to section 127 of the act, directors required to act in the interest of owners, but they shall consider the effects of their decision on the interests of employees, suppliers, customers, community, and environment.¹⁶⁷ Businesses also began to spend many resources of their business to solve SEEC problems.¹⁶⁸ Despite the fact that there is some shifting of the debate from shareholders' primacy approach to stakeholders' approach, shareholders primacy approach remains the dominant feature of corporate governance of to date because of the law, the social norm and the force of stock market.¹⁶⁹ Below a clear elaboration has been made how the law, social norm and stock market exacerbate the problem of shareholders primacy.

¹⁶³ Thomas Kelley, Law and Choice of Entity on the Social Enterprise Frontier, *Tulane La W Review*, 2009, Vol. 84, pp. 337-,378, P. 350

¹⁶⁴. For example, in 2006, "the European Commission ("EC") enacted a Resolution entitled, "Corporate Social Responsibility: A New Partnership. In this resolution, Europe acknowledged that CSR has become "an increasingly important concept for competitiveness both globally and within the E.U., and is part of the debate about globalization, competitiveness and sustainability." In addition, the commission established CSR alliance that works to towards the development of CSR in the continent including "1) raising awareness and improving knowledge on CSR and reporting on its achievements; 2) helping to mainstream and develop open coalitions of cooperation; and 3) enabling the environment for CSR." (see Alissa Mickels, 'Beyond Corporate Social Responsibility, p. 276)

¹⁶⁵ Carol Liao, For-Profit, Non-Profit, And Hybrid: The Global Emergence of Legally 'Good' Corporations and The Canadian Experiment, p. 78

¹⁶⁶ Ibid.

¹⁶⁷ Ibid.

¹⁶⁸ Alissa Mickels, 'Beyond Corporate Social Responsibility, p. 279

¹⁶⁹ Judd F. Sneirso, 'The Sustainable Corporation And Shareholder Profits', *Wake Forest Law Review*, 2011, Vol. 42, PP 541-559, at P. 550 (herein after, Judd F. Sneirso, The Sustainable Corporation, and Shareholder Profits)

A. Corporate laws and profit maximization

The first cause for the insignificant role of for-profit oriented businesses in solving SEEC problems of the community is the existence of a law that obliges directors and managers to maximize the interests of owners irrespective of stakeholders' interest. Traditionally, corporate laws, especially corporate laws of the Anglo-Americans, impose a fiduciary duty on managers to act in the 'best interest of the corporation' including "duty of loyalty, the duty of care and duty of good faith".¹⁷⁰ These fiduciary duties require managers or directors to act in the "best interest of corporation".¹⁷¹ Literally, the fiduciary duties of managers or directors known to be a duty towards the corporation.¹⁷² However, through interpretation, these duties extended to shareholders of the corporation.¹⁷³ Fiduciary duties of managers or directors compel them to act in the best interest of both to the corporation and to its shareholders by disregarding the interests of the stakeholders of stakeholders.¹⁷⁴

In common law countries, shareholder primacy approach gets support even by case laws.¹⁷⁵ For example, in a case "*Guth v. Loft, Inc.*," the Delaware Supreme Court ruled that directors and officers have the duty of loyalty to the corporation particularly to "affirmatively protect the interests of the corporation" and to "refrain from acting to *injure the corporation or to deprive it of profit or advantage*" (*emphasis added*).¹⁷⁶ Moreover, in 1986, in a case '*Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, the supreme court of Delaware decided that directors have a duty to increase the wealth of shareholders during the sale of the corporation by selling at a higher price regardless of the interests of other stakeholders.¹⁷⁷ Fearing the liabilities that would arise in the consequence of breaching such duties, directors and managers

¹⁷⁰ Kevin V.Tu, *Socially Conscious Corporations and Shareholder Profit*, p. 132

¹⁷¹ *Ibid.*

¹⁷² Judd F. Sneirso, *The Sustainable Corporation, and Shareholder Profits* 551

¹⁷³ *Ibid.*

¹⁷⁴ Kevin V.Tu, *Socially Conscious Corporations, and Shareholder Profit*, p. 133

¹⁷⁵ *Ibid.*

¹⁷⁶ D.G. Smith, Andre S. Gold, *Research Handbook on Fiduciary Law*, in D.G. Smith, Andre S. Gold (ed.), *Research Handbooks Corporate law and Governance Series*, 1st ed., Edward Elgar Publishing Inc., UK, Cheltenham, 2018, P. 277

¹⁷⁷ Kevin V.Tu, *Socially Conscious Corporations, and Shareholder Profit*, p. 133

mostly favor the interest of shareholders than stakeholders' interest. Consequently, the role of corporations in solving the SEEC of the society remains very minimal.

In fact, recently, different countries including Anglo-American countries enacted statutes, others constituents' statutes, that allow manager, directors and other officers of a corporation to consider the interests of other constituents during decision making.¹⁷⁸ In the United States of America, for example, many states have enacted a constituents' statute that gives a discretionary power to the managers to take into account the interests of other non-shareholders' interest in “ day-to-day decision-making, change of control situations, and hostile takeovers”.¹⁷⁹ Yet, this approach doesn't avoid the dominance of shareholders interest maximization norm since such statutes don't permit managers and directors to pass a decision in favor of other stakeholders at the cost of shareholders.¹⁸⁰ In addition, though such statutes incorporate the CSR and stakeholders approach to corporate governance, these approaches by themselves have their own limitation. Proponents of both CSR and stakeholders' interest approach provides that considering the interests of non-shareholders' interest ultimately increases the corporations' profitability while they recommend for corporations to consider non-shareholders' interest.¹⁸¹ This assertion implies that, still, managers should consider stakeholders' interest thinking that it will increases ultimately the interests of the corporation, but not with the interest of protecting their interest. This indicates the “adherence to the status quo”_ the dominance of shareholders interest over other stakeholders' interest.¹⁸²

B. Social norms and profit maximization

In addition to the influence of law, the shareholder primacy problem is caused by the norm or perception that corporate managers have towards the purpose of the

¹⁷⁸ For example, in the United States, most states enacted a statute called 'other constituency statutes' that allow directors and officers to “consider all of the firm's constituencies-not just its shareholders-when determining what constitutes the company's best interests.” (Judd F. Sneirso, *The Sustainable Corporation And Shareholder Profits*, p. 553)

¹⁷⁹ Felicia R. Resor, 'Benefit Corporation Legislation', *Wyoming Law Review*, 2012, Vol. 12, Pp. 91-113, at P. 97 (herein after, Felicia R. Resor, 'Benefit Corporation Legislation')

¹⁸⁰ *Id.* p. 98

¹⁸¹ Carol Liao, *For-Profit, Non-Profit, And Hybrid: The Global Emergence Of Legally 'Good' Corporations And The Canadian Experiment*, p. 97

¹⁸² *Ibid.*

corporation.¹⁸³ By definition, norms are ‘informal Social regularities that individuals feel obligated to follow because of an internalized sense of duty, because of a fear of external non-legal sanctions, or both.’¹⁸⁴ It is commonly perceived norm that the directors’ duty is to maximize the interest of shareholders.¹⁸⁵ This perception is developed due to the influence of business schools, court rulings, academic writings, and Medias.¹⁸⁶ Though there is some sort of norm transformation from shareholders’ profit maximization to balancing both shareholders’ and stakeholders’ interest,¹⁸⁷ still, there is a persistent perception in most corporate managers, especially in the USA, that their primary duty is to maximize shareholders’ interest in the corporation.¹⁸⁸

C. Stock market force and profit maximization

The third contributory factor for the existence of shareholders’ primacy problem in corporate governance and thereby the weak participation of business in solving SEEC problems is the influence of the market force.¹⁸⁹ Normally, if the management has a good performance in maximizing the interests of shareholders, the stock of the corporation can be sold in a higher stock market price.¹⁹⁰ The price of the stock in the stock market determined based on the management performance of the corporation, among others_ a better managerial performance, a higher price of the corporation’s stock in the stock market.¹⁹¹ This can be done when managers decides against the interests of stakeholders interest that would have the effect of reducing the returns of shareholders.¹⁹² Similarly, the performance of managers evaluated based on the price of

¹⁸³ Judd F. Sneirso, *The Sustainable Corporation And Shareholder Profits*, p. 554

¹⁸⁴ Richard H. MacAdams, ‘the Origin, Development, and Regulation of Norms’, *Michigan Law Review*, 1997, vol.96, at p. 340 as cited by Judd F. Sneirso, *The Sustainable Corporation And Shareholder Profits*, p. 555

¹⁸⁵ J. Haskell Murray, ‘Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes’, *American University Business Law Review*, 2012, Vol.2, PP. 1-53, at p, 17 (herein after, J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*)

¹⁸⁶ *Id.* p. 17

¹⁸⁷ Judd F. Sneirso, *The Sustainable Corporation And Shareholder Profits*, p. 555

¹⁸⁸ J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, p. 18

¹⁸⁹ Ian B.Lee, *Corporate Law, Profit Maximization, and the "Responsible"*, p. 37

¹⁹⁰ *Ibid.*

¹⁹¹ Ian B.Lee, *Corporate Law, Profit Maximization, and the "Responsible"*, p. 37

¹⁹² *Ibid.*

the corporation's stock in the stock market, among other things.¹⁹³ This vicious circle forced managers to focus on maximizing shareholders' profit through selling stocks at a higher market price regardless of its impact on the stakeholders' interest. This exacerbates when the managers have a share from the profit of the stock sold in the stock market.¹⁹⁴ Managers prefer to sell a stock at a higher price to increase the capital of the corporation not to lose their position that would have lost provided that the corporation taken over by other corporation.¹⁹⁵ Thus, the influence of market causes managers to deviate from the stakeholders' approach of corporate governance and, rather, to lean to shareholders' maximization governance approach.

2.5. Difference and Similarities of Social Enterprise and Other Corporate and Non-corporate entities

2.5.1. Social Enterprises versus Nonprofit Organizations (NPOs)

By their very nature, both social enterprise and NPOs aimed primarily to achieve nonfinancial objectives i.e. solving SEEC problems of the community.¹⁹⁶ In both cases, they strive to achieve such nonfinancial missions through adopting business strategies that are practiced by traditional profit-making businesses. Nowadays, even NPOs are allowed to engage in commercial activities to generate income to fund their mission.¹⁹⁷ But, unlike nonprofit entities, social enterprises reward some sort of return to investors, as an incidental to their non-financial mission.¹⁹⁸ Except for payment of a reasonable compensation, nonprofit legal entities are totally prohibited to distribute profit to members or founders.¹⁹⁹ Because of the possibility of distributing a limited amount of profit to investors in social enterprises, social enterprises, unlike nonprofit entities, can issue equity security to raise their capital through attracting new equity investors.²⁰⁰ In

¹⁹³ Judd F. Sneirso, *The Sustainable Corporation And Shareholder Profits*, p. 556

¹⁹⁴ *Ibid.*

¹⁹⁵ *Ibid.*

¹⁹⁶ Robert A. Katz' & Antony Page, *the Role of Social enterprise*, P. 67ff

¹⁹⁷ "Should Nonprofits Seek Profits?", available at < <https://hbr.org/2005/02/should-nonprofits-seek-profits> > accessed on April 27, 2018

¹⁹⁸ Michael D. Gottesman, *From Cobblestones to Pavement*, P. 348

¹⁹⁹ Robert A. Katz' & Antony Page, *the Role of Social enterprise*, P. 67

²⁰⁰ Michael Blatchford and Margaret Mason, 'Introducing the Community Contribution Company: A New Structure for Social Enterprise', *presented for the Legal Education Society of Alberta*, 2013, p. 17 (herein after referred, Michael Blatchford and Margaret Mason, *Introducing the Community Contribution Company*)

addition, in most jurisdictions, if not all, nonprofit legal entities allowed to undertake entrepreneurial activities only on a certain limited areas of business.²⁰¹ But, social enterprises can engage in the production and sale of goods and services freely like that of traditional profit-making businesses.²⁰² Moreover, in some cases, social enterprises may receive a donation from donors like that of nonprofit legal entities.²⁰³

2.5.2. Social Enterprise versus For-profit Profit Business

At a first glance, one may suppose that social enterprise is the same as with a for-profit business that discharges its CSR properly since in both case, there is a blend of social and environmental missions to profit-making objective.²⁰⁴ But there is an observable difference between social enterprise and responsible business. In the case of responsible businesses, CSR is an “incidental” objective to the profit-making mission of a business.²⁰⁵ Contrary to this, profit-making is “incidental” to the social mission in case of social enterprises.²⁰⁶ While social enterprises make social goals a primary motive of their existence regardless of its impact on their businesses success, traditional for-profit businesses practice CSR thinking that it will increase a profit to their transaction.²⁰⁷ For-profit businesses practice CSR, not with a truly conscious of solving SEEC problems, but as a means of building a brand to their business.²⁰⁸ It is better to mention here, the slogan of Greyston to understand the difference between social enterprises and traditional for-profit entities. According to Greyston, ‘[social enterprises] don't hire people to bake brownies. [They] bake brownies to hire people.’²⁰⁹ In fact, traditional for-profit may hire people, for example, with an attractive salary. But that is the corollary or natural effect of doing a business, not a primary motive of their existence.

²⁰¹ Michael D. Gottesman, *From Cobblestones to Pavement*, p. 348

²⁰² Alissa Mickels, *Beyond Corporate Social Responsibility*, p. 281

²⁰³ Keren G. Raz, *Toward an Improved Legal Form For Social Enterprise*, p. 294-295

²⁰⁴ Mystica M. Alexander, *A Comparative Look at International Approaches to Social Enterprise*, p. 5

²⁰⁵ Joseph W. Yockey, *Does Social Enterprise Law Matter?* P.773

²⁰⁶ Keren G. Raz, *Toward an Improved Legal Form For Social Enterprise*, p. 289

²⁰⁷ Mystica M. Alexander, *A Comparative Look at International Approaches to Social Enterprise*, p. 6

²⁰⁸ *Ibid*

²⁰⁹ Alicia E. Plerhoples, ‘Representing Social Enterprise’, *Clinical Law Review*, 2013, vol. 20, 215- 265, at p.227 (herein after, Alicia E. Plerhoples, *Representing Social Enterprise*)

Unlike for-profit businesses, social enterprises enter a deep commitment that “animates everything it does” towards solving SEEC problems of societies.²¹⁰ As Reiser wrote;

Social enterprises Integrate philanthropy into their business models at a more basic level than companies that make corporate contributions or practice CSR. Social entrepreneurs pursue social and business goals together, viewing them as synergistic and mutually reinforcing, as equal partners in their business vision. This deep and particular commitment to philanthropic endeavor is the thrust of the social enterprise ideal.²¹¹

In general, though both social enterprise and responsible businesses are legal entities that blend non-financial objectives with profit-making objectives, they differ in that the former primarily aim solving SEEC problems, unlike traditional for-profit entities which make non-financial objectives always subordinate to their profit-making objective.²¹² They reinvest the principal amount of their profit to their mission with a possible distribution of a limited amount of profit to investors.

2.5.3. Social Enterprises versus Cooperatives

Social enterprises share some similarities and differences with cooperative legal entities. By definition, cooperative legal entities refer entities that “owned by, and run for the benefit of, its members - it has no external shareholders to pay in the form of dividends, and as such does not usually seek to maximize and make large profits or capital gains. [They] exist for the members to benefit from the services they provide.”²¹³ Like that of social enterprises, the primary mission of cooperative legal entities is to solve SEEC ills left unsolved by the public sector through adopting entrepreneurial strategies.²¹⁴ But unlike social enterprise whose main focus is to solve SEEC problems of non-members, cooperative legal entities primarily focus to address members’ SEEC problems.²¹⁵ In fact, currently, social enterprises may also use legal forms of cooperative, but with a different aim_ solving non-members’ problem primarily. For Example, in Europe,

²¹⁰ Joseph W. Yockey, Does Social Enterprise Law Matter? p. 774

²¹¹ Dana Brakman Reiser, ‘For-Profit Philanthropy’, *Fordham Law Review*, 2009, Vol.77, P. 2450, as cited by Joseph W. Yockey, Does Social Enterprise Law Matter? p. 774

²¹² Thomas Kelley, Law and Choice of Entity on the Social Enterprise Frontier, p. 351

²¹³ “Demutualization of Cooperatives: Reasons and Perspectives”, available at <www.coopgalor.com/doc/DemutualizationCooperatives21.5.08.pdf> accessed on April 26, 2018

²¹⁴ Antonio Fici, ‘Cooperatives and Social Enterprises: Comparative and Legal Profile’, in Burno Roelants, (ed.), Scalivini et al, *Cooperatives and social enterprises: Governance and normative framework*, 1st ed. CECOPA, CICOPA Europe, 2009, p. 80

²¹⁵ Demutualization of Cooperatives: Reasons and Perspectives”, available at <www.coopgalor.com/doc/DemutualizationCooperatives21.5.08.pdf> accessed on April 26, 2018

social enterprises operate in the cooperative legal form called social cooperatives.²¹⁶ Unlike traditional co-operatives model whose aim is to serve its members, the social co-operatives primarily aimed at to serve the community with profit non-distribution constraint.²¹⁷

2.6. Major Advantages of Social Enterprises

2.6.1. Financial Sustainability

The first basic advantage of social enterprise compared with other legal entities is financial sustainability. Here, financial sustainability refers when the financial input of a legal entity equals or exceeds its financial output or cost.²¹⁸ Since social enterprises generate profit through engaging actively and freely in commercial activities, they can become financially sustainable.²¹⁹ Indeed, the mere engagement of the enterprises in the economic activities may not necessarily make them financially sustainable. Rather, social enterprises become profitable and financially sustainable because of the existence of social branding of their goods and services in the market.²²⁰ Creation of a brand is the hallmark advantage that helps social enterprises to be financially sustainable.²²¹ The term brand, as defined by the American Marketing Association, refers ‘[a] name, term, design, symbol, or any other feature that identifies one seller’s good or service as distinct from those of other sellers.’²²² Since the primary, if not the exclusive, mission of social enterprise is to solve SEEC problems including unemployment, poverty, climate change, and others, its products and services will get acceptance on the part of customers, investors, and communities.²²³

²¹⁶ Jacques Defourny and Marthe Nyssens, Conceptions of Social Enterprise in Europe, p. 4ff

²¹⁷ Mystica m. Alexander, A Comparative Look at International Approaches to Social Enterprise, p. 5

²¹⁸ Robert A. Katz & Antony Page, ‘Sustainable Business, p. 853

²¹⁹ Id. p. 852

²²⁰ Robert A. Katz' & Antony Page, the Role of Social enterprise, P. 44

²²¹ Ibid.

²²² Dana Brakman Reiser, ‘Benefit Corporations —A Sustainable Form of Organization?’ *Wake Forest Law Review*, 2011, Vol. 46, pp. 591-625, at P. 621 (herein after, Dana Brakman Reiser, ‘Benefit Corporations —a Sustainable Form of Organization?’). see also “American Marketing Association”, available at <<https://www.ama.org/resources/Pages/Dictionary.aspx?dLetter=B>> accessed on April 21, 2018

²²³ Robert A. Katz' & Antony Page, the Role of Social enterprise, P. 44

To describe more succinctly, the deep commitment of the enterprise towards social and environmental missions helps the enterprise to build a brand to its products and services. To describe this advantageous of social enterprise Dana Brakman Reiser writes the following excerpt;

Nonprofits, in essence, sell their halo. When they offer products to consumers, affiliations to partners, and jobs to employees, they are selling a sense of righteousness or trustworthiness or both. Forprofits [sic] sell efficiency. They offer products of the highest quality and lowest price, affiliations to draw in revenue, jobs that pay a market wage, and training inefficient business operations. Social Entrepreneurs see themselves as offering something quite different. The Profit motive makes them lean, efficient, innovative. But, their Social mission keeps them virtuous and responsible. Thus, neither traditional nonprofit nor for-profit forms send the right message.²²⁴

From this excerpt, we can, at least, understand that social enterprises have an overriding advantage against the nonprofit and for-profit entities in branding its products and services and thereby to become financially sustainable. A detail discussion is made below about the advantage of branding in social enterprises.

2.6.1.1. Advantages of Social Branding

The existence of brand in the products and services of the social enterprise, in turn, has the following advantages to investors. Firstly, it helps to attract customers so that they can buy products and services of the enterprise in preference to products and services of other market competitors.²²⁵ Many consumers prefer to buy and use the products and services of social enterprises i.e. from businesses that are socially and /or environmentally oriented.²²⁶ For example, a survey study conducted in the USA in 2015 found that the preference of consumers to buy and pay more for the products and services of companies which have a deep commitment towards bringing “positive social and environmental impact” increases to 66% from 55% and 50% in 2014 and 2013 respectively.²²⁷ In another study made in the USA, it is found that 80% of consumers are interested to buy products of socially oriented business with 10% additional price from the price of the same product of other ordinary business.²²⁸The consumers’

²²⁴ Dana Brakman Reiser, ‘Benefit Corporations —A Sustainable Form of Organization? P. 622

²²⁵ Alicia E. Plerhopes, can an Old Dog Learn New Tricks? P. 235

²²⁶ Ibid.

²²⁷ Michael A. Hacker, “Profit, People, Planet” Perverted: Holding Benefit Corporations Accountable To Intended Beneficiaries, *Boston College Law Review*, 2016, Vol. 57, PP.1747-1780, P. 1754-1755 (herein after, Michael A. Hacker, “Profit, People, Planet” Perverted: Holding Benefit Corporations Accountable To Intended Beneficiaries)

²²⁸ Dana Brakman Reiser, *Theorizing Forms For Social Enterprise*, p. 323

preference towards products and services of social enterprises will also cause bidders to shift their attention to the products and services of such enterprises.²²⁹ Thus, branding helps the products and services of the enterprise to be competitive enough and override the stiff competition that they may face in the market from other market actors especially from the traditional for-profit businesses.

Secondly, the social branding will help social enterprises to attract socially conscious and talented employees.²³⁰ Employees may voluntarily receive a lower salary payment from social enterprise legal entities provided that the enterprise is socially and environmentally conscious.²³¹ This also ultimately contributes to the financial sustainability of social enterprises since it helps to reduce expenses of the enterprise in the form of wage payments. Thirdly, branding helps to attract “mission-sympathetic investors who might accept below-market returns in order to promote the social good.”²³² As mentioned somewhere before, social enterprises can issue equity securities to attract new equity investors. Logically, equity investors’ desire to invest in a certain business entity that has good reputation or branding. Hence, the existence of good reputation in its products and services will help the social enterprise to attract new equity investors.

Finally, the existence of brand in the product and services of social enterprise helps to attract “quasi-donor”.²³³ By definition, quasi-donor refers those bodies that buy products or services of a social enterprise with above market price with the view of assisting the enterprise to generate more revenue so that it can realize its social/altruism goal.²³⁴ Quasi-donors prefer to make a donation to social enterprises through over-payment for the purchases than pure donation since they receive goods or services in return for the payment and ... “may be convinced that the hybrid nature of social

²²⁹ Alicia E. Plerhoples, *Can An Old Dog Learn New Tricks?* P. 235

²³⁰ Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, p. 52

²³¹ *Ibid.*

²³² Robert A. Katz' & Antony Page, *the Role of Social enterprise*, P. 93

²³³ Dana Brakman Reiser, *Theorizing Forms For Social Enterprise*, p. 736

²³⁴ *Ibid.*

enterprise will produce more, better, or qualitatively different social good than will charities”.²³⁵ In general “[b]rands that establish a reputation for environmental stewardship among today’s youngest consumers have an opportunity to not only grow market share but build loyalty among the power-spending Millennials[sic] of tomorrow, too”.²³⁶ To sum up, branding helps the social enterprise to be financially sustainable and hence, reward investors more profit.

2.6.2. Mission Sustainability

Logically, the natural consequence of financial sustainability of social enterprises is mission sustainability. As repeatedly mentioned in the previous topics, the primary mission of social enterprise legal entities is to solve SEEC problems of the community. The financial strength of social enterprises helps them to realize their nonfinancial missions provided that there is a commitment of investors, managers, and directors of social enterprises to their nonfinancial objectives.²³⁷ Because of financial sustainability, social enterprises can easily supply “public goods and services” that are not adequately rendered by other sectors.²³⁸ It helps to reduce poverty, unemployment prevalence, famine, food insecurity, price inflation, climate change problem and other problems of the communities.

Social enterprises attempt to realize their SEEC missions using different methods. To mention them, firstly, they may use their purchasing system as a tool to realize their social/environmental missions.²³⁹ Specifically, social enterprises may realize their nonfinancial missions by purchasing goods and services of disadvantaged producers, market-friendly producers, or producers who have a market accessibility problem.²⁴⁰

²³⁵ Dana Brakman Reiser, *Theorizing Forms For Social Enterprise*, p. 736

²³⁶ Michael A. Hacker, “Profit, People, Planet” Perverted: Holding Benefit Corporations accountable to Intended Beneficiaries, p. 1755 (taken from the footnote and see also “Millennials Going Green Means Retail Must Follow” <<https://www.mytotalretail.com/article/millennials-going-green-means-retail-must-follow/>> accessed on April 21, 2018

²³⁷ Robert A. Katz & Antony Page, ‘Sustainable Business’, p. 851

²³⁸ Weisen Tang, *The Research on Social Enterprise Legal Systems —To Establish the Social Enterprise Legal System in China*, p. 44

²³⁹ J. Gregory Dees and Beth Battle Anderson, *For-Profit Social Ventures*, p. 4

²⁴⁰ *Ibid.*

Secondly, they may use their employment strategy to realize their mission.²⁴¹ This can be done through employing “*disadvantaged individuals* (such as people with disabilities, drug addicts, ex-convicts, homeless teens, etc.) with the goal of providing training and development opportunities” (*emphasis added*).²⁴² Thirdly, they may serve their social mission through producing goods and services which have a social benefit by their very nature such as education, environmentally friendly goods and services.²⁴³ Fourthly, they employ their methods of production as a means to achieve their nonfinancial missions.²⁴⁴ Lastly, they may use their marketing system as a strategy to achieve their mission which may include “Providing housing to the homeless, family planning for the rural poor, and food to the needy”.²⁴⁵

The mission sustainability of social enterprises, in turn, helps the government to realize sustainable development²⁴⁶ in the country.²⁴⁷ In the contemporary world, bringing a sustainable development is the hottest agenda that attracts the attention of governments. Governments of many countries work to bring sustainable development in their country. Practically, however, realizing such development remains a very challenging task of governments. The primary mission of social enterprises (nonfinancial mission) is directly related to the policy pillars of sustainable development (social, environmental, cultural and economic development). One may find that the mission of social enterprises revolves around the aforementioned pillars of sustainable development. They are working to reduce poverty, unemployment, income inequality, illiteracy rate, the prevalence of diseases and poor health condition, famine, pollution, deforestation,

²⁴¹ J. Gregory Dees and Beth Battle Anderson, *For-Profit Social Ventures*, p. 4

²⁴² *Ibid.*

²⁴³ *Ibid.*

²⁴⁴ *Ibid.*

²⁴⁵ *Id.* p. 5

²⁴⁶ Under this study, the term sustainable development is used to refer bringing an all-inclusive development in the three pillars namely social, environmental and economic development (“The Three Pillars of Sustainability”, available at <<http://www.thwink.org/sustain/glossary/ThreePillarsOfSustainability.htm>> accessed on April 26, 2018)

²⁴⁷ Andrew M. Wolk, *Social Entrepreneurship and Government: A New Breed of Entrepreneurs Developing Solutions to Social Problems*, 2007, p. 27ff or available at <<https://community-wealth.org/content/social-entrepreneurship-government-new-breed-entrepreneurs-developing-solutions-social-problems>> accessed on April 26, 2018

climate change and other. Even they help the government to reduce its expenditure in some areas and to shift to other most needy areas.²⁴⁸ Hence, social enterprises are the strategic tool to help the government in realizing its sustainable development policy.

2.7. Challenges of Social Enterprise

Though social enterprises have the above-mentioned advantages, they may also face some challenges which are elaborated below. The first big challenge for social enterprise is balancing the financial and nonfinancial objectives.²⁴⁹ Naturally, social enterprises blend two extremes in a single firm_ one extreme is making a profit to owners and the other extreme is solving SEEC problems of the society.²⁵⁰ They are motivated to realize both extremes simultaneously in a single entity. Even their achievement is measured by looking their achievements with respect to these two extremes.²⁵¹ But realizing these two extremes at the same time is a very challenging task. For example, in order to have a good social achievement, they may be obliged to compromise the profit to be distributed to owners.²⁵² Similarly, to have a good profit margin to owners, social enterprises may be obliged to compromise their social mission.²⁵³

The challenge of balancing these two extremes may be exacerbated when there is a mission drift problem by owners or managers of the social enterprises. Though originally social enterprises motivated to solve SEEC, through time, however, owners/managers of the social enterprise may be attracted by the profitability of social enterprises and may decide to drift away from the social mission that the enterprise had originally.²⁵⁴ This problem is called “mission drift” or “mission creep”.²⁵⁵ In the case of social enterprise, mission drift refers to the change of the mission of the enterprise from

²⁴⁸ Ross Kelley, *The Emerging Need for Hybrid Entities*, p. 651

²⁴⁹ “The challenges of social enterprise”, available at <<https://ethniccommunities.govt.nz/story/challenges-social-enterprise>> accessed on April 26, 2018

²⁵⁰ Nardia Haigh and Andrew J. Hoffman, *Hybrid organizations: The Next Chapter of Sustainable Business*, p. 131

²⁵¹ *Ibid.*

²⁵² J. Gregory Dees and Beth Battle Anderson, *For-Profit Social Ventures*, p. 12

²⁵³ *Ibid.*

²⁵⁴ Joseph W. Yockey, *Does Social Enterprise Law Matter?* p. 780

²⁵⁵ Ross Kelley, *The Emerging Need for Hybrid Entities*, p. 635

social and/ or environmental mission to wealth maximization of owners through driving much profit from their business.²⁵⁶ If social enterprises drift towards profit-making, by default, they will be changed from social enterprise to profit-making traditional businesses. This will ultimately affect the interests of stakeholders such as customers who always buy goods and services of such businesses believing that they are social oriented entities; donors that donate a fund to such businesses believing that their fund will be used for the social purpose by the enterprise and others.

The second possible challenge of social enterprises is that they may face stiff competition in the market from the side of traditional profit-making businesses.²⁵⁷ Since social enterprises are business entities, they undertake commercial activities in a market freely and compete with products and services of other profit-making entities. But the SEEC mission of such businesses adds a cost to them that doesn't exist in other profit-making businesses.²⁵⁸ Social enterprises may spend much money in realizing their social mission. This additional cost will undermine the quality of products and services of the social enterprises in relative to products and services of profit-oriented businesses.²⁵⁹ The third possible challenge is that difficulty of measuring the social achievement of social enterprises.²⁶⁰ As mentioned before, the success of social enterprises needs to be assessed both from the perspective of financial and social achievement. But the assessment of the social success of social enterprises becomes a very challenging task since social achievements, by their nature, are non-measurable in number.²⁶¹ It is hardly possible to measure the social success of social enterprises in “an efficient, timely, and reliable fashion” and this will cause stakeholders to be skeptics towards social enterprises.²⁶²

²⁵⁶ Joseph W. Yockey, Does Social Enterprise Law Matter? p. 780

²⁵⁷ J. Gregory Dees and Beth Battle Anderson, For-Profit Social Ventures, p. 9

²⁵⁸ Ibid.

²⁵⁹ Ibid.

²⁶⁰ James Austin et al, 'Social and commercial entrepreneurship: same, different, or both', *Entrepreneurship: Theory and Practice Journal*, 2006, vol.30, no.1, pp. 1-22, at p. 372 (herein after, James Austin et al, Social and commercial entrepreneurship: same, different, or both)

²⁶¹ James Austin et al, Social and commercial entrepreneurship: same, different, or both, P. 372

²⁶² J. Gregory Dees and Beth Battle Anderson, For-Profit Social Ventures, p. 8

CHAPTER THREE: SOCIAL ENTERPRISE IN ETHIOPIA: ANALYSIS OF POLICY NEEDS, REGULATORY CONCERNS AND PERTINENT OF EXISTING BUSINESS LEGAL REGIME

3.1. Introduction

The focus of the previous two chapters is to give some introductory and conceptual understanding of social enterprise in general. Having such a general concepts in mind, in this chapter, the researcher tries to give some critical analysis of social enterprise in Ethiopia with the focus of the policy and regulatory environment. In doing so, the chapter begins by providing general overview of social enterprise in Ethiopia. In addition, in the first chapter, it is touched that social enterprises in Ethiopia are treated as if they are a profit-oriented business without receiving any special policy support.²⁶³ There is no any proved evidence, however, whether they should be given special policy support or not. The second section of this chapter is, therefore, devoted to assessing the existence of factors that necessitate giving special policy supports for social enterprises in Ethiopia. The researcher attempts to explore some major justifications that may necessitate a special policy support for social enterprises in Ethiopia. By doing this, the researcher answers the first specific research question.

Moreover, in the second chapter, it is pointed out that social enterprise blends the social and profit-making missions in a single business undertaking.²⁶⁴ The first and foremost objective of social enterprise is to solve SEEC problems of societies using business strategies.²⁶⁵ Corresponding to solving SEEC problems, there is the motive of driving profit to be distributed to owners which is incidental to their primary social purpose.²⁶⁶ Social enterprise has also a blend of capitals collected from various sources of finance.²⁶⁷ To illustrate them, such enterprise may be financed by donor-funded, government subsidies, and investors'

²⁶³ *Supra*, p. 6, Chapter One, Section 1.2, Para. 1

²⁶⁴ *Supra*, p. 16-20, Chapter Two, section 2.3., Sub Section 2.3.1. and 2.3.2.

²⁶⁵ Robert A. Katz' & Antony Page, the Role of Social enterprise, P. 59

²⁶⁶ *Supra*, p. 19, Chapter two, Section 2.3.1, Para. 2

²⁶⁷ Benjamin M. Lef, 'Preventing Private Inurement in Tranched Social Enterprises', *Seton Law Review*, 2015, vol.45, pp. 1-62, at p. 13 (herein after, Benjamin M. Lef, Preventing Private Inurement in Tranched Social Enterprises)

contributions, direct loans from financial institutions, and incomes derived from their business.²⁶⁸

Because of these features, social enterprise has some unique regulatory concerns that need to be answered by social enterprise regulation. The third section of this chapter is, therefore, focused to identify such unique regulatory concerns of social enterprise. In this section, it is attempted to list out the regulatory concerns of social enterprise that will arise because of the aforementioned features. It is not the focus of this part, however, to identify the regulatory concerns that are shared with other ordinary for-profit businesses. An indication has also been made what problems will arise unless such concerns of social enterprise are not settled by law. By doing so, the researcher answers the second research specific research question of the study.

After identifying the unique concerns of social enterprise, the researcher tries to analyze the suitability of the existing business law of Ethiopia to regulate such concerns of social enterprise. As stated in the first chapter, currently, social enterprises in Ethiopia are operating through the existing legal and regulatory environment of for-profit businesses.²⁶⁹ There is no, however, scientifically researched finding whether the regulatory regime of ordinary business fits to regulate the concerns of social enterprise. The researcher, therefore, attempts in this part to analyze the pertinent of existing legal framework of business in Ethiopia vis-à-vis the unique regulatory concerns of social enterprise. In analyzing this, the researcher tries also to substantiate by showing the current practices in respect to regulating social enterprise in the country. By doing so, the researcher answers the third specific research question.

²⁶⁸ Benjamin M. Lef, Preventing Private Inurement in Tranched Social Enterprises, p. 13

²⁶⁹ *Supra*, p. 6, Chapter One, Section 1.2, Para. 1

3.2. Overview of the Concept of Social Enterprise in Ethiopia

In Ethiopia, similar to other countries, for a long period of time, legal entities were mainly grouped into two major sectors namely for-profit and non-profit.²⁷⁰ While for-profit legal entities aim to maximize owners' financial interest,²⁷¹ NPOs aim to address SEEC problems of societies without making a distribution of profit to members.²⁷² It was a noticeable fact that charity works such as solving the SEEC problems of the community were predominantly branded as the task of NPOs, in addition to government. NPOs have played a pivotal role in solving the SEEC problems that societies have faced in the history of the country.²⁷³ They were helping the community at the time of difficulties including famines through providing "reliefs and aids".²⁷⁴ Beyond rendering temporary reliefs and aids, they were also actively participating in the development policies that the country was implementing at different periods.²⁷⁵ The main source of funds for NPOs, in doing so, was from sources other than trade activities including donation, debt and membership fees.²⁷⁶

But unlike NPOs, for-profit legal entities gave a primary attention for maximizing the interests of investors or owners.²⁷⁷ This trend is, however, began to shift in the recent

²⁷⁰ Civil Code of the Empire of Ethiopia, 1960, *Negarit Gazzeta*, Extraordinary issue, Proc. No. 165, 19th year, No. 2, art 404 (herein after, Civil Code of the Empire of Ethiopia, Proc. No. 165/1965)

²⁷¹ Civil Code of the Empire of Ethiopia, Proc. No. 165/1965, art 405 and Commercial Code of the Empire of Ethiopia, 1966, *Negarit Gazzeta*, Extraordinary issue, Proc. No. 166, 19th year, No. 3, art 5, 210 of the commercial code (herein after, Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966)

²⁷² Civil Code of the Empire of Ethiopia, proc. No. 165/1965, art. 404

²⁷³ Sisay Habte Gemed, Doing Business via nonprofits: Lessons from the USA for Ethiopia, LL.M. Thesis, Central European University, 2015, (available at <www.etd.ceu.hu/2015/habte_sisay.pdf>), p. 29

²⁷⁴ Ibid.

²⁷⁵ Ibid.

²⁷⁶ As it is enshrined under article 25 of the commercial code of Ethiopia, nonprofit legal entities particularly the association typology of nonprofit prohibited to undertake any trade activities. In fact, there is a contradiction between article 405 of the civil code and article 25 of the commercial code. From article 405 of the civil code, it can be understood that associations, as one typology of nonprofit legal entities, can undertake income generating activities, though they are prohibited to share the profits to members. But, under article 25 of the commercial code of Ethiopia associations are prohibited to conduct any trade activities_ those activities listed under article 5 of the commercial code. In fact, currently, NPOs are enterprising themselves i.e. transforming from traditional donative based nonprofit to social enterprise status by engaging in income-generating economic activities as the law permits them to do so (Charities and Societies Proclamation, 2009, *Federal Negarit Gazeta*, Proc. No. 621, 15th year, No. 25, art. 103 (herein after, Charities and societies proc. No. 621/ 2009))

²⁷⁷ *Infra*, p. 51, *Supra* note, Chapter Three, Section 1.1. Para. 2

periods as charity works start to be done by private investors, social entrepreneurs, through establishing a social enterprise business type.²⁷⁸ In the contemporary time, investors have started to depart from the profit maximization norm of businesses and operate a business with the primary motive of addressing SEEC ills of the society by consider themselves as a social entrepreneur.²⁷⁹ They participate actively in addressing SEEC problems which include unemployment, health-related problems, environmental problems, illiteracy, poverty, social exclusion and other SEEC problems.²⁸⁰ In doing so, they collect their operational funds primarily by engaging in the production and sale of goods and services.²⁸¹ They keenly undertake an economic activity to drive sufficient income for their non-financial mission.²⁸² Surprisingly, some social enterprises also receive a direct donation from donors as an additional source of funding their operation declaring that they are working to improve the life of the community.²⁸³ Some also fund their enterprise through collecting money using internet system which is known as

²⁷⁸ *Supra*, p. 3, Chapter One, Section 1.1, Para. 2

²⁷⁹ *Supra*, p. 3, Chapter One, Section 1.1, Para. 2

²⁸⁰ British council, *The State of Social Enterprises in Ethiopia*, p. 24

²⁸¹ For example, as Tenagne Degefu, Administration Manager of Tebita Ambulance, indicated that Tebita Ambulance renders an ambulance service in a reduced or zero price for the people who can't afford to pay by adopting cross subsidization approach. Specifically, it subsidizes itself by the income derived from services given for international NGOs, Embassies, and others (Interview with Tenagne Degefu, Administration Manager of Tebita Ambulance, *on the financial source of social enterprises in Ethiopia*, April 28, 2018)

²⁸² "Understanding Social Entrepreneurship", available at <https://www.thereporterethiopia.com/content/understanding-social-entrepreneurship> accessed on May 12, 2018

²⁸³ For example, Tebita Ambulance received both a technical assistance and cash assistance from American Webster state University and Norway Partners for Change respectively ((Interview with Tenagne Degefu, Administration Manager of Tebita Ambulance, *on the financial source of social enterprises in Ethiopia*, April 28, 2018). It got these grants to subsidize the Tebita Paramedic College that is established under the Tebita Ambulance and which is giving a free education for free for sixteen students (Ibid.). Another example of a social enterprise that receive a fund from donors is Whiz Kids Workshop PLC. which "runs a series of innovative media programmes(sic) that educate millions of children and youth in both urban and rural areas across Ethiopia, offering entertaining and culturally relevant content" (Ethiopian Social Enterprise Delivers Pioneering Innovative Education Programs at Scale", available at <https://ethiopia.britishcouncil.org/about/press/ethiopian-social-enterprise-delivers-pioneering-innovative-education-programmes-scale>) accessed on May 14, 2018. This social enterprise receive a funding support from the British Council that works to support social enterprises in the Eastern Africa by designing a project named as "the *Support for Social Enterprises in Eastern Africa* project"(Ibid). This company also received a donation from the USAID to fund activity in "the production of the Tsehai Loves Learning educational T.V. series" (USAID-funded TV Series to boost Reading, Writing, and Social skills", <https://et.usembassy.gov/usaaid-funded-tv-series-boost-reading-writing-social-skills/>) available at accessed May 14, 2018)

“crow funding” system.²⁸⁴ In addition to solving the SEEC problem of the community, social entrepreneurs who invest their money in the social enterprise also receive a limited portion of dividend or profit from their investment.²⁸⁵ The amount of the profit to be distributed to owners is, in fact, determined by owners of social enterprises depending on the profitability of their business.²⁸⁶ Though they receive some amount of profit from their enterprise, social entrepreneurs contend that their motive of profit-making is subordinate to their Non-financial mission.²⁸⁷ Nevertheless, appreciating the existence of some good beginnings of the practice of social enterprise in the country, it is yet in its infant stage.²⁸⁸ Most social enterprises were established after 2010.²⁸⁹ Having this introductory concept of the state of social enterprises in Ethiopia in mind, in the next sections, the researcher tries to assess whether Ethiopia needs to develop a special policy and regulatory framework for social enterprise.

3.3. Appraisal of Policy Needs of Social Enterprise in Ethiopia

As mentioned in the first chapter, currently, there is no a special policy framework designed for social enterprises in Ethiopia.²⁹⁰ As Mr. Yoseph Alemu, Director of Share Companies and Sector Association Follow Up and Support Directorate at the Federal Ministry of Trade (FMOT), stated there is not even any attempt or beginning on the part of the government to give a special policy support for social enterprises in Ethiopia.²⁹¹ They are, rather, treated in the policy environment of ordinary-for profit

²⁸⁴ For example, Whiz Kids Workshop PLC. Collects money through crow funding to fund “Tsehai’s Amharic Classroom Library Project to build libraries in Ethiopian public elementary schools.” (“Ethiopian Entrepreneur Bruktawit Tigabu Launches Crowdfunding [Sic] Campaign for Tsehai’s Amharic Classroom Library Project”, available at < <http://www.zehabesha.com/ethiopian-entrepreneur-bruktawit-tigabu-launches-crowdfunding-campaign-for-tsehai-amharic-classroom-library-project/>> accessed on May 14, 2018)

²⁸⁵ Interview with Tenagne Degefu, Administration Manager of Tebita Ambulance, *on the profit allocation policy of social enterprises in Ethiopia*, April 28, 2018.

²⁸⁶ Ibid.

²⁸⁷ “Understanding Social Entrepreneurship”, available at <<https://www.thereporterethiopia.com/content/understanding-social-entrepreneurship>> accessed on May 12, 2018

²⁸⁸ British council, *The State of Social Enterprises in Ethiopian*, p. 14

²⁸⁹ Id. p. 21

²⁹⁰ *Supra*, p. 6, Chapter One, Section 1.2, Para. 1

²⁹¹ Interview with Mr. Yoseph Alemu, Director of Share Companies and Sector Association Follow Up and Support Directorate at the FMOT, *on the needs of policy support of social enterprise businesses in Ethiopia*, May 3, 2018.

businesses.²⁹² They receive a government policy supports only when that support is available for other for-profit businesses. Given this fact, the next issue is should Ethiopia come up with a special policy framework for social enterprise. To describe otherwise, is there a need to give special policy support for social enterprises in Ethiopia? To answer this issue, the researcher tries to examine it from two perspectives i.e. from the perspective of the importance of social enterprise business type for the country and from the perspective of practical challenges that existing social enterprises are facing because of the absence of a special policy supports.

3.3.1. The Importance of Social Enterprise for Ethiopia

To begin with, normally, a country needs to worry about giving special policy supports or encouragements for a particular business type, for social enterprises in this case, only if the development of such business has some overriding worth over other business types. Coming to the existence of needs for development of social enterprises in Ethiopia, in the opinion of this researcher, there are two major reasons that necessitate the development of social enterprises in Ethiopia. The first one is the existence of severe SEEC problems in the country and the potentiality of social enterprise to solve such troubles. People in the country have been and are now suffering innumerable SEEC problems. Without overlooking the achievements made by the country in reducing such problems, one can still confidently speak that illiteracy, poor health condition, market price inflation, unemployment, social exclusion, income inequality, climate changes, poor technological development and poverty are the headache of the Ethiopian society.

Given these deeply rooted problems in the country, it is incontestable that Ethiopia needs to encourage a social enterprise business type which strives principally to solve SEEC problems of the community. By the very nature, social enterprises are essential tools to solve SEEC problems of the societies as they are primarily working to eliminate such problems using business strategies and principles.²⁹³ Practically also, they are playing a pivotal role in solving social and environmental problems of the society in

²⁹² Interview with Mr. Yoseph Alemu, Director of Share Companies and Sector Association Follow Up and Support Directorate at the FMOT, *on the needs of policy support of social enterprise businesses in Ethiopia*, May 3, 2018.

²⁹³ See, *supra*, p. 20, Chapter Two, Section 2.3, Sub section 2.3.2. Para. 1

Ethiopia through adopting a business method.²⁹⁴ They are playing a significant role in reducing unemployment, improving the health condition, education, and life of the societies, solving environmental problems and assisting socially excluded societies.²⁹⁵ By doing these, they are assisting the Ethiopian government to achieve its sustainable development goals. If so, such type of business shall be encouraged through providing special policy supports. Regarding this issue, Mr. Yoseph Alemu argues that so long as social enterprises are working to cut down, if not to avoid, SEEC problems of the community, they have to be facilitated in Ethiopia through providing different policy supports. Generally, the existence of innumerable SEEC problems in Ethiopia and social enterprises' role addressing such problems can be raised as one justification to encourage them and, in turn, to give special policy supports.

The second justification for the need to encourage social enterprises in Ethiopia is the limitations of other sectors namely the nonprofits, for-profit and public sectors towards solving SEEC problems. Mostly, tackling the SEEC problems of the society, for a long period of time, has been left to be the task of the government and NPOs in Ethiopia. But neither of them able to solve such problems satisfactorily due to different limitations. They unable to address such problems adequately because of the budget and capital constraint respectively. Though the government has deeply rooted motivation in addressing SEEC problems in the country, it unable to become successful in addressing such problems due to budget limitation.²⁹⁶ Similarly, the role of nonprofit legal entities in solving SEEC problems is very limited due to the problem of capital constraint which caused by the legal restrictions imposed by law.²⁹⁷ Among the current restrictions imposed by law, restriction of Ethiopian charities and societies not to use beyond 10% of their fund from abroad,²⁹⁸ restriction of the area of business to be pursued by NPOs

²⁹⁴ British Council, *The State of Social Enterprises in Ethiopia*, p. 24

²⁹⁵ *Ibid.*

²⁹⁶ Interview with Mr. Yoseph Alemu, Director of Share Companies and Sector Association Follow Up and Support Directorate at the FMOT, *on the needs of policy support of social enterprise businesses in Ethiopia*, may 3, 2018

²⁹⁷ Gebre Yntiso Deko, 'Civil Society and Income Generation Activities in Ethiopia', *Development Assistant Group Ethiopia, Final Report*, 2012, P.42-43 (herein after, Gebre Yntiso Deko, *Civil Society and Income Generation Activities in Ethiopia*)

²⁹⁸ Charities and societies proclamation no 621/ 2009, art 2

only to areas related to the purpose of the entity²⁹⁹ and limiting the tax deductibility of donations made to nonprofit entities to 10%³⁰⁰ are the major contributing factors for problem of capital constraint and thereby to the minimal role of NPOs in addressing SEEC problems in the country. The researcher believes that social enterprise can fill these limitations of NPOs and the public sector as they have multiple sources of funds including equity capitals, incomes from their business, donations, contributions, and others. Even they can engage in any profitable area of businesses without any legal restriction since they are private investor-owned businesses. This will help them to be financially strong and successful in addressing SEEC problems of the community better than other sectors.

Moreover, as a matter of practice, if not law, for-profit businesses in Ethiopia have the problem of shareholders primacy. In most cases, in the corporate culture of Ethiopia, the profit-making objective is given priority over solving the SEEC problems of the community. Mostly, the role of private businesses is limited to donating a very little amount of money out of their tens of million profit waiting for the occurrence of some incident or problem.³⁰¹ Badly to say, some private businesses even failed to discharge their CSR properly, let alone to work to solve SEEC problems as their primary mission.³⁰² Social enterprises can reverse this problem as they give primacy for solving

²⁹⁹ የበጎ አድራጎት ድርጅቶችና ማኅበራት የገቢ ማስገኛ ሰራዊት ላይ የሚሰማሩበትን ሁኔታ ለመወሰን የወጣ መመሪያ ቁጥር 07፣ የበጎ አድራጎት ድርጅቶችና ማኅበራት ኤጀሲ፣ 2004, አንቀጽ 5 (ከዚህ ቀጥሎ፣ የበጎ አድራጎት ድርጅቶችና ማኅበራት የገቢ ማስገኛ ሰራዊት ላይ የሚሰማሩበትን ሁኔታ ለመወሰን የወጣ መመሪያ ቁጥር 07/2004)

³⁰⁰ Federal Income Tax Proclamation no. 979/2016, art. 24/2

³⁰¹ To mention an example, Dashin Bank spent only 1.34 million for social purpose (through donation) in the 2015/2016 fiscal year which is very nominal while its gross profit was 223, 559, 764 birr (Dashin bank 20th annual report of 2015/2016, p. 16 and 23).

³⁰² Though some multinational corporations (MNC) recently started to adopt policy of CSR under their corporation policy, almost all national companies and government organizations don't properly discharge their CSR (Kassaye Deyassa, 'CSR from Ethiopian Perspective', *International Journal of Scientific & Technology Research*, 2016, Vol. 5, No. 04, pp. 299-328, p. 622). For example, , it is found that the private commercial banks in Ethiopia have looser attitude towards financing green industries, lending for low income communities, and less engagement in community development (Yeneneh Tadesse, on the Role of Private Commercial Banks on Corporate Social Responsibility in Ethiopia, MA thesis, Addis Ababa University, Department of Accounting and Finance, June 2015, (available at Addis Ababa University Repository), pp. 40-48)

SEEC problems of the community. This enables them to address the shareholders' primacy problem in the case of for-profit businesses.

Once social enterprises are proven to play a pivotal role in solving the SEEC problems of the society in Ethiopia in a better way than other categories of businesses and sectors, then, they need to be boosted in the country. One means of developing such business type in a country is through providing policy supports. It is an obvious fact that policy supports are the benchmark for the growth of a sector or businesses in a country. The desire of a country to encourage a certain form of business shall be preceded by the act of framing favorable policy environment for such business. Thus, there is a need to give a special policy support for social enterprises in Ethiopia as there is a special need for their development in the country.

3.3.2. Practical Challenges Faced by Social Enterprises in Ethiopia

To justify the existence of needs to give special policy supports for social enterprises, first, it is better to assess whether there are challenges that social enterprises face due to the absence of special policy supports. Presently, because of the absence of special policy attention for social enterprise in Ethiopia, existing social enterprises face some critical challenges that would have otherwise been solved through special policy instruments. To see such challenges, first, there is a problem of low level of understanding about the concept of social enterprises on the side of the community in the country.³⁰³ Surprisingly, as Mr. Yoseph Alemu describes there is even lack of awareness about the nature of social enterprises operating in the country on the part of government officials, let alone on the part of the community.³⁰⁴ As this type of business is a newly developed category of business in the country, there is a critical problem of lack of awareness about the nature or purpose of such business.³⁰⁵ Most persons see

³⁰³ Interview with Tenagne Degefu, Administration Manager of Tebita Ambulance, *on practical challenges of social enterprises faced due to the absence of special policy support*, April 30, 2018

³⁰⁴ Interview with Yoseph Alemu, Director of Share Companies and Sector Association Follow Up and Support Directorate at the FMOT, *on the needs of policy support of social enterprise businesses in Ethiopia*, may 3, 2018

³⁰⁵ Ibid.

such business as an ordinary profit-making business, though they are working primarily to solve SEEC problems of the community.³⁰⁶

The poor understanding of the community about social enterprises has its own negative impact on the development of such business in the country. Customers will not, for example, buy products and services of such businesses in preference to products and services of other profit-oriented businesses unless they have a clear understanding of the nature of such businesses. Similarly, donors may not support social enterprises unless they have knowledge about such business. Social conscious investors may not also buy equities of social enterprise. Financial institutions may not be voluntary to give a loan for such type of businesses unless they are well familiarized as to the business nature of such enterprises. Donors, individuals, and other stakeholders should have clear knowledge about the nature of social enterprise in general and the value it may create for the community. It is only when the category of business gets acceptance on the part of the community that it can be easily breakthrough in the country.

Second, there is a problem of low level of the skill of blending social and profit missions in a single entity on the part of investors.³⁰⁷ Normally, realizing both the social and profit mission in a single entity simultaneously requires having both the skill of charity work and business. The success of social enterprises rely on the skill of those individuals that involve in such business, be it as manager, director, employee or owner, to balance both profit and social mission in a single entity.³⁰⁸ But as Mrs. Tenagne Degefu, Administration Manager of Tebita Ambulance, stated, currently, social entrepreneurs in Ethiopia engage in the market and compete with other for-profit legal entities without taking any training how to blend social and profit mission in a single business firm.³⁰⁹

³⁰⁶ Interview with Tenagne Degefu, Administration Manager of Tebita Ambulance, *on practical challenges of social enterprises faced due to the absence of special policy support*, April 30, 2018

³⁰⁷ Ibid.

³⁰⁸ OECD, *Boosting Social Enterprise Development, Good Practice Compendium*, OECD Publishing, Paris, 2017, p. 24

³⁰⁹ Of course, some assistance have been given from non-governmental organization. For example, the British council which is enforcing the two year project on “supporting social enterprises in East Africa” gives some assistance for social entrepreneurs in Ethiopia to have awareness and skill about social

Consequently, they face a critical challenge in balancing the social and profit purpose of their enterprise.³¹⁰ As Mrs. Tenagne Degefu stated most entrepreneurs in the country who consider themselves as a social entrepreneur lack skill how to be successful in realizing both the financial and non-financial missions in a single business entity.

Third, there is a problem of inaccessibility of finance for social enterprises.³¹¹ As noted before, social enterprises in Ethiopia are predominantly trying to solve the social problems of the community.³¹² To this end, obviously, they need to have much capital/funds. But, practically, they are facing a critical challenge in accessing funds for their operation.³¹³ They unable to get loans, for example, from financial institutions because of the collateral requirements.³¹⁴ Financial institutions are even doubtful about the profitability of social enterprises because of lack of awareness about the nature of the business.³¹⁵ Fourth, there is a problem of market access for the products and services of social enterprises.³¹⁶ They are competing with the products and services of other for-profit entities.³¹⁷ This exposes them to face a stiff competition in the market and to have inadequate income from their operation which, in turn, limits their ability to solve SEEC problems.³¹⁸

enterprise business in the country (Interview with Tenagne Degefu, Administration Manager of Tebita Ambulance, *on practical challenges of social enterprises faced due to the absence of special policy support*, April 30, 2018

³¹⁰ Ibid.

³¹¹ Ibid.

³¹² *Supra*, p. 47, Chapter Three, section 3.2. Para. 1

³¹³“Understanding Social Entrepreneurship”, available at <https://www.thereporterethiopia.com/content/understanding-social-entrepreneurship> accessed on May 12, 2018 and “Ethiopian Social Enterprise Delivers Pioneering Innovative Education Programs at Scale”, available at <https://ethiopia.britishcouncil.org/about/press/ethiopian-social-enterprise-delivers-pioneering-innovative-education-programmes-scale> accessed on May 14, 2018

³¹⁴ Ibid.

³¹⁵ Interview with Mrs. Tenagne Degefu, Administration Manager of Tebita Ambulance, *on practical challenges of social enterprises faced due to the absence of special policy support*, April 30, 2018

³¹⁶ Interview with Ayerdi Nure, Production Manager of Ecopia PLC, *on practical challenges of social enterprises faced due to the absence of special policy support*, May 16, 2018

³¹⁷ Ibid and Interview with Mrs. Tenagne Degefu, Administration Manager of Tebita Ambulance, *on the on practical challenges of social enterprises faced due to the absence of special policy support*, April 30, 2018

³¹⁸ Ibid.

All the aforementioned challenges of social enterprises in Ethiopia can only be solved through providing policy supports. The skill of social entrepreneurs to blend the financial and non-financial missions can be enhanced when there is policy endeavor on the part of the government to create such skills using different mechanisms such as giving skill creation training both in respect to the entrepreneurial and social dimension of social enterprise. Similarly, the problem of poor understanding of the concept of social enterprise can be addressed only if there is policy striving on the part of the government to enhance the level of understanding of the community about the concept of social enterprises. It can be created only when there are continuing discussions about the concept through Medias, conferences, websites, publications and other means. Moreover, the problem of inaccessibility of finance can be solved when there are social enterprise funding policy schemes. Lastly, the inaccessibility of market can be solved when there is capacity building policy support of social enterprises. This can be done through expanding their production capacity, market skill, management skill and through creating a link among social enterprises or with other market actors. Generally, the challenge that social enterprises are currently facing can be invoked as another justification to frame a special policy support for social enterprises.

To sum up the discussion, there is a need to frame a special policy supports for social enterprises different from other ordinary for-profit businesses. The existence of sever SEEC problems in the country, the crucially of social enterprises to solve SEEC problems of the society and thereby assisting the government to realize its sustainable development, and the challenges that they are currently facing are sufficient grounds to give them special policy supports and encourage them accordingly.

3.4. Regulatory Concerns of Social Enterprise and Appropriateness of Existing Business Legal Regime of Ethiopia to Regulate Them

3.4.1. The Legal Form

The first issue that will come into our mind when we think social enterprise is the availability of a legal form that allows investors to blend social and profit-making objectives in a single business entity. As mentioned in the second chapter, social enterprises are businesses that blend financial and non-financial missions in a single legal entity.³¹⁹ They are motivated by the mission of realizing “triple bottom lines” (social, environmental, and profit) in a single undertaking.³²⁰ To license such type of investors to engage in the market, there shall exist a legal form that permits investors to blend both the social and profit-making objectives in a single business entity. Indeed, the mere existence of a form that allows the blend of the social and profit-making objective may not, however, suffice. Rather, the form needs to be designed in a way that allows investors, customers, employees, donors/funders and other stakeholders to identify socially-oriented businesses from profit-oriented businesses.³²¹ Though it may not be a conclusive evidence as to the genuineness of the social mission, the nomenclature of the form of the business can at least gives the first-impression to stakeholders that whether the enterprise’s primary motive is to realize social missions.³²²

“Mission-sympathetic parties” including donors, employees, customers, and investors who want to make a contribution to social-oriented businesses will, at the first glance, look at the name of the form using which social enterprises are licensed and registered to identify the entity’s primary mission.³²³ If the form of the enterprise transmits a

³¹⁹ Benjamin M. Lef, Preventing Private Inurement in Tranched Social Enterprises, p. 10

³²⁰ J.Haskell Murray, Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes, p. 4

³²¹ John Tyle et al, ‘Producing Better Mileage: Advancing the Design and Usefulness of Hybrid Vehicles for Social Business Ventures’, *Quinnipiac Law Review*, 2015, Vol. 33, PP. 235-338, at p. 242 (herein after, John Tyle et al, Producing Better Mileage: Advancing the Design and Usefulness of Hybrid Vehicles for Social Business Ventures)

³²² Id. p. 243

³²³ Robert A. Katz' & Antony Page, the Role of Social enterprise, P. 93

message to the society about the purpose of the business, stakeholders may easily distinguish social conscious businesses from others. This can help them to avoid confusion in determining the status of the businesses while they make interactions with such businesses. Donors, for example, hesitate to give a donation for such enterprises if they are registered in a form that can't inform the purpose of the enterprise.

Furthermore, the form of the social enterprise shall allow the social entrepreneur to build a brand to their products and services.³²⁴ As cited in the second chapter, branding is the core advantage that social entrepreneurs can receive from investing in social enterprises.³²⁵ Because of the social aspect of social enterprises, customers will give special preference for products and services of such enterprises, donors may incite to support such businesses; talented employees may be attracted to work in such businesses, and investors may become interested to invest in such legal entities.³²⁶ But this can be so when there is a form that specifically designed for social enterprises and easily identifiable. If the form of the enterprise tells the mission of the business, legal branding can be created for social enterprises and customers will be attracted to use the products and services of such firms provided that other things are the same. The name of the legal form of social enterprises in the UK is the best example for this discussion. UK has designed "*Community Interest Company*" as a legal form for social enterprises.³²⁷ When we see the name of the "Community Interest Company", it can transmit the message to the society about the purpose of the businesses that adopt this form. It, at least, tells us that the businesses that are licensed through this form have the mission of serving the community along with profit-making motive.

Generally, in addition to the need to have a legal form that permits to blend the social and profit mission in a single entity, the name of the form shall be easily identifiable by

³²⁴ Robert A. Katz' & Antony Page, the Role of Social enterprise, P. 44

³²⁵ *Supra*, p. 36-39, Chapter Two, Section 2.6.1. Sub section 2.6.1.1.

³²⁶ *Supra*, p. 37, Chapter Two, Section 2.6.1. Sub section 2.6.1.1 Para. 1

³²⁷ Pauline O'Connor, 'The New Regulatory Regime for Social Enterprises in Canada, P. 37

customers, donors, and other stakeholders and it shall also help owners to establish a brand for his business.

➤ **Suitability of Existing legal forms of business in Ethiopia for social enterprise**

Under the Ethiopian Commercial code, there are basically two ways of doing a business i.e. as a sole proprietorship³²⁸ and as a business organization.³²⁹ A person may need to undertake a business in his individual capacity without creating any cooperation with someone else. The available legal form for such type of business persons is sole proprietorship form. Individuals may also be interested to conduct a business in cooperation with other persons who have a common objective by bringing their capital or labor together.³³⁰ The available legal forms for such type of businesses are³³¹ the ordinary partnership, joint venture, general partnership, limited partnership, Share Company and private limited company.³³² Any person who has the interest to undertake a business in collaboration with his friends, families or other persons can choose either of these forms of business organization. Indeed, the new draft commercial code, which is not yet officially ratified, comes with some changes in respect to legal forms of business organization. On the one hand, it avoids the ordinary partnership business form from the list of the forms of business organization and on the other hand, it comes with a new type of business legal form called *private limited partnership*.³³³ A private limited partnership is defined as a business that two or more persons come together to render professional service and whose liability is limited to the asset of the partnership (*translated by the author*).³³⁴

³²⁸ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. 5ff

³²⁹ Id. art. 210ff

³³⁰ The Commercial Dichotomy of Business organization and Its Legal Significance Under the Ethiopian Law, *Bahir Dar University Journal of Law*, 2014, Vol. 3, No. 1, PP. 36-93, at p. 40 (herein after, The Commercial Dichotomy of Business organization and Its Legal Significance Under the Ethiopian Law)

³³¹ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. 212

³³² Id. art. 212

³³³ The Draft Commercial code of Ethiopia, book II, art. 4/4 and 75

³³⁴ To provide the exact Amharic version of the provision, “ሃላፊነቱ የተወሰነ የሽርክና ማኅበር ማለት ሁለትና ከዚያ በላይ የሆኑ ባለሙያዎች የሙያ አገልግሎት ለመስጠት የሚመሰርቱት እና ኃላፊነቱ በማኅበሩ ሃብት ላይ ብቻ የተወሰነ የንግድ ማኅበር ነው” (the Draft Commercial code of Ethiopia, book II, art.75)

In fact, some writers list cooperative legal form as an additional available legal form for businesses in Ethiopia.³³⁵ This researcher, however, doesn't agree about the availability of cooperative business legal form in Ethiopia. The cooperative legal form is not a legal form available for investors in a strict sense. Rather, it is a legal form designed for individuals who want to solve their common SEEC problems.³³⁶ An investor, for example, cannot choose cooperative legal form as an option for his investment. From the outset, it is hardly possible even to say that cooperatives are businesses since their objective is not to make a profit from their business. They are, rather, entities established to solve members' problem. Thus, Cooperatives should not be included under the list of available legal forms in Ethiopia.

Given these legal forms of business, the next issue is that whether social enterprise in Ethiopia can operate using either of these business forms. This issue can be analyzed from two perspectives. First, it can be explored from the point of social entrepreneurs who want to participate in the commercial activities with the primary aim of solving SEEC problems along with the distribution of a limited amount of profit, called as for-profit social enterprises. Under the current business laws of Ethiopia, though there is no clear permission, at least, there is no prohibition to operate a business with the primary motive of solving SEEC problems of the society along with the distribution of a limited amount of profit to owners. Individuals who want to undertake a business in Ethiopia as a trader or business person need, among others, to engage in economic activities which designed as such by law "*professionally*" and "*for gain*" (*emphasis added*).³³⁷ Here, the term *professionally* and *for gain* refers to the regular engagement of a person in the economic activities³³⁸ and the act of driving profit/benefit for their

³³⁵ For example on a legal guide written by Mehrteab Leul & Associates Law Office mentioned cooperative legal forms as one form available for doing business in Ethiopia (Mehrteab Leul & Associates Law Office, *Doing Business in Ethiopia: A Brief Legal Guide*, 1st ed., 2015, pp., 4ff)

³³⁶ Cooperative societies proclamation, 2016, Federal Negarit Gazette, proc. No. no. 985, 23rd year no. 7, Article 2/1 (herein after, Cooperative societies proc. No. 985/2016)

³³⁷ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. 5 and Commercial Registration and Licensing, 2016, Proc. No. 980, 22nd year, no. 101, art 2/2(Commercial Registration and Licensing proc.no. 980/2016)

³³⁸ The Commercial Dichotomy of Business organization and Its Legal Significance Under the Ethiopian Law, p. 64

livelihood respectively. The law doesn't, however, prohibit the reinvestment of the majority portion of businesses' profit to charitable/social purposes by limiting the portion to be distributed to owners so long as owners agreed to that effect. It doesn't fix the amount of the profit to be distributed to investors to be a trader or business person.

What if, for example, investors agree to limit their portion of return to be distributed to them only ten percent or else and to reinvest the remaining to social purposes? Can the regulatory authority refuse to license and register such investors as a trader or business person? The answer is probably not. The law requires only the continuous engagement of a person in the commercial activities and deriving of some benefit from such activities in the form of profit, regardless of the amount to be distributed to him. Even, it is illogical to think that the law will have the intent to prohibit the reinvestment of the majority portion of businesses' profit for the social mission in present era when socially responsible businesses are highly encouraged. Thus, persons who want to undertake economic activities with the primary objective of resolving SEEC problems in tandem with the distribution of a limited amount of profit can be licensed as a trader/business person using the existing businesses legal forms.

Practically also, social enterprises are operating using the existing legal forms of for-profit businesses.³³⁹ As Mr. Yoseph Alemu stated since there is no a clear law that prohibits the blend of a profit with a social mission in a single business entity in Ethiopia, the trade licenser, MOT and other Trade Bureaus, simply issue the trade license though the primary aim is to solve SEEC problems.³⁴⁰

Yet, even though the law doesn't prohibit the licensing and registration of such type of businesses, the name of existing legal forms don't fit to protect both the interests of stakeholders and social entrepreneurs. As mentioned above, the name of the legal form

³³⁹ Interview with Yoseph Alemu, Director of Share Companies and Sector Association Follow Up and Support Directorate at the FMOT, *on the possibility of blending social and profit making objective in a single business entity*, may 3, 2018

³⁴⁰ Ibid.

social enterprises needs to communicate the purpose of the enterprise so that stakeholders and owners can identify social enterprises from other ordinary businesses and easily build a brand to their business respectively. Coming to the existing legal forms of business in Ethiopia, however, none of them are able to describe the *purpose* of the business to the community. For example, a social enterprise that wants to be licensed and registered as a general partnership,³⁴¹ limited partnership,³⁴² share company³⁴³ or private limited company³⁴⁴ is required by law to include the name of the form using which they have been established next to the trade name of the business.

These forms, however, don't tell us the mission/purpose of the business. None of them send a message to stakeholders including customers, donors, investors and others whether the mission of the business is solving SEEC problems or maximizing owners' financial interest. For example, Ecopia (Ecological Products of Ethiopia) private limited company (PLC) is a for-profit social enterprise that operates a food processing business in Ethiopia with the objective of creating the market opportunity for farmers, improving food security and rural development in the country.³⁴⁵ But these missions of the Ecopia PLC can't be inferred from the name of the form through which the Ecopia operates i.e. from the 'Private Limited Company'. The name 'Private Limited Company' doesn't have any indication as to the purpose of the business. Donors who want to make a donation; customers who want to buy from the socially conscious business; investors who want to buy social oriented businesses' equity; and other stakeholders can't easily identify whether Ecopia is a socially committed company or not.

Similarly, this problem creates a difficulty for owners of the Ecopia PLC to build a brand to their products and services.³⁴⁶ Unless the purpose of the enterprise can be

³⁴¹ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. 281/1

³⁴² Id. art. 297/2

³⁴³ Id. art. 305

³⁴⁴ Id. art. 514/2

³⁴⁵ "Ecopia (Ecological Products of Ethiopia)" available at <<http://www.ecopia.de/ecopia-organic-food/>> accessed on May 15, 2018

³⁴⁶ Interview with Tenagne Degefu, Administration Manager of Tebita Ambulance, *on the understanding of the concept of social enterprise businesses in Ethiopia*, April 30, 2018

deduced from the name of the form of the business, it can't receive the advantage of the branding of its products and services. Its products and services will be branded only on the part of the customers who closely know the purpose of the enterprise. But had the forms designed in a way that indicates the purpose of the enterprise, customers who didn't even know the company before may prefer to buy products of such businesses by simply looking the mission of company from the name of the form through which the producing company registered. In fact, social enterprises can communicate the purpose of their firm to the people using a trade name as the law doesn't forbid to use such type of trade names. But, in such a case, the brand will be limited only to the specific enterprise which uses a trade name that conveys the purpose of the business. There will not exist a legal branding for the social enterprise in general. Even, allowing social enterprises to operate in a scattered legal form using their own trade name will cause uncertainty of form for a social enterprise on the part of socially conscious investors and societies.

Second, though it is not the main focus of the study, the issue of legal form can be appreciated from the perspective of investors who want to engage in the commercial activities freely and predetermine to reinvest the whole profit to their mission. Under the existing business legal structure, it is hardly possible to be licensed as a business unless owners have the intention to receive any profit at all. Under the commercial code, the law sets the intention of engaging in the commercial activities professionally and *for gain* to be licensed and registered in the existing business legal forms.³⁴⁷ At this juncture, the expression *for gain* is used not only to indicate the motive of driving profit from the commercial activities but also to refer the intention of receiving a private benefit by the investor. To clarify more, it is better to see the definition given for partnership agreement under the commercial code of Ethiopia. As it is provided under the commercial code, conclusion of a *partnership agreement* between members is a pre-request to conduct a business in the form of business organization.³⁴⁸ In defining the

³⁴⁷ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. Art. 5 and commercial code and registration and licensing proclamation No. 980/2016, art. 2/2

³⁴⁸ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. 210/1

phrase ‘partnership agreement’, the code provides the participation of owners/shareholders “*in the profit and losses arising out [the business]*” as one definitional element among others (*emphasis added*).³⁴⁹ This phrase shows us that sharing of profit of the business is the requirement for individuals to be considered as a trader or business person. The expression goes *beyond the intention of making a profit* by requiring them to *participate* in the distribution of the profit. The missing of the intention to participate in the profit of the business may, therefore, cause the denial of license and registration by the concerned authority as a business organization. Therefore, it is hardly possible that social enterprises who reinvest 100% of their business’s profit to social purpose can be licensed and registered in the legal forms listed in the commercial code of Ethiopia.

If so, the next issue is should Ethiopia allow such type of social entrepreneurs to be licensed as a trader under the commercial code. The answer to this issue should not be in affirmative. The researcher believes that businesses which undertake any commercial activity freely and reinvests the whole profit to social purpose should be inhibited from being licensed as a trader in Ethiopia. If we allow such business to operate in Ethiopia, in effect, they will be the same with NPOs. Allowing such businesses which are, by default, the same with NPOs to drive income by engaging in any business area freely will contradict with the rationales of restricting the area of income-generating activities in the case of nonprofit entities. Currently, nonprofit entities are restricted to undertake income generating activities on areas that are related to their charitable purpose.³⁵⁰ The rationale behind this restriction is to protect the interests of profit seeker individuals in the market. If we allow them to engage freely in any area of business, nonprofit entities will undermine the market competitiveness of for-profit firms. They will dominate the market since they easily build a brand to its product and services because of its SEEC mission, on the one hand, and the existence of supporting mechanisms from donors, on the other hand. The same works for social enterprises which reinvests the whole profit for the social purpose. Private investors may be driven out from the market if we allow

³⁴⁹ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. 211

³⁵⁰ Charities and societies proclamation No. 621/ 2009, art. 103/1

social enterprises which reinvest 100 % of its profit to the social purpose without restricting the area of businesses operation.

Even, if such type of business is allowed to operate in Ethiopia, it will give rise to the problem of horizontal inequity between nonprofit entities and social enterprises. The mission of both entities, (social enterprises) and nonprofit entities, is solving social problems of the community at large. Though they have the same mission, they differ in that while social enterprises that would be established as per the commercial code can engage in any economic activities, nonprofit entities restricted to undertake income generating activities on areas that are related to their charitable purpose.³⁵¹ Because of this, nonprofit entities may not be able to compete with social enterprises while they strive in realizing their mission through conducting income-generating activities. It will undermine the work of nonprofit entities.

Because of these reasoning, social entrepreneurs that have no any interest in receiving any return from their business should not be allowed to be licensed and operate as a trader. They have to be, rather, obliged to operate as a nonprofit entity through the charities and societies proclamation so long as the existing restrictive nonprofit laws of Ethiopia don't amend.

3.4.2. Evaluation of the Non-financial Mission of Social Enterprise

Naturally, when social entrepreneurs enter the market, their intention is expected to be benefiting the society or community at large, rather than maximizing their private interest.³⁵² They engage in the market calming that their primary mission is to solve SEEC problems of the community. But, this may not be always the case. Sometimes, the social motive of social enterprise investors may not be as true as declared. Profit seeker investors may falsely claim the status of social enterprise, though their actual

³⁵¹ Charities and societies proclamation No. 621/ 2009, art. 103 and የበጎ አድራጎት ድርጅቶችና ማህበራት የገቢ ማስገኛ ሰራወች ላይ የሚሰማሩበትን ሁኔታ ለመወሰን የወጣ መመሪያ ቁጥር 07፣ የበጎ አድራጎት ድርጅቶችና ማህበራት ኤጀሲ፣ 2004, አንቀጽ 5

³⁵² Blatchford and Margaret Mason, *Introducing the Community Contribution Company*, p. 8 and Dana Brakman Reiser, 'Benefit Corporations —a Sustainable Form of Organization?', p. 597

primary objective is maximizing their own private benefit.³⁵³ Especially, the existence of branding advantage in social enterprises may inspire greedy investors to claim deceitfully the status of social enterprises during formation.³⁵⁴ The fake status of a social enterprise may, consequently, result in the problem of “green or social washing”, whereby investors use or attempt to use the “branding” and “goodwill” advantage of social enterprise, by alleging that they are social entrepreneurs, though they are not actually.³⁵⁵

It may give rise to a problem where investors “pay only lip service to the social mission thereby depriving the *potential branding and signaling benefits of being perceived as a social enterprise* without actually contributing a significant social benefit.” (*Emphasis added*)³⁵⁶ To show this problem, Robert A. Katsz & Antony Page describe it as “*a wolf (the conventional business) in sheep's clothing (the social enterprise form) (emphasis added)*.”³⁵⁷ Hence, to avoid the mock use of the status of social enterprises and thereby to prevent the happening of green or social washing, social entrepreneurs shall be required by law to pass a certain criteria of social mission evaluation set by law³⁵⁸ They have to be required by law to show whether they are really inspired by and to achieve social missions, and thus to benefit the community. To do so, the law shall set clear social mission evaluation criteria that a social enterprise needs to pass. In fact, the standards that the social mission of the enterprise going to be evaluated may vary depending on the SEEC problem of countries. For example, in the social enterprise model law of USA, the social mission of the enterprise evaluated by requiring to pass the public benefit test i.e. bringing ‘a material positive impact on society and the environment ... as measured

³⁵³ Michael A. Hacker, “Profit, People, Planet” Perverted: Holding Benefit Corporations Accountable To Intended Beneficiaries, P. 1757

³⁵⁴ Robert A. Katz & Antony Page, Sustainable Business, p. 865

³⁵⁵ Michael A. Hacker, “Profit, People, Planet” Perverted: Holding Benefit Corporations Accountable To Intended Beneficiaries, P. 1757

³⁵⁶ Robert A. Katz & Antony Page, Sustainable Business, p. 865

³⁵⁷ Ibid.

³⁵⁸ Blatchford and Margaret Mason, Introducing the Community Contribution Company, p. 8 and Dana Brakman Reiser, ‘Benefit Corporations —a Sustainable Form of Organization?’, p. 597

by a third-party standard.’ (*Internal quotations omitted*).³⁵⁹ Specifically, in the USA, social mission is said to exist when the purpose of the enterprise is;

- (1) providing low-income or underserved individuals or communities with beneficial products or services;
- (2) promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business;
- (3) protecting or restoring the environment;
- (4) improving human health;
- (5) promoting the arts, sciences, or advancement of knowledge;
- (6) increasing the flow of capital to entities with a purpose to benefit society or the environment; [or]
- (7) conferring any other particular benefit on society or the environment.³⁶⁰

Whatever the criteria of evaluating the social mission of the enterprises, it is the concern of social enterprise regulation to set some social mission evaluation yardsticks/standards for a legal entity to acquire the status of social enterprise and to prevent the fake use of the status of social enterprise that may ultimately result in social or green washing problem.

➤ **Appropriateness of existing business Laws of Ethiopia to evaluate the non-financial mission of social enterprise during formation**

When we see the existing Ethiopian business laws, we can’t find any provision that fits to evaluate the social mission of social enterprises during the formation stage. If social enterprises are left to be regulated in the existing business laws of Ethiopia, the regulatory organ can’t require them to pass a certain social mission evaluation criteria as there is no any legal base to do so. There is no any provision that deals with the non-financial missions of a business. Even, practically, social enterprises are operating as a social-conscious business without being evaluated during their formation whether they have really a social or other non-financial missions.³⁶¹ They are licensed and registered like a traditional for-profit business without being required to show their social mission.³⁶² But, if we simply allow investors to claim the status of the social enterprise without evaluating their social mission, self-centered investors may use the social enterprise status falsely to get the branding benefit of the social enterprise. This may

³⁵⁹ Dana Brakman Reiser, *Theorizing Forms For Social Enterprise*, p. 690

³⁶⁰ American Model Benefit Corporation Legislation with Explanatory Comments, 2016, section 102

³⁶¹ Interview with Abiy Mohammed, the Team Leader of Share Companies and Sector Association Follow Up and Support Directorate at the FMOT, *on the current practice of social mission evaluation of social enterprises during the formation stage*, may 4, 2018 and Interview with Ayerdi Nure, Production Manager of Ecopia PLC, *on the evaluation of the social mission during the formation stage*, may 16, 2018

³⁶² Interview with Elsa Siyum, Legal Expert at the FMOT, *on social enterprise regulation in Ethiopia*, April 30, 2018

create the problem of social washing. It may expose stakeholders to be manipulated by sham social entrepreneurs. Sham social entrepreneurs may use their false status to get donations, attract customers, and government subsidies if any. Therefore, it can be simply concluded that the existing business laws of Ethiopia don't fit to regulate the social mission evaluation concern of social enterprises during their formation.

3.4.3. Allocation of Profit

Naturally, the very reason for the emergence of any social enterprise is to achieve a certain social goal, rather than maximizing owners' private gain.³⁶³ Accruing of private benefit to owners through distributing profit is their incidental or secondary mission.³⁶⁴ As time goes by, however, the primary mission of social entrepreneurs may be "shadowed" by the profit-making motive.³⁶⁵ Investors may be fascinated by the profitability of their enterprise and decide to drift towards receiving a lot amount of dividend from their enterprise's profit by reducing the portion of profit that would otherwise be reinvested to the social mission.³⁶⁶ The possibility of shifting towards profit maximization to owners of social enterprises may be exacerbated after the enterprise builds a brand to its products and services in the pretext of solving social and environmental problems. The tendency of investors to receive much profit from their social enterprise will finally lead to the problem of "mission drift",³⁶⁷ "a process of organizational change, where an organization diverges from its main purpose or mission" through time.³⁶⁸ The existence of mission drift, obviously, will cause the loss of non-financial missions of the enterprise.

Thus, it is the concern of a social enterprise regulation to regulate the allocation of the profit and thereby to thwart the problem of drifting of the mission of the enterprise

³⁶³ Mystica m. Alexander, A comparative Look at International Approaches to Social Enterprise, p. 4

³⁶⁴ Keren G. Raz, 'Toward an Improved Legal Form For Social Enterprise, p. 289

³⁶⁵ Joseph W. Yockey, 'The Compliance Case for Social Enterprise', *Michigan Business & Entrepreneurial Law Review*, 2014, Vol. 4, pp. 1-46, at P. 6 (Herein after, Joseph W. Yockey, The Compliance Case for Social Enterprise)

³⁶⁶ Joseph W. Yockey, Does Social Enterprise Law Matter? p. 780

³⁶⁷ Ibid.

³⁶⁸ Chris Cornforth, 'Understanding and Combating Mission Drift in Social enterprises', *Social Enterprise Journal*, 2014, Vol. 10, No.1, PP. 1-20, at p. 3 (herein after, Chris Cornforth, Understanding and Combating Mission Drift in Social enterprises)

towards profit-making by forgetting its original mission. A regulation needs to be made by law as to how the profit of social enterprises shall be allocated.³⁶⁹ Profits need to be allocated in a way that can balance the interests of shareholders and stakeholders of social enterprises.³⁷⁰ A legal specification needs to be made how much of the profit should be reinvested to the SEEC missions and to be distributed to owners.

This will help to maintain or lock the SEEC missions of the enterprise by preventing owners of social enterprises from distributing the whole or the huge part of the profit to their private benefit.³⁷¹ Indeed, a difficulty may arise in determining the amount of profit to be distributed to owners and to be reinvested for social purposes. For example, if we put the cap for the profit to be distributed to owners above 50%, in effect, social enterprises may become the same with for-profit businesses that discharge their CSR properly. The social missions may still remain subordinate to profit-making objective and it may be hardly possible to say that the primary purpose of social enterprises is solving SEEC problems. Similarly, if we make the cap of profit to be distributed to owners very few, it may have the effect of discouraging investors to undertake social enterprises in the country. Thus, the restriction shall be in the middle of the two extremes i.e. it shall reconcile the interests of stakeholders and investors in the social enterprise.

➤ **Feasibility of rules in the Commercial Code of Ethiopia to regulate the profit allocation concern of social enterprise**

When we closely scrutinize the existing profit allocation rules of businesses in Ethiopia, however, we can understand that the law doesn't regulate the profit allocation of businesses. The law, rather, leaves the power to determine the allocation of the profit of the business to be determined by the decision of shareholder meeting in the case of companies, partners in the case of partnerships, and traders in the case of a sole proprietorship.³⁷² Similarly, if we allow social enterprises to operate under the existing

³⁶⁹ The UK'S Mission Alignment Working Group, Profit with Purpose Businesses, 2014, p. 14 (herein after, The UK'S Mission Alignment Working Group, Profit with Purpose Businesses)

³⁷⁰ Ibid.

³⁷¹ Ibid.

³⁷² For example, the profit allocation of share companies required to be determined by the ordinary shareholders meeting (Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. 419/1)

business laws, the allocation of their profit will be determined by the decision of owners like that of traditional for-profit businesses. If, for example, investors of social enterprises decide to distribute the whole profit of their business to their private benefit rather than reinvesting to their social mission, there is no any legal means to prohibit them from doing so. The regulatory authority can't forbid them from doing that since there is no a law that imposes a restriction on the allocation of profit of social enterprises.³⁷³ In practice also, social enterprises in Ethiopia are freely deciding how much profit to be distributed to the owner and to be reinvested for the furtherance of their non-financial missions.³⁷⁴ The allocation of the profit of the social enterprise is determined by the owners of the business.³⁷⁵

Letting them distribute the profit of the enterprise to owners without imposing any restriction may, however, create an opportunity for owners of social enterprises to drift towards maximizing their own interest through distributing more profit of the business as time goes by. Even it may create a chance for owners to distribute the sum of money collected from donors to their private benefit. As elaborated before, currently, social enterprises in Ethiopia receive a donation subsidy besides to their business income.³⁷⁶ If we permit the profit allocation of such entities to be determined by owners, some self-interested entrepreneurs may enrich themselves by distributing donor- funded capitals for their private benefit. To conclude, the existing business laws of Ethiopia don't fit to regulate the profit allocation of social enterprises.

3.4.4. Asset Transfer, Sale of Business and Merger

Besides to the aforesaid regulatory concerns of social enterprise, the transfer of assets to members or to third party both at the time of dissolution and operational stage; the sale of the social enterprise to another investor; and merger of social enterprise with

³⁷³ Interview with Yoseph Alemu, Director of Share Companies and Sector Association Follow Up and Support Directorate at the FMOT, *on the current regulation of profit allocation of social enterprises in Ethiopia*, may 3, 2018

³⁷⁴ Interview with Tenagne Degefu, Administration Manager of Tebita Ambulance, *on the current practice of allocation profit of social enterprises in Ethiopia*, April 30, 2018

³⁷⁵ Interview with Ayerdi Nure, Production Manager of Ecopia PLC, *on the practice of profit allocation of social enterprises in Ethiopia*, May 16, 2018

³⁷⁶ *Supra*, p. 47, Chapter Three, section 3.2. Para. 1

other for-profit business are concerns that a social enterprise regulation needs to worry about. To begin with, firstly, the concern of asset transfer arise when a specific asset is transferred to another third party through sale or else during the operational life of the enterprise. Here, an asset is understood as “an item or property which is owned by a [social enterprise]...and which has a money value.”³⁷⁷ It includes tangible assets such as land and equipment, intangible assets such as trade name and goodwill, and financial assets such as shares and stocks.³⁷⁸ Normally, a transfer of a single asset to another person may not be a problematic provided that the asset is transferred with a fair market value and in realizing social objectives.³⁷⁹ Nevertheless, sometimes, directors of social enterprises may, for example, sell an asset of the social enterprise below the market value of the asset to another for-profit business in which they have a share.³⁸⁰ An asset may be transferred to owners or directors below the market price in the pretext of sale to drive income for their non-financial objectives. This will ultimately weaken the attainment of the non-financial missions of the enterprise. It may also result in the problem of mission drift. To prevent the happening of such problem, some restrictions need to be imposed by law on the transfer of assets during the operational life of the enterprise.

Secondly, the issue of asset transfer of social enterprises may arise at the time of the dissolution of the enterprise.³⁸¹ Comparable with traditional for-profit businesses, social enterprises may be dissolved due to different reasons. Then, the issue that will arise is how the assets that left after the accomplishment of liquidation should be distributed. In traditional for-profit businesses, upon their dissolution, assets left after the liquidation

³⁷⁷ The Free Dictionary”, available at < <https://financial-dictionary.thefreedictionary.com/asset> > accessed on May 30, 2018

³⁷⁸ Ibid.

³⁷⁹ Carol Liao, ‘The Next Stage of CSR for Canada: Transformational Corporate Governance, Hybrid Legal Structures, and the Growth of Social Enterprise’, *McGill International Journal of Sustainable Development Law and Policy*, 2013, Vol. 9, No. 1, pp. 53-85, at p. 80 (herein after, Carol Liao, The Next Stage of CSR for Canada)

³⁸⁰ Robert T. Esposito, *The Social Enterprise Revolution in Corporate Law*, P. 677

³⁸¹ Ibid.

process permitted to be distributed to owners or shareholders.³⁸² But if the assets of social enterprise allowed to be distributed to owners freely upon the dissolution of social enterprise, it may affect the interests of donors who were donating grants to the enterprise; customers who paid beyond market price for the products and services of the enterprise thinking that the enterprise is socially motivated entity; and government which may give to the enterprise different policy supports including tax credit. To protect the interests of such stakeholders, therefore, there shall exist some means of locking the assets of social enterprises during the dissolution of social enterprises.

Thirdly, the concern of the social enterprise regulation may exist when there is the sale of the social business as a whole or merger of a social enterprises with another for-profit business.³⁸³ The owner of social enterprise may decide to sell his enterprise/the whole business to another person for different reasons. Buyers, profit-oriented buyers, may highly interested to buy the enterprise since social enterprises are better than traditional for-profit businesses in building a brand for their products and services.³⁸⁴ The sale of the businesses has two prominent problems. On the one hand, the seller may enrich himself by selling the whole business including capitals collected from grants and other supporting mechanisms. On the other hand, the new owner may divert away from the original social mission of the social enterprise entity and may focus on generating much profit to his own benefit.³⁸⁵ As Susan Mac Cormac wrote, the social mission of social enterprise, in most cases, 'is dependent on founders' fervor, and when founders retire or sell, their *social legacy* is often lost as more traditional owners and managers takeover.' (*Emphasis added*)³⁸⁶ This problem is named as a legacy problem.³⁸⁷ The legacy problem

³⁸² For Example, under the Ethiopian commercial code, assets left after the settlement of the debts of the business organization allowed to be distributed to owners or shareholders of the dissolved business (Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art.270 and 505)

³⁸³ J.Haskell Murray, 'Social Enterprise Innovation: Delaware's Public Benefit Corporation Law', *Harvard Business Law Review*, 2014, vol.4, pp. 345- 371, at P. 366

³⁸⁴ J.Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, p. 40

³⁸⁵ Susan H. Mac Cormac Et Al., 'The Emergence of New Corporate Forms: The Need for Alternative Corporate Designs Integrating Financial And Social Missions', *Summit on The Future of The Corporation: Paper Series On Corporate Design*, p. 88- 97 As Cited by Robert A. Katz' & Antony Page, *The Role of Social Enterprise*, P. 96

³⁸⁶ *Ibid.*

³⁸⁷ Robert A. Katz' & Antony Page, *the Role of Social enterprise*, P. 95

is defined as the “risk of subordinating social missions to the profit” following to the change of ownership of the social enterprise.³⁸⁸ It is one type of mission drift that new owners of social enterprise drift away from their non-financial objectives towards driving profit for private benefit following to change of ownership.³⁸⁹ Stakeholders of social enterprises especially donors and beneficiaries may lose a certain interest in the social enterprise provided that there is a loss of legacy of the original founder’s after the enterprise has been taken over by another new purchaser. Hence, the law should have a means to maintain the mission of the enterprise during the sale of social enterprises.

By the same token, the loss of legacy may occur when there is a merger of social enterprises with another for-profit business.³⁹⁰ A social enterprise may merge with another traditional for-profit business due to different reasons. The merger of a social conscious entity with a profit-conscious entity may result in the loss of the legacy of social mission or it may at least give rise to a difficulty of detecting whether the legacy of social mission survives after the action of the merger. Therefore, to avoid such undesirable consequence of the merger, a legislative regulation must be made about the merger of social conscious entities with profit-oriented entities.

Generally, because of these potential problems which may arise following the transfer of asset, sale of the enterprise or merger of the enterprise with another for-profit business, regulating the transfer of assets of social enterprises both during the operational and dissolution stage; change of ownership in the sell-out or takeover of it by another person; and the merger of social enterprises with another traditional for-profit businesses become the concern of social enterprise regulation.

³⁸⁸ Robert A. Katz' & Antony Page, *the Role of Social enterprise*, P. 95

³⁸⁹ Joseph W. Yockey, *Does Social Enterprise Law Matter?*, p. 793

³⁹⁰ Alicia E. Plerhoples, *Can an Old Dog Learn New Tricks?* P. 236

➤ **The fitness of Ethiopian business legal regime to regulate the asset transfer, sale, and merger concerns of social enterprise**

When we examine the existing business law provisions of Ethiopia, we may not find any restriction on the asset transfer, sale, and merger of a business. At the time of the operational life of the business, owners have full freedom to transfer a specific asset of their business to the third party through sale, donation or else. There is no any legal restriction on the transfer of the asset of businesses to the third party so long as owners agree. Similarly, under the existing laws, assets left after the process of liquidation during the dissolution of businesses are allowed to be distributed freely to shareholders or owners of the business.³⁹¹

Hence, if we regulate social enterprises under the existing business laws of Ethiopia, it means that they can freely transfer the asset of the enterprise without being locked both during the operational and dissolution period. Practically, too, social enterprises are freely transferring their asset in their operational life.³⁹² The only requirement to transfer the assets of the enterprises is the approval of directors, managers or owners to that effect.³⁹³ Allowing social entrepreneurs to transfer assets of the enterprise may, conversely, affect the interests of donors that donate an asset or else believed that the asset will be used for a social purpose. It may also affect the interests of individuals who made any contribution in different ways towards the enterprises thinking that the enterprise will remain committed to its non-financial missions; and interests of government which may give different supports trusting that such businesses will assist it in solving SEEC problems of the community.

Moreover, under the existing business law rules of Ethiopia, there is no any restriction as to the sale of businesses.³⁹⁴ Owners of the businesses can sell their business as a whole if they want. There is no any provision that requires owners to consider the

³⁹¹ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, 270, 295, 303, and 505,

³⁹² Interview with Ayerdi Nure, Production Manager of Ecopia PLC, *on the practice of asset transfer of the enterprise during the operational life of social enterprises in Ethiopia*, may 16, 2018

³⁹³ Ibid.

³⁹⁴ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art 150ff

interests of stakeholders at the time of sale of a business to another person in the existing business law of Ethiopia. Owners are free to maximize their private interest through selling their business to the maximum purchase price regardless of its impact on the stakeholders' interest in the post-sale. Furthermore, as per the commercial code of Ethiopia, business entities are free to decide the merger of their business with another business legal entity³⁹⁵ unless it has an anti-competitive effect.³⁹⁶ The decision to merge with another firm is left to be made by the concerned business entity.³⁹⁷ Unless the merger has the effect of anti-competitive effect on the market, there is no any ground that regulatory organ can interfere in the merger decision of business firms.

Thus, if we regulate social enterprises through the existing business rules of Ethiopia, they will be free to sell their business to a third party without considering the interests of other non-stockholders interest. This may, however, create a couple of problems. First, the owners may enrich themselves by selling the whole business which comprises assets collected from donations, the government supports, and contributions from other social-conscious persons. Second, the sale of a business may result in the loss of legacy problem whereby the new purchaser changes the social mission of the enterprise to profit mission. This also affects the interests of stakeholders who had made different contribution thinking that the non-financial missions of the enterprise will remain intact. Similarly, if we let social enterprises to be housed under the existing business laws, they can merge with another for-profit business without being restricted. This may also have the effect of loss of legacy of the original social enterprise. After the taking place of the merger of the enterprise with another for-profit business, the social mission of the entity in the pre-merger may be darkened by the profit-making mission of the for-profit business. Generally, the existing business laws of Ethiopia don't fit to regulate the asset transfer, sale and merger concerns of social enterprises.

³⁹⁵ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. 549ff

³⁹⁶ Trade Competition and Consumer Protection Proclamation, 2013, Federal Negarit Gazette, 20th year, no 28, Proc. No. 813, art. 9

³⁹⁷ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. 550

3.4.5. Disclosure of the Performance of the Enterprise

Like the case of traditional profit-making businesses, there is a problem of information asymmetry in social enterprise.³⁹⁸ In most cases, the information of the social enterprise is not known for outsiders.³⁹⁹ It is only reachable for persons who control the enterprise such as managers, directors, and owners. The problem of information asymmetry may frighten stakeholders to make interaction with social enterprises. Unless there is disclosure of the social performance of the enterprise, stakeholders such as donors that made a donation; customers who consumes the products and services of such enterprises persistently and sometimes above the market price; quasi-donors that buy products and services of the enterprise above the market price and social conscious investors which buy equities of the enterprise may not know whether their contribution is really used to address SEEEEC problems. To reduce this problem, therefore, a minimum disclosure legal requirements need to be set by law that any social enterprise must fulfill.⁴⁰⁰ It is only when the act of the social enterprise is disclosed that individuals or government know whether the enterprise actually acts in line with its non-financial mission, and can apply for regulatory measures to be taken against any deviance if any.⁴⁰¹

One means of disclosing the performance of the social enterprises is requiring them to make a report on their performance in respect with their non-financial objectives to the enforcement organ.⁴⁰² Unlike traditional for-profit businesses which are required only to prepare a financial report, social enterprises should be required to produce a report about their non-financial performance in addition to financial reporting and to publicize it on websites, newspapers or else. They shall be required to present both the report of their social achievement in addition to financial performance annually or bi-annually according to the manner and conditions set for by law. This reporting requirement will help to know that whether the social enterprise genuinely acts in accordance with its

³⁹⁸ Joseph W. Yockey, Does Social Enterprise Law Matter? P. 792

³⁹⁹ Id. P.793

⁴⁰⁰ The UK'S Mission Alignment Working Group, Profit with Purpose Businesses, p. 13-14

⁴⁰¹ Policy Department C: Citizens' Rights and Constitutional Affairs of European Parliament, A European Statute for Social and Solidarity-Based Enterprise, p. 28

⁴⁰² The UK'S Mission Alignment Working Group, Profit with Purpose Businesses, p. 13-14

original mission i.e. achieving social missions.⁴⁰³ It will help stakeholders to have awareness about the actual social performance of the enterprise and to act accordingly. It will also serve as the regulatory body to take any measure provided that there is a deviation from the original mission.

In fact, the mere existence of self-reporting of the performance of the entity may not necessarily safeguard the continuity of the original mission of the enterprise. It shall be, rather, evaluated against certain standards set by law and there shall exist a certification mechanism about the performance of the enterprise.⁴⁰⁴ Specifically, there shall exist auditing of the non-financial social performance of social enterprises, social auditing, in addition to financial auditing of the enterprise.⁴⁰⁵ The social performance of an enterprise shall be audited by independent and professional social auditors.⁴⁰⁶ Social auditing shall be made in order to protect stakeholders of social enterprises from the problem of social or “green washing” _ claiming to be a socially conscious business, though it actually not.⁴⁰⁷ In general, requiring social enterprises to fulfill minimum standards of transparency will be one concern of regulation of social enterprises since it is a strategic tool to give a notice for stakeholders of social enterprises such as customers, donors, and investors whether the enterprise really acts in accordance with its original mission.⁴⁰⁸

➤ **Adequateness of the disclosure requirements under the commercial code of Ethiopia to regulate transparency concerns of social enterprise**

Under the existing Ethiopian business law, we can find some rules that require businesses to fulfill some standards of transparency.⁴⁰⁹ For example, as it is provided

⁴⁰³ The UK’S Mission Alignment Working Group, Profit with Purpose Businesses, p. 13-14

⁴⁰⁴ Rebecca Lee, The Emergence of Social Enterprises in China: The Quest for Space and Legitimacy, p. 96

⁴⁰⁵ Ibid.

⁴⁰⁶ Joseph W. Yockey, Does Social Enterprise Law Matter? P. 822

⁴⁰⁷ “Social Accounting and audit for the Community Sector” available at <https://socialauditnetwork.wordpress.com/2015/12/12/the-need-for-social-audit/> accessed on May 15, 2018

⁴⁰⁸ John Tyle et al, Producing Better Mileage: Advancing the Design and Usefulness of Hybrid Vehicles for Social Business Ventures, p. 292

⁴⁰⁹ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. 446

under the commercial code, directors of share companies are required to prepare the annual report on each financial year in respect to the balance sheet, profit and loss accounts, and the companies activities and affairs in the financial year.⁴¹⁰ They are mandatorily required to prepare the annual report on the above-mentioned areas. Similarly, though it is not a mandatory requirement, the law indicates the possibility of making a report in the case of partnership business on the management of the partnership provided that the partners require.⁴¹¹

Besides to the requirement of reporting, the law requires, especially in the case of share companies and private limited companies, the auditing of such reports by professional auditors.⁴¹² The law imposes a duty on auditors to audit “the books and securities of the company; to verify the correctness and accuracy of the inventories, balance sheets and profit and loss accounts; [and] to certify that the report of the board of directors reflects the correct state of the company’s affair.”⁴¹³ But when we carefully see these transparency requirements, they have two major shortfalls. On the one hand, the disclosure requirements emphasize only to the financial performance of the businesses. There is no a clear and mandatory requirement of reporting and auditing of the *non-financial performance* of the business. The existing reporting and auditing requirements focus on the disclosure of the financial performance of the business including the balance sheets, and profit and loss accounts. On the other hand, even the report of the financial performance of businesses are not required to be made for a regulatory organ and rather, the law requires such reports to be prepared at the partnership or company level and to be read out to partners or shareholders in their meeting.⁴¹⁴ The existing business laws of Ethiopia don’t require the report of the businesses to the regulatory authority and to be evaluated by the authority, except the reports of financial businesses.⁴¹⁵

⁴¹⁰ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. 446/2

⁴¹¹ Id. art. 249/1, 295 and 303

⁴¹² Id. art. 368ff and 358

⁴¹³ Id. art. 374/a, b &c and 358/4

⁴¹⁴ Id. art. 419, 249/1

⁴¹⁵ Financial businesses namely banks, micro finances and Insurances are required to produce a report of the financial statements and other reports prescribed by National Bank of Ethiopia to the regulatory

Likewise, if we make social enterprise to be licensed and regulated through existing business laws, they may not prepare any social performance report and they may not be also audited since there is no any rule that requires the social reporting and auditing. Even, in practice, there is no any practice of formal disclosure and auditing of the social performance of the social enterprises in Ethiopia.⁴¹⁶ As Mr. Abiy Mohammed asserts there is not even the practice of financial reporting to the regulatory authority let alone the social performance of businesses.⁴¹⁷ The social performance of social enterprises is neither disclosed to the society formally nor audited whether it is adequate and rightly made.⁴¹⁸ This may, however, cause stakeholders including government to face problem of information asymmetry. Stakeholders may not exactly know whether the enterprise acts in accordance with its original social mission or not. Because of the information asymmetry, they may be cheated by fake social enterprises. Donors may, for example, donate a certain amount of donation to fake social enterprises due to the problem of lack of information about the actual performance of the enterprise. To sum up, the disclosure requirements under the existing business law of Ethiopia are not sufficient to regulate the social performance of social enterprises.

3.4.6. Duty and Liability of Directors and Managers towards Stakeholders

The other concern of social enterprise regulation is the duty and liability of directors and managers towards stakeholders.⁴¹⁹ In the corporation tradition, though they are owned by shareholders, the power to control the activities of the corporation is exercised

authority, National Bank of Ethiopia. (See Banking Business Proclamation, 2008, *Federal Negarit Gazzeta*, Proc. No. 592, 14th year, No. 57, art. 28, Micro Finance Business Proclamation, 2009, *Federal Negarit Gazzeta*, Proc. No. 626, 15th year, No. 33, art. 15/2 and Insurance Business Proclamation, 2012, *Federal Negarit Gazzeta*, Proc. No. 746, 18th year, No. 57, art. 33.)

⁴¹⁶ Interview with Ayerdi Nure, Production Manager of Ecopia PLC, *on the practice of disclosure and audit of the social performance of social enterprises in Ethiopia*, may 16, 2018

⁴¹⁷ Abiy Mohammed, Team Leader of share companies and sector association follow up and support directorate at the Federal Ministry of Trade, *on the current practice of disclosure of the social performance of social enterprise Businesses in Ethiopia*, may 4, 2018

⁴¹⁷ *Ibid.*

⁴¹⁸ *Ibid.*

⁴¹⁹ Thomas J. White IIX, 'Benefit Corporations: Increased Oversight through Creation of the Benefit Corporation Commission', *Journal of legislation*, 2014-2015, vol. 41, no. 2, pp. 329-352, at p. 342 (herein after, Thomas J. White IIX, Benefit Corporations: Increased Oversight through Creation of the Benefit Corporation Commission)

by directors and managers.⁴²⁰ Shareholders, in most cases, have a very limited participation in the management of the activities of their business, except that they participate in the corporate governance through shareholders meeting.⁴²¹ They are simply beneficiaries of the fruits of their business. They empower directors and managers to manage and control the corporation as a proxy for them.⁴²² In doing so, directors and managers required to act in the best interest of their appointees_ shareholders of the enterprise.⁴²³ Specifically, they do have a duty to act in the best interest of the corporation and its shareholders.⁴²⁴ Any breach of such duty will result in a derivative suit⁴²⁵ against them by shareholders and may finally make them liable.⁴²⁶ But they don't have a mandatory duty to solve SEEC problems of the community, stakeholders, but not to create a negative impact on them.⁴²⁷

As mentioned in the second chapter, unlike the traditional for-profit businesses, social enterprises have blended missions i.e. social and profit-making objective.⁴²⁸ Because of these blended objectives of social enterprises, directors and managers of such businesses need to strive to realize both missions simultaneously.⁴²⁹ Consequently, directors and managers have the duty to maximize the interests of owners and stakeholders through driving appropriate profit and through enforcing the non-financial mission of the enterprise properly respectively.⁴³⁰ In social enterprises, therefore, the duty of directors and managers includes their accountability to stakeholders “who [have] an interest or

⁴²⁰ Michael A. Hacker, “Profit, People, Planet” Perverted: Holding Benefit Corporations Accountable To Intended Beneficiaries, P, 1761

⁴²¹ “Role of Shareholders of the Corporation” available at <https://thebusinessprofessor.com/knowledge-base/role-of-shareholders-of-the-corporation/> > accessed on 5/15/2018

⁴²² Id. P, 1761 &1762

⁴²³ Thomas J. White IIX, Benefit Corporations: Increased Oversight through Creation of the Benefit Corporation Commission, p. 342

⁴²⁴ Michael A. Hacker, “Profit, People, Planet” Perverted: Holding Benefit Corporations Accountable To Intended Beneficiaries, P. 1762

⁴²⁵ Derivative suit means “[a] lawsuit brought by a shareholder of a corporation on its behalf to enforce or defend a legal right or claim, which the corporation has failed to do” (“Derivative Action” available at <https://legal-dictionary.thefreedictionary.com/Derivative+suit> > accessed on May 15, 2018)

⁴²⁶ Ibid.

⁴²⁷ Ibid.

⁴²⁸ *Supra*, p.18, Chapter Three, Section 2.3.

⁴²⁹ Robert T. Esposito, The Social Enterprise Revolution in Corporate Law, P. 699

⁴³⁰ Ibid.

concern with the business but does not necessarily have an ownership interest in the business”.⁴³¹ Thus, like that of traditional for-profit businesses, a legislative declaration needs to be made about the existence of the duty of directors and managers of the social enterprises to protect the interests of non-shareholders, in addition to their accountability to stockholders.⁴³² The liability of directors and managers towards non-shareholders for the failure to discharge their duty towards stakeholders of a social enterprise shall be established by law.

In fact, the mere declaration of the existence of the duty of directors or managers to protect the interests of non-stockholders may not be a guarantee for the protection of stakeholders’ interest in the enterprise. Directors or managers may act against the interests of stakeholders by breaching their duty to act in accordance with what is required by law.⁴³³ In such a case, another specific issue may arise that how and by whom a suit should be instituted before a court of law against a director or manager that violates his duty.⁴³⁴ In traditional for-profit businesses, any breach of directors or managers’ duty gives to shareholders the right to institute a derivative suit before a court of law.⁴³⁵ Shareholders can seek remedy before a court for the damage they have suffered due to the failure of directors or managers to discharge their corporate duty properly. Similarly, there shall exist a means for stakeholders of social enterprises to claim the damage they will have suffered because of the failure of directors or managers to act in accordance with their duty that they have towards non-stockholder. Non-stockholders needs to have the opportunity to claim their violated interest before a court either through being represented by shareholders of the enterprise⁴³⁶ or by themselves.

⁴³¹ Thomas J.White IIX, Benefit Corporations: Increased Oversight through Creation of the Benefit Corporation Commission, 342

⁴³² Mark S. Blodgett et al, Social Enterprise: Reaffirming Public Purpose Governance Through Shared Value, P.326

⁴³³ Michael A. Hacker, “Profit, People, Planet” Perverted: Holding Benefit Corporations Accountable To Intended Beneficiaries, P, 1765

⁴³⁴ Ibid.

⁴³⁵ Id. P, 1764

⁴³⁶ For example, in USA, in almost all states, right to bring a legal action before a court of for the violation of stakeholders’ right is required to be exercised by shareholders representing non-shareholders. (Robert T. Esposito, The Social Enterprise Revolution in Corporate Law, P. 700)

➤ **Adequacy of existing fiduciary rules of Ethiopia to regulate the duties and liabilities of directors and managers of social enterprises towards stakeholders**

When we closely analyze the existing business laws of Ethiopia, we may not find a provision that expressly indicates the existence of duty and liability of directors and/or managers towards stakeholders. In fact, though the commercial code of Ethiopia doesn't clearly impose a duty on directors and managers to consider interests of stakeholders and a liability for any breach, the law imposes a general duty on them to discharge the duties imposed on them in *the memorandum, article of association or partnership agreement (emphasis added)*.⁴³⁷ This shows that the duties of managers and directors may ensue from the memorandum, article of association or partnership agreement of businesses in addition to the law.⁴³⁸ Thus, for example, if a business imposes a duty on its manager and directors to consider the interests of stakeholders under its memorandum, article of association or partnership agreement, then, the law will make directors and managers liable for any breach of that duty.⁴³⁹

But the problem comes when there is no any duty imposed on managers and directors of social enterprises to consider the interests of stakeholders under their memorandum, article of association or partnership agreement. In such a case, there is no any legal ground to make liable directors and managers for their failure to consider interests of stakeholders. In the same manner, if we regulate the fiduciary duties and liabilities of directors and managers of social enterprises under the existing fiduciary laws of Ethiopia, directors, and managers may not be liable for the failure to maximize the social interest of stakeholders so long as such duty is not stated in the memorandum, article of association or partnership agreement of the enterprise. Even when we regulate the duties of managers and directors of social enterprises under the existing business legal regime, the only competent persons that can institute a court proceeding to enforce the liability

⁴³⁷ Commercial Code of the Empire of Ethiopia, Proc. No. 166/1966, art. 241/2, 363, 364, and 530

⁴³⁸ Id. art. 241/2, 363, 364, and 530

⁴³⁹ Id. art. 241/2, 364, and 530

of directors will be shareholders or owners of the business.⁴⁴⁰ Sometimes, however, shareholders/owners of social enterprises may conspire with directors to forget the social mission of their businesses and, rather, to focus on the profit-making objective. In such cases, no one can enforce the liabilities of directors or managers that they have towards stakeholders. Generally, the existing business laws of Ethiopia don't fit to regulate the duties and liabilities of directors and managers of social enterprises towards stakeholders.

3.4.7. Tax Treatment of Social Enterprises

The tax treatment of social enterprise is another most contentious concern of social enterprise regulation. Since taxation is one instrument of regulation of business, the regulation of social enterprise needs to worry about it. Traditionally, for the purpose of taxation, legal entities are classified as for-profit and nonprofit.⁴⁴¹ In most jurisdictions, while for-profit businesses classified as taxable legal entities, nonprofit entities have been treated as tax exempted entities.⁴⁴² Based on this dichotomy, for-profit businesses are required to pay tax on the income they have derived from their economic activities after the deduction of necessary deductible expenses.⁴⁴³ In contrast, nonprofit legal entities are given a privilege of tax exemption for the income they have derived by engaging in economic activities that are related to their charitable purpose.⁴⁴⁴ They are also beneficiaries of tax-deductible donations.⁴⁴⁵ Contributions made by for-profit corporates for nonprofit entities are tax- deductible expenses.

⁴⁴⁰ For example, in case of share companies, the power to bring a proceeding before a court against directors for any breach of duty is left to be exercised by shareholders upon passing a resolution to do so in the general meeting (Commercial code of Ethiopia, art. 365)

⁴⁴¹ Lloyd Hitoshi Mayer and Joseph R. Ganahl, 'Taxing Social Enterprise', *Stanford Law Review*, 2014, Vol. 66, pp. 387-442, at p. 404ff (herein after, Lloyd Hitoshi Mayer and Joseph R. Ganahl, Taxing Social Enterprise)

⁴⁴² Emily Cohen, Benefit Expenses: 'How The Benefit Corporation's Social Purpose Changes The Ordinary And Necessary', *William & Mary Business Law Review*, Vol. 4, PP.269-308, at 285ff (herein after, Emily Cohen, Benefit Expenses: How The Benefit Corporation's Social Purpose Changes The Ordinary And Necessary)

⁴⁴³ Joseph M. Binder, 'A Tax Analysis of the Emerging Class of Hybrid Entities', *Brooklyn Law Review*, 2013, Vol. 78, No 2, pp. 625-661, at p. 636 (herein after, Joseph M. Binder, A Tax Analysis of the Emerging Class of Hybrid Entities)

⁴⁴⁴ Id. p. 637

⁴⁴⁵ Ibid.

The tax-exempt status of nonprofit entities, however, has some restrictions.⁴⁴⁶ On the one hand, the exempt privilege applies only for incomes derived from economic activities that are directly related to their charitable purpose and, on the other hand, tax deduction of donations made to nonprofits restricted up to a certain percentage, mostly to 10%.⁴⁴⁷ The exemption of nonprofit entities from tax liability is justified by the reason that it is a means of government subsidy of nonprofit entities for the cost they have incurred in providing social services including “health care, education, research, and aid to the poor” that would have been otherwise given by the government.⁴⁴⁸ The government provides such privilege for nonprofit entities for the reason that their work reduces its responsibility of giving social services.⁴⁴⁹ It forfeits the income that it would have collected from taxing nonprofit entities, believing that the work of nonprofit entities reduces its expenditure that would otherwise be incurred in providing such services. It also justified by the reason that it is a means of softening restrictive laws of nonprofits.⁴⁵⁰ Mostly, nonprofit laws impose some restrictions that ultimately expose them to the problem of capital constraint.⁴⁵¹ Non-distribution restriction, for example, limits nonprofit entities to raise their capital through issuing equity securities.⁴⁵² Thus, tax exemption status is justified to give a financial support to nonprofit entities as a means to rectify the capital constraint problem.

The other justification is that nonprofit entities don’t actually receive an income to be spent for the entities’ benefit, rather they serve as “*a conduit through which a fund flows*” to persons who are targeted beneficiaries of the services of the entities (*emphasis added*).⁴⁵³ Because of the absence of an actual income to be received by them, except an income to be transferred to beneficiaries, they have to be tax exempted and rather,

⁴⁴⁶ A Tax Analysis of the Emerging Class of Hybrid Entities, p. 637

⁴⁴⁷ Ibid.

⁴⁴⁸ Lloyd Hitoshi Mayer and Joseph R. Ganahl, Taxing Social Enterprise, p. 412

⁴⁴⁹ Emily Cohen, Benefit Expenses: How the Benefit Corporation's Social Purpose Changes the Ordinary and Necessary, p. 288

⁴⁵⁰ Lloyd Hitoshi Mayer and Joseph R. Ganahl, Taxing Social Enterprise, p. 413

⁴⁵¹ Ibid.

⁴⁵² Ibid.

⁴⁵³ Emily Cohen, Benefit Expenses: How The Benefit Corporation's Social Purpose Changes The Ordinary And Necessary, p. 288

such incomes shall be taxed at the individual level who receives the benefit in the form of donation or else.⁴⁵⁴ The justification for tax deductibility of contributions is that taxes are imposed ‘to reduce private consumption and accumulation in order to free resources for public use’.⁴⁵⁵ Thus, they conclude that since charitable contributions are made for the public benefit, they have to be exempted from tax liability.⁴⁵⁶

Having this dichotomy of the tax treatment of for-profit and nonprofit legal entities, then, the next issue is that to which dichotomy social enterprises should be grouped. Or in short, should social enterprises be taxable entities or should they receive a favorable tax treatment? As mentioned in the first chapter, social enterprise is the fuse of the features of for-profit and nonprofit legal entities.⁴⁵⁷ They look like for-profit businesses because they engage freely in the production and sale of goods and services and distribute a limited amount of dividend to owners.⁴⁵⁸ They also look like nonprofit entities since their primary aim is to serve the community or public at large.⁴⁵⁹ With this hybrid feature, the tax status of social enterprises becomes the contentious issue. Theoretically, some scholars argue in favor of giving favorable tax treatment to the social enterprise while some others totally oppose the favorable tax treatment of such businesses. Below, the arguments and justifications of both sides are given.

➤ **Arguments for and against tax privilege for social enterprises**

To begin with, some scholars argue that social enterprises shall be granted some form of favorable tax treatment.⁴⁶⁰ Scholars who propose the favorable tax treatment of social enterprises justifies their argument based on the *purpose/function* of such businesses.⁴⁶¹ They argue that, by the very nature, social enterprises primarily motivated to benefit the community or society at large, rather than driving private gain, like that of nonprofit entities. They provide services that the government would otherwise be required to

⁴⁵⁴ Emily Cohen, Benefit Expenses: How The Benefit Corporation's Social Purpose Changes The Ordinary And Necessary, p. 288

⁴⁵⁵ Lloyd Hitoshi Mayer and Joseph R. Ganahl, Taxing Social Enterprise, p. 413

⁴⁵⁶ Ibid.

⁴⁵⁷ *Supra*, p. Chapter Two, Section 1.1. Para. 2

⁴⁵⁸ *Supra*, p. 34, Chapter three, Section 2.5.2. Para. 1

⁴⁵⁹ *Supra*, p. 31, Chapter three, Section 2.5.1. Para. 1

⁴⁶⁰ Michael D. Gottesman, From Cobblestones to Pavement, p. 354

⁴⁶¹ Lloyd Hitoshi Mayer and Joseph R. Ganahl, Taxing Social Enterprise, p. 423

render.⁴⁶² Then, scholars argue that the public benefit justification for tax exemption of nonprofit entities shall be extended to social enterprises since their primary purpose is the same with nonprofit entities' purpose i.e. giving a "public benefit".⁴⁶³ They add that the main criteria to tax or not to tax an entity should not be based on the form it has been formed, but it should be based on the purpose of the entity i.e. whether the entity has a public purpose or not.⁴⁶⁴ Unless social enterprises are given a favorable tax treatment, there may exist unfair tax treatment between nonprofit and social enterprises whose functions are the same.⁴⁶⁵

Finally, they concluded that an entity that has the mission to benefit the public shall automatically receive favorable tax treatment regardless of the form it has been formed.⁴⁶⁶ With the same reasoning mentioned before, supporters of this argument argue that donations made to social enterprises should be deducted as a deductible expense for the donors.⁴⁶⁷ In addition, supporters of this position argue that the tax privilege of social enterprises is justified to compensate the sacrifices they may make while they serve the community at large i.e. profits they would have otherwise received from their business.⁴⁶⁸ Furthermore, they argue that social enterprises should be given some preferred tax treatment to incentivize them to render community services.⁴⁶⁹

Contrast to this, some other scholars argue that social enterprises shall be taxed like any other ordinary businesses.⁴⁷⁰ They argue that since social enterprises have an earned income and profit, they have to be taxed based on the traditional principle of taxation i.e. earned incomes and surplus of corporates are taxable.⁴⁷¹ They argue that social enterprises drive an income and make a profit through engaging in the production and

⁴⁶² Joseph M. Binder, A Tax Analysis of the Emerging Class of Hybrid Entities, p. 645

⁴⁶³ Lloyd Hitoshi Mayer and Joseph R. Ganahl, Taxing Social Enterprise, p. 423

⁴⁶⁴ Ibid.

⁴⁶⁵ Michael D. Gottesman, From Cobblestones to Pavement, p. 354

⁴⁶⁶ Lloyd Hitoshi Mayer and Joseph R. Ganahl, Taxing Social Enterprise, p. 423

⁴⁶⁷ Michael D. Gottesman, From Cobblestones to Pavement, p. 354

⁴⁶⁸ Lloyd Hitoshi Mayer and Joseph R. Ganahl, Taxing Social Enterprise, p. 428

⁴⁶⁹ Michael D. Gottesman, From Cobblestones to Pavement, p. 354-355

⁴⁷⁰ Lloyd Hitoshi Mayer and Joseph R. Ganahl, Taxing Social Enterprise, p. 422ff

⁴⁷¹ Joseph M. Binder, A Tax Analysis of the Emerging Class of Hybrid Entities, p. 645

sale of goods and services. Even they can have much profit than or at least they are as profitable as traditional for-profit businesses since they have a branding advantage due to their social oriented strategy.⁴⁷² Because of this, they may not have capital constraint problem, in contrast to nonprofit entities.⁴⁷³ Thus, they argue that justification of subsidizing nonprofit entities through tax exemption should not be extended to social enterprises as they have an economic ability to pay tax.⁴⁷⁴ They also criticized favorable tax treatment of social enterprises saying that it will cause reduction of government's income that would be collected from taxation.⁴⁷⁵ More strongly, scholars argue against preferential tax privilege of social enterprises fearing that it will "result in an abuse and exploitation of the exemption."⁴⁷⁶ Their reasoning is that fake social enterprises may use their tax exemption status as a justification to evade their tax duty.⁴⁷⁷

These theoretical arguments of the issue of taxability of social enterprises do not, however, settled yet. Scholars don't able to reach a consensus on this issue. These two extremes, rather, left to be settled by the tax laws of each country in the world. Accordingly, while some countries give some form of tax privilege for social enterprises, others tax them as a for-profit businesses.⁴⁷⁸ Whatever the case, the tax legislation needs to avoid the confusion in respect to the tax status of social enterprises. It shall be determined by tax legislation whether the tax privilege of nonprofit legal entities analogically applies to social enterprises or not.

⁴⁷² Joseph M. Binder, A Tax Analysis of the Emerging Class of Hybrid Entities, p. 651

⁴⁷³ Ibid.

⁴⁷⁴ Ibid.

⁴⁷⁵ Michael D. Gottesman, From Cobblestones to Pavement, p. 355

⁴⁷⁶ Ibid.

⁴⁷⁷ Ibid.

⁴⁷⁸ For example, the UK government introduced a special tax relief for social enterprises in 2014. This tax relief was introduced with the aim of motivating or encouraging social entrepreneurs or investors to invest their money in social enterprises ("The Social Investment Tax Relief in the United Kingdom", available at < <https://www.centreforpublicimpact.org/case-study/social-investment-tax-relief-scheme-united-kingdom/> > accessed on May 29, 2018). Similarly, in the Philadelphia, social enterprises have been given some forms of tax credit to flourish their development in the country (Lloyd Hitoshi Mayer and Joseph R. Ganahl, Taxing Social Enterprise, p. 423)

➤ **Tax treatment of social enterprise under the current tax regime of Ethiopia and its conduciveness to facilitate such business in the country**

Similar to other countries, for the purpose of taxation, private legal entities in Ethiopia classified as taxable and non-taxable. While nonprofits legal entities receive a tax exemption privilege, for-profit businesses are taxable entities.⁴⁷⁹ Except for the necessary deductible expenses, the income of for-profit businesses is fully taxable.⁴⁸⁰ In contrast to for-profit businesses, nonprofit entities entitled a tax privilege in two ways. First, incomes derived by nonprofit legal entities are tax exempted provided that the income is derived from the business which directly related to the mission of the firm.⁴⁸¹ Second, they have a privilege to receive tax-deductible donations from for-profit businesses.⁴⁸² As it is provided under the income tax proclamation no. 979/2016, donations made to nonprofits are tax deductible provided that it is made;

to Ethiopian charities and Ethiopian civil societies⁴⁸³ or “in response to a call for development or an emergency call issued by the government to defend the sovereignty and integrity of the country, to prevent or to provide relief in relation to man-made or natural disaster or an epidemic; or for any other similar cause” (emphasis added).⁴⁸⁴

Coming to the case of the tax treatment of social enterprises, the existing tax law doesn't give a special tax treatment for such businesses. We can find nowhere a tax provision that expressly indicates the tax status of social enterprise in Ethiopia. Even, practically, as Mr. Yesuf Ibrahim, Director of the Legal Directorate of the Ethiopian Revenues and Customs Authority (ERCA), affirmed, social enterprises in Ethiopia are taxed as an ordinary for-profit business.⁴⁸⁵ They are taxed as a profit-oriented business because of the absence of a special tax status of such business under the existing tax regime of

⁴⁷⁹ Federal Income Tax Proclamation, 2016, Federal Negarit Gazette, proc. no. 979/2016, 22nd year, No. 104, art. 65/1(m) and art. 18ff (herein after, Federal Income Tax Proclamation no. 979/2016)

⁴⁸⁰ Id. art. 20

⁴⁸¹ Id. art. 65/1(m)

⁴⁸² Id. art. 24

⁴⁸³ “Ethiopian charities” and “Ethiopian civil societies” means “charities or societies that are formed under the laws of Ethiopia, all of whose members are Ethiopians, generate income from Ethiopia and wholly owned by Ethiopians and it also includes charities or societies that use not more than 10% of its fund from foreign source” (Charities and societies proclamation/621/2009, art. 2/2)

⁴⁸⁴ Id. art. 24/1(a/b)

⁴⁸⁵ Interview with Yesuf Ibrahim, Director of the Legal Directorate of the Ethiopian Revenues and Customs Authority (ERCA), *on the current tax treatment of social enterprises in Ethiopia*, on May 4, 2018

Ethiopia.⁴⁸⁶ It doesn't mean, however, that they are not beneficiaries of tax privileges granted for ordinary for-profit businesses. Like for-profit business entities, social enterprises in Ethiopia can be beneficiary of tax privileges in two ways. First, when they make a donation for the non-profit entities. As mentioned before, donations made by the for-profit business are tax-deductible expenses if they are made following the rules and conditions are given by law.⁴⁸⁷ Similarly, by logical inference, this privilege can be extended to social enterprises since currently they are treated as a business in Ethiopia. If social enterprises make a donation to entities that are entitled to receive a tax-free donation, then, they can apply for the tax deduction for such expenses like what ordinary business do.

Second, they can be beneficiary of the charity expenses they may have incurred by themselves rather than donating to other charity entities.⁴⁸⁸ As it is provided under the income tax regulation no. 410/2017, in addition to donations made to charity entities, charity expenses incurred by business entities directly without using nonprofit entities as a conduit are considered as tax-deductible expenses.⁴⁸⁹ Thus, like other profit-oriented businesses, expenses incurred directly by social enterprise businesses in a charity work are tax-deductible under the existing tax regime of Ethiopia.⁴⁹⁰

But the researcher believes that the existing tax treatment of social enterprises is not conducive enough to facilitate the development of such type of businesses in the country due to the following two reasons. First, the tax-deductibility of donations made to nonprofit entities or expenses incurred for charity works is allowed only to the extent of 10% of the taxable income of the business.⁴⁹¹ A business (a social enterprise in this case)

⁴⁸⁶ Interview with Yesuf Ibrahim, Director of the Legal Directorate of the Ethiopian Revenues and Customs Authority (ERCA), *on the current tax treatment of social enterprises in Ethiopia*, on May 4, 2018

⁴⁸⁷ Federal Income Tax Proclamation no. 979/2016, art. 24

⁴⁸⁸ Council of Ministers Federal Income Tax Regulation, 2017, 23rd year, No. 80, 23rd year, Regulation No.410, art. 33/1 (herein after, Council of Ministers Federal Income Tax Regulation no. 410/2017)

⁴⁸⁹ Id. art. 33/1

⁴⁹⁰ Interview with Yesuf Ibrahim, Director of the Legal Directorate of the ERCA, *on the current tax treatment of social enterprises in Ethiopia*, on May 4, 2018

⁴⁹¹ Federal Income Tax Proclamation no. 979/2016, art. 24/2

which incurred more than 10% of its taxable income for charity works or donation may not be able to receive a tax deduction privilege for the expense it has incurred above 10%. This tax-deductible cap may frustrate social enterprises whose major income is expected to be employed for a charitable purpose. Mr. Yesuf Ibrahim also criticized this tax-deductibility cap as a very minimal for social enterprises whose major profit is going to be used to achieve social missions.⁴⁹²

Second, under the existing tax regime of Ethiopia, social enterprises can't receive tax-deductible donations from donors. As it is provided under the income tax proclamation, a donation is tax-deductible only when it is made to nonprofit entities particularly to Ethiopian charities and Ethiopian civil societies.⁴⁹³ Limiting this privilege only to those donations made to Ethiopian charities and Ethiopian civil societies may have the effect of discouraging for-profit businesses to support social enterprises through giving grants.

Rather, to facilitate the social enterprises in the country, they need to be given a more favorable tax privilege than what they are receiving under the current tax regime. The social activities of social enterprises reduce the burden/cost that the government may incur in providing social services. They are assisting the government to tackle SEEC problems of the society like that of nonprofit entities. They incur many costs while they unravel SEEC problems of the community. Unless we accord them some form of tax privilege, they may not be successful in realizing their social mission. Supporting this, Mr. Yesuf Ibrahim argues that since social enterprises are aiding the government in attaining its policy of bringing sustainable development through solving SEEC problems, they have to be enhanced through providing some sort of favorable tax privilege different from other ordinary for-profit businesses.⁴⁹⁴

⁴⁹² Yesuf Ibrahim, Director of the Legal Directorate of the ERCA, *on the adequateness of current tax treatment of social enterprises in Ethiopia*, on May 2/5/2018

⁴⁹³ Federal Income Tax Proclamation no. 979/2016, art. 24/1(a).

⁴⁹⁴ Interview with Yesuf Ibrahim, director of the legal directorate of the ERCA, *on the adequateness of current tax treatment of social enterprises in Ethiopia*, on May 4, 2018

Of course, a difficulty may arise in determining the specific nature of the tax privilege that should be granted for social enterprises. Should we grant to them total tax exemption privilege or any other less favorable tax treatment? Concerning this issue, Mr. Yesuf Ibrahim argues that since, by their nature, social enterprises distribute some portion of their profit to owners, they should not be given total tax exemption status.⁴⁹⁵ The researcher also agrees with Mr. Yesuf's argument. Giving the total tax exemption status for such businesses like that of nonprofit entities may not be appropriate. Unlike nonprofit entities, in case of social enterprises, there is a possibility of distribution of profit to owners though it is not a significant one. If we give total tax exemption privilege for social enterprises, in effect, the profit that will be distributed to the investors will escape from corporate tax liability at the corporate level. Therefore, to avoid the problem of corporate tax evasion in respect to profits to be distributed to owners, the researcher is of the opinion that the tax exemption status of social enterprises should not be a total exemption. Rather, it shall be limited to the extent of the profit that will be reinvested to the social mission. Profits that is going to be distributed to owners should be taxed both at the corporate and individual level.

In addition, social enterprises shall be beneficiary of tax-deductible donations. Since the primary focus of social enterprises is resolving SEEC problems similar to nonprofit entities, donations made to such businesses shall be deductible. The main justification to tax deductibility of donations made to nonprofit entities is to inspire businesses to have a contribution to charity works. This rationale shall also apply to donations made to social enterprises. Donations made to social enterprises also ultimately spend for charity works. Thus, to facilitate the participation of for-profit businesses in charity works through donating some amount of capital to social enterprises, the tax deductibility privilege of businesses shall include donations made to social enterprises. But when we give this privilege for social enterprises, we have to be sure that there is a strong regulatory mechanism that ensures the use of capitals collected from donations solely for charitable purposes.

⁴⁹⁵ Interview with Yesuf Ibrahim, director of the legal directorate of the ERCA, *on the adequateness of current tax treatment of social enterprises in Ethiopia*, on May 4, 2018

3.4.8. Regulatory Oversight of Social Enterprise

Thus far, attempts have been made to enlist the unique substantive regulatory concerns of social enterprises. Indications have been also made as to the need for determination of such substantive concerns by legislation. The mere existence of a well-designed regulation may not be, however, a guarantee for the proper enforcement of such regulatory rules.⁴⁹⁶ Though they are voluntarily established social-oriented business, in some cases, they may fail to act in accordance with their blended objective. Thus, a regulatory oversight needs to be made by a government enforcement organ whether these businesses are actually performing as required by law.⁴⁹⁷ Specifically, there shall exist an enforcement authority that can supervise the activities of social enterprises, receive complains and take administrative measures, protect investors and customers from being misled by false social enterprises, maintain the community interest in such businesses and follow up the general state of social enterprise sector in the country.⁴⁹⁸

➤ The current practice of regulatory oversight of social enterprises in Ethiopia

Currently, there is no a special regulatory authority empowered to supervise social enterprises. They are, rather, regulated and supervised by the MOT and Equivalent Regional Trade Bureaus.⁴⁹⁹ They are overseen as an ordinary profit-making business by supervisory organ of profit-oriented businesses.⁵⁰⁰ As the Mr. Abiy Mohammed, the Team Leader of share Companies and Sector Association Follow Up and Support Directorate at the FMOT, stated the existing supervision of social enterprises is limited only on the business aspect of such enterprises as there is no specific regulatory legislation that gives a mandate for MOT or equivalent Regional Trade Bureaus to follow up the social performance of social enterprises.⁵⁰¹ Specifically, the oversight is

⁴⁹⁶ Dana Brakman Reiser, 'Regulating Social Enterprise', *UC Davis Business Law Journal*, 2013, Vol.14, Pp. 231-246, at P. 240 (herein after, Dana Brakman Reiser, *Regulating Social Enterprise*)

⁴⁹⁷ *Ibid.*

⁴⁹⁸ Dana Brakman Reiser, *Regulating Social Enterprise*, p. 240

⁴⁹⁹ Interview with Elsa Siyum, Legal Expert at the FMOT, *on the current Regulatory Oversight of Social Enterprises in Ethiopia*, April 30, 2018

⁵⁰⁰ Interview with Tewodros Getu, Higher Legal Officer at Yeka Sub-city Administration Office, Department of Trade Licensing and Registration Office, *on the regulatory oversight of social enterprises in Ethiopia*, may 3, 2018

⁵⁰¹ Abiy Mohammed, Team Leader of share Companies and Sector Association Follow Up and Support Directorate at the FMOT, *on the current oversight of social enterprise Businesses in Ethiopia*, may 4, 2018

focused on to follow up whether they are operating in accordance with their license and producing a quality product.⁵⁰² Consequently, they are left to operate freely without any regulatory follow up as to the alignment of their acts to their original social mission in their operational life.⁵⁰³

Nevertheless, leaving social enterprises to engage in the market without being supervised by any regulatory authority as to their social performance may invite fake social entrepreneurs to claim the status of the social enterprise. An enterprise that spends a nominal amount of money for the social purpose may claim the status of social enterprises to attract customers and receive donor-funded capitals. This may, in turn, results in the misleading of stakeholders including investors, donors, consumers and even the government. Because of the problem of information asymmetry, outsider stakeholders of social enterprises may be manipulated by a fake social enterprise. Just to prevent this problem, there shall exist a regulatory authority that controls social enterprises starting from the entrance up to the exit period. There shall exist an authority that can license social enterprises by checking the fulfillment of requirements during formation, supervise their operation in the operational stage and exit period, and that can take appropriate measures against them when there is a deviation from the law.

Another interrelated issue is which specific government authority should have a mandate to regulate social enterprises in Ethiopia. As mentioned in the first chapter, social enterprises have the blend feature of charities and for-profit businesses.⁵⁰⁴ If so, should they be regulated by MOT and Regional Trade Bureaus or Charities and Societies Agency (CSA), or both, or should we need to have another separate regulatory authority? If we give the mandate to regulate social enterprises to MOT and equivalent Regional Trade Bureaus, they will not be successful in supervising the social performance of social enterprises since they hadn't familiarized how the social

⁵⁰² Interview with Tewodros Getu, Higher Legal Officer at Yeka Sub-city Administration Office, Department of Trade Licensing and Registration Office, *on the regulatory oversight of social enterprises in Ethiopia*, may 3, 2018

⁵⁰³ Ibid.

⁵⁰⁴ *Supra*, p. 1, Chapter One, Section 1.1. Para. 2

performance of businesses can be supervised and measured. These authorities are not experts on supervising the charity work of legal entities. Rather, they are well familiarized with supervision concerns of businesses. Similarly, if we leave them to be regulated by the CSA, it will not be effective in supervising the business aspect of social enterprises as its specialty is supervising only the social works of entities.

Then, the other alternative is giving the mandate of supervising social enterprises for both authorities i.e. MOT, and CSA. Giving the mandate to supervise the social aspect of social enterprises to CSA and the business aspect to the MOT will be an effective means of regulating social enterprises since both of them are experts in their respective mandate. Mrs. Abiy Mohammed also argues that it is possible to have a separate regulatory authority for each respective operation of social enterprises.⁵⁰⁵ But this researcher doesn't agree with the Argument of Mr. Abiy Mohammed. Giving the mandate of regulating social enterprises to two different regulatory authorities may create inconvenience for social entrepreneurs. For example, they will be required to make a report about their business performance to the ministry of trade, and about their social performance to the CSA. This will not be convenient for social enterprise owners or manager and directors.

This researcher, rather, is of the opinion that Ethiopia needs to establish new separate regulatory authority specifically mandated with regulating social enterprises starting from their formation till their exit. Both the social and business performance of social enterprises shall be supervised by a single regulatory authority. Establishing a single separate regulatory authority for the social enterprise will, on the one hand, help to have a strict regulatory oversight of the social and financial performance of such businesses and on the other hand, it will be convenient for social entrepreneurs to fulfill supervision requirements. In fact, one may argue that establishing a single regulatory authority for a single category of business will be costly for the government. But the cost that a

⁵⁰⁵ Abiy Mohammed, Team Leader of Share Companies and Sector Association Follow Up and Support Directorate at the FMOT, *on the current oversight of social enterprise Businesses in Ethiopia*, may 4, 2018

government may incur in supervising such businesses using a separate authority will not exceed the benefit that the country including the community will get due to better supervision. Thus, the cost that the government may incur for the supervisory organ of social enterprises shall not be invoked as a justification not to establish a separate regulatory authority for such businesses.

Chapter Four

Conclusion and Recommendation

4.1. Conclusion

The researcher conducted this study to answer three specific research questions and thereby to answer a single main research question. To begin with the specific questions, the first one is that are there factors necessitate to frame a special policy framework for social enterprises in Ethiopia? In analyzing this question, the researcher identifies two major factors which necessitate giving special policy framework for social enterprise. The first one is the existence of very stressful SEEC problems in the country and potentiality of social enterprise to solve such problems. It is pointed out that currently there are many SEEC problems in the country and social enterprise is a better tool to solve such problems than other sectors. Consequently, it is denoted that there is a need to give special policy support to social enterprises as policy instruments are tools to enhance the development of a certain business type.

The second major factor is the existence of some practical challenges faced by social enterprises because of the absence of special supports. It is revealed that social enterprises are facing challenges such as inaccessibility of market, poor skill to blend social and profit mission, lack of awareness of social enterprises on the part of the community and inaccessibility of finance due to the absence of special policy supports. Thus, to address these challenges of social enterprises, it is indicated that there is a need to frame special policy supports for social enterprises in Ethiopia.

The second research question is what are the regulatory concerns of social enterprises? In answering this question, the researcher identifies eight major regulatory concerns of social enterprises that a social enterprise regulation needs to address. To list them, designing a business legal form that fits to blend profit and social mission; requiring social entrepreneurs to pass non-financial mission evaluation criteria set by law during formation; regulating the allocation of profit,; regulating the transfer of asset, sale and

merger of social enterprises; setting requirements for social performance disclosure; establishing the duty and liability of directors and managers of social enterprise towards stakeholders; determining the tax status of social enterprises; and establishing a social enterprise supervisory government authority are the major regulatory concerns of social enterprise identified in the study.

After identifying these regulatory concerns of social enterprises, the researcher analyses the third research question i.e. are the existing business laws of Ethiopia fit to regulate the unique concerns of social enterprises? In solving this question, the researcher tries to analyze the existing regulatory environment of business in light of the unique regulatory concerns of social enterprise. In this part, it is indicated that the existing business laws of Ethiopia are not fit to regulate the regulatory concerns of social enterprise. It is indicated that the existing legal forms of business don't suitable for social enterprise business type as none of them can transmit the purpose of the business to the community. Existing legal forms can't protect the interests of owners of social enterprise i.e. brand building interest and stakeholders' interest i.e. to identify social enterprises from others since they are not designed in a way to transmit the message as to the purpose of the business.

It is also indicated that the existing legal structures of business don't fit to evaluate the social mission of the enterprise during formation, restrict the profit distribution of the enterprise, regulate the transfer of an asset, the sale of the social enterprise and merger of social enterprise with other profit-oriented business, and regulate the information disclosure as to the performance of the enterprise. In addition, it is indicated that the existing business regulatory regime of Ethiopia doesn't suit to impose duties and liabilities on directors towards maximizing the interests of the community. In the existing laws, the duty and liability of directors and managers limited towards owners of the business, not to stakeholders. Stakeholders can't bring a case before a court of law when there is a failure of directors and managers to maximize the societal interest the community. It is also found that, currently, there is no any supervisory authority that supervises the social performance of social enterprises.

Following that the researcher indicates that since the existing legal regime of businesses doesn't fit address the potential concerns of social enterprise, problems such as information asymmetry, mission drift, social washing, and loss of legacy or existence of fake social enterprises might have arisen if we left them to be regulated in the existing business regulatory regimes of Ethiopia. It is open for owners of social enterprise to manipulate capitals collected from sources from donations and other sources other than investors' contributions for their personal benefit.

It is also pointed out that the tax treatment of social enterprises under the existing tax regime of Ethiopia is not conducive enough to facilitate such types of business in the country. It is marked that though social enterprises are primarily working to tackle SEEC problems of the society like that of nonprofit entities, they are not beneficiaries of any special tax privilege in the existing tax regime of Ethiopia. The researcher noted that the absence of special tax privilege has a negative impact on the development of social enterprises in the country. After analyzing the specific research questions of this study, the writer answers the main research question in affirmative i.e. Ethiopia needs to frame a special policy and regulatory regime for social enterprise.

4.2. Recommendation

In this study, it is reached on two major conclusions. The first one is there is a need to give special policy support for social enterprises in Ethiopia and the second one is the existing business legal regime of Ethiopia doesn't fit to regulate social enterprise's concerns. Given these conclusions, the researcher tries to give some recommendations that he thinks fit to facilitate and regulate such types of businesses in the country. The researcher classified these recommendations as a general and specific recommendation.

4.2.1. General recommendation

The general recommendation is that the Ethiopian government must come up with a special policy and regulatory regime for social enterprise. It shall frame a policy and regulatory framework of social enterprises that fit to facilitate and regulate them properly. A new legislation shall be enacted which can prevent the happening of

information asymmetry, mission drift, loss of legacy, entrance of fake social entrepreneurs, and social/green washing problem in the social enterprise sector.

4.2.2. Specific Recommendations

➤ Specific policy support recommendations

To facilitate the development of social enterprises in the country, the Ethiopian government must give policy support for social enterprises specifically through;

- Creating skill how to blend both profit-making and social/charity missions in a single business entity,
- Creating awareness about the concept of social enterprises for the society at large. This can be done through Medias, conferences, websites, publications and other means,
- Enabling them to have financial access. This can be done through establishing special financing scheme for social enterprises, and
- Enabling them to be competitive enough in the market. It can be done, for instance, through expanding their production capacity, market skill, management skill and through creating a link among social enterprises or with other market actors

B. Specific regulatory recommendations

In addition to the above mentioned specific policy support recommendations, the law that the Ethiopian government needs to enact for social enterprises must come up with;

- A legal form that can transmit the purpose of the social enterprise licensed and registered using that form,
- A set of criteria against which the existence of non-financial missions is going to be evaluated during formation,
- A rule that determines the profit allocation policy of social enterprise,
- A rule that imposes some restriction on the asset transfer, sale and merger of social enterprise,
- A rules that requires social enterprises to disclose both their social and financial performance to the regulatory authority and thereby to the public, and to be audited,
- A fiduciary rule that imposes duties and liabilities on managers and directors of social enterprise towards stakeholders and empower the latter to claim against

directors or managers for the breach of their duty before a court of law either through the regulatory organ or by themselves,

- A tax provision that allows social enterprises to receive tax exemption privilege for the portion of the profit that would be reinvested for social purposes and to receive tax-deductible donation, and
- Finally, the new law shall establish a specific and separate regulatory authority empowered to regulate social enterprises

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□ Interviews

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5. Interview with Tewodros Getu, Higher Legal Officer at Yeka Sub-city Administration Office, Department of Trade Licensing and Registration Office, may 3, 2018
6. Interview with Yesuf Ibrahim, Director of the Legal Directorate of the ERCA on May 4, 2018
7. Interview with Yoseph Alemu, Director of Share Companies and Sector Association Follow Up and Support Directorate at the FMOT, May 3, 2018